

Modern Water plc

Annual Report and Accounts 2013



MODERNWATER

www.modernwater.com

Modern Water owns a portfolio of water technologies to address the limited availability of fresh water and the treatment and disposal of wastewater worldwide. By 2025, it is forecast that two-thirds of the world's population will live in countries classified as water-stressed. Climate change is likely to further exacerbate this situation.

Managed by an executive team with extensive experience in the water industry, Modern Water is at the leading edge of new and developing technologies, which are vital to the future sustainability of the world's most precious commodity.

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Business at a Glance

Modern Water owns, installs and operates world-leading membrane technologies and develops and supplies advanced systems for water monitoring.

UK

First European sales conference for the Monitoring division held in April 2013.

Scandinavia

Modern Water secures the first sales of trace metal analysers in Scandinavia.

China

Modern Water participates in UK trade mission to China led by UK Prime Minister, David Cameron.

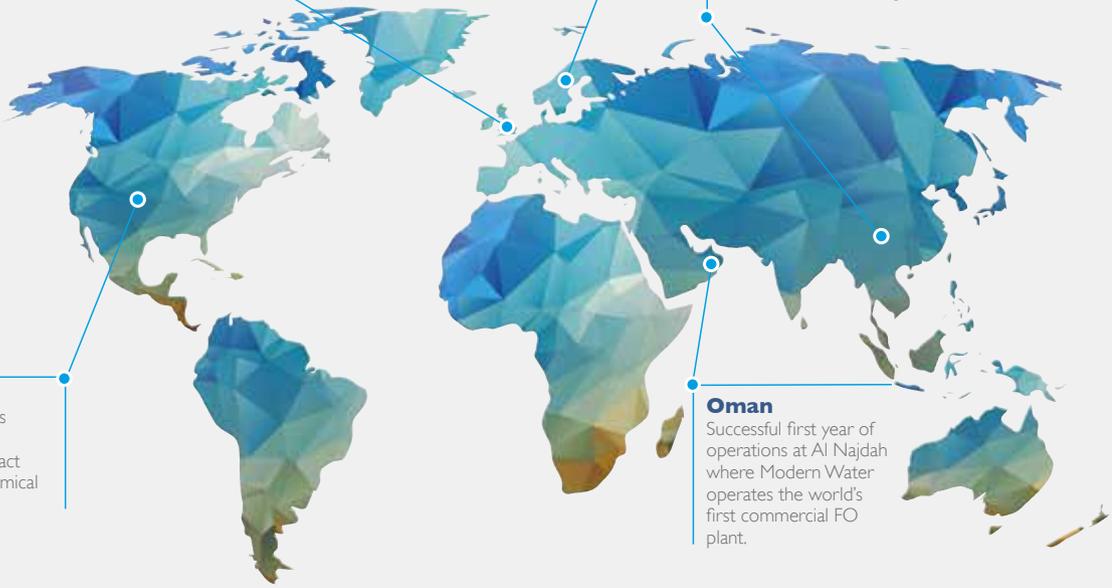
Modern Water announces new Chinese website in January 2013 and new office in Shanghai in December 2013.

US

Modern Water signs substantial product development contract with global agrochemical company.

Oman

Successful first year of operations at Al Najdah where Modern Water operates the world's first commercial FO plant.



Membrane Processes Division

Modern Water has developed and commercialised a world-leading forward osmosis desalination technology with up to 30% lower energy usage and improved product water quality.

Applications include:

- Desalination
- Drinking water
- Wastewater concentration
- Process water
- Produced water treatment
- Enhanced oil recovery
- Make-up water for evaporative cooling

World-leading
forward osmosis
technology

Monitoring Division

The Monitoring division provides toxicity, trace metals and environmental monitoring systems. The range includes equipment for portable, online, and laboratory use. All systems are easy to use and are able to be operated by technicians in any location around the world.

Applications include:

- Drinking water
- Municipal wastewater
- Contaminated land and water
- Industrial wastewater
- Mining
- Oil and gas
- Power generation and waste incineration
- Research and development

Toxicity, Trace Metal
and Environmental
monitoring systems

Chairman's Statement



Neil McDougall
Executive Chairman

“Modern Water signed three new contracts at UK Government trade mission to China led by David Cameron.”

Last year proved to be a busy year for Modern Water, with both our Membrane Processes and Monitoring divisions completing key steps in their growth strategy.

Significant highlights during the year included signing three key contracts in China as part of the UK Government's Chinese trade mission; our Monitoring division signing a new product development contract with a global agrochemical company; and a share placing raising £10 million before expenses.

The first quarter of 2013 saw the placing of 20 million new Ordinary Shares, which significantly increased the Group's cash position and raised net proceeds of £9.55m. We were delighted by the strong support from both existing and new shareholders. Funds from the placing allow us to continue to pursue opportunities identified by our Membrane Processes division, principally in our strategic markets of China and the Middle East, further commercialise our Forward Osmosis (FO) technology and consequently hit key milestones in our strategy for continued growth. The funds are also being used to grow our Monitoring business by licensing and acquiring innovative, proven products to further leverage our international distribution network.

Membrane Processes Division

In December 2013, Modern Water was part of a UK Government trade mission to China, led by the UK Prime Minister, David Cameron. The first day of the mission was held in Beijing when Modern Water agreed three new contracts. The event was attended by Lord Livingston of Parkhead, UK Minister of State for Trade and Investment.



The most significant signing was for an outline contract to provide a 500m³ per day FO desalination plant at the XuGong Island development in Hangzhou Bay, near Shanghai. It represents a milestone in Modern Water's development as it will be our first plant in

China and demonstrates further scaling up of our FO technology. Successful completion of this project will give us a strong position from which to compete for further projects in China.

Another noteworthy contract signed during the UK-China summit was with Hangzhou Water; China's largest desalination equipment

and construction company. This contract stipulates that Modern Water acts as its sole distributor for its containerised seawater reverse osmosis desalination plants in the Middle East and its non-exclusive distributor in the rest of the world outside China.

During 2013 Modern Water also successfully completed the first year of its operation and maintenance contract at its largest FO plant to date (200m³/d) located in Al Najdah, Oman.

Monitoring Division

The Monitoring Division saw an increase in revenue in 2013 to £3.5 million. The trace metal range of monitoring products saw the greatest increase in sales with a 9% increase on 2012.

Expanding our product portfolio and developing routes to market continued to be two important activities for the Monitoring division during 2013. In July we signed a new substantial product development contract with global agrochemical company United Phosphorus Inc., which will see Modern Water develop and supply a new herbicide testing system. Additionally, in October we signed an exclusive distribution agreement with Beijing Green Science and Technology, already one of our key distribution partners, which will underpin our revenues in the next two years, covering mainland China, Hong Kong and Macau.

Overview

Modern Water has progressed significantly during 2013. We began the year strongly by completing a highly successful share placing and ended it on another high note by signing three new contracts in China, one of our key markets. As we move into 2014 the Group remains financially strong with net cash of £11.4 million and is well placed to continue to grow in the future.

On behalf of the Board I would like to thank all the team at Modern Water for their ongoing dedication as we look ahead to further progress in 2014.

Neil McDougall,
Executive Chairman
12 March 2014

Strategic Report



Simon Humphrey
Chief Executive Officer

“ We continue to pursue our strategy to scale up the level and reach of market activities in both our membrane and monitoring divisions. ”

The Directors of Modern Water plc (the Company) and its subsidiary undertakings (which together comprise the Group) present their Strategic Report for the year ended 31 December 2013.

Principal Activities

Modern Water plc is the holding company of a trading group, the principal activities of which are to own, develop and supply technologies, products and services related to the provision of fresh water and treatment and disposal of waste water; specifically:

- design, construction, testing, installation, commissioning and operation of desalination plants and water cooling systems;
- water quality monitoring, environmental monitoring and soil testing; and
- saline wastewater treatment systems and electro-coagulation wastewater treatment systems.

Key Markets

The past 12 months have seen Modern Water deliver its growth strategy in key markets, particularly China. The selection of our Forward Osmosis (FO) technology for an outline contract to construct a desalination plant on the Chinese island development of XuGong confirmed the Group's position as the world-leading FO technology provider. Subject to agreement of the final contract, this will be China's first FO plant and puts Modern Water in a strong position to compete for further projects.

China is also a key market for our Monitoring division and during 2013 we signed an exclusive distribution agreement with Beijing Green covering mainland China, Hong Kong and Macau. The agreement will maximise sales opportunities throughout the current Chinese five year plan, as well as provide a strong platform for Modern Water's products during the crucial planning stages of the next five year plan.

Key Performance Indicators

At the Group's current stage of development, the directors consider that strategic and operational progress is best measured by achievement against technical and business development milestones. Key milestones against which progress was made in 2013 were:

- scaling up the level and reach of market activities in both Membrane and Monitoring divisions, including the opening of the new Modern Water office in Shanghai and the signing of distribution agreements in both Membrane and Monitoring divisions;

- development of relationship with Hangzhou Water; with the signing of the Xugong Island agreement as well as a distribution agreement in the Middle East;
- building on existing relationships in the Middle East, with the completion of the first year of the Al Najdah O&M contract in Oman; and
- growth of Monitoring division revenue, licensing and development of new products and signing of new distribution agreements both with existing distributors (Beijing Green Science and Technology Company) and new distributors.

During 2014 we will focus on making further progress against these objectives and additional objectives, which were not completed in 2013, including:

- agreement of, and delivery on, final contract for Xugong Island project;
- entry into industrial water market in China;
- progress projects with Kazema in Kuwait; and
- build on opportunities for deployment of waste water technologies.

Further details of strategic and operational progress for the two main operating divisions are detailed in the Membrane Processes and Monitoring sections of this Strategic Report. The Board reviews strategic, operational and financial information on a monthly basis to measure progress. The key financial highlights of 2013 were:

- gross profit increased to £1.7m (2012: £1.4m);
- operating loss before tax, interest, depreciation and amortisation reduced to £4.0m (2012: £4.7m);
- placing of new shares in February raised net proceeds of £9.55m;
- cash outflow, excluding the fund raise, improved by £1.7m to £3.87m (2012: £5.53m); and
- cash as at 31 December 2013 was £11.4m (2012: £5.8m).

Further information on the financials is detailed in the Financial Review section of this Strategic Report.



Membrane Processes Division

“ Our strategy is to focus on China as one of our key markets. ”

Our growth strategy is well underway and the commercialisation of our FO technology is accelerating.

Operational Review

In just two years since the award of the world's first commercial FO desalination contract, Modern Water has successfully installed and commissioned the plant in Oman, and completed the first year of its operations and maintenance contract in September 2013. Operating conditions at Al Najdah, in particular the quality of feed water, have been challenging but the plant has performed beyond expectations. Despite the difficult operating conditions we have been able to achieve our goal of becoming a 100% locally managed operation in Oman with support from our central technical team.

Growth Strategy

Our growth strategy is well underway and the commercialisation of our FO technology is accelerating. In early 2013, we announced our strategy to focus on China as one of our key markets. We believe that our FO technology is an excellent solution to help China overcome its challenge of providing clean water to the 400 cities that currently face water scarcity. We have established a strong presence in China in 2013; with a new Chinese website going

live in January; opening a new office in Shanghai in November; and signing an outline contract for a FO desalination plant on XuGong Island in December. The XuGong Island contract is still subject to final agreement, but once complete will be China's first FO desalination plant and provides a strong platform for Modern Water in China.

In December, Modern Water also strengthened its partnership with its Chinese desalination partner, Hangzhou Water, and signed an agreement to act as its exclusive distributor in the Middle East and non-exclusive distributor in the rest of the world outside China for its containerised seawater reverse osmosis plants.

Patent Portfolio

A key part of our strategy is to invest in our intellectual property. Our patent portfolio significantly strengthened in 2013 and our Membrane Processes division was granted an additional 14 patents across eight patent families. This includes the new thermal desalination patent which as at 31 December 2013 had been granted in ten jurisdictions and is pending in several more.



Monitoring Division

“ Revenue growth through the expansion of product portfolio and leverage of our experienced and established global distribution network. ”

The Monitoring division continued to make progress in 2013, seeing the first sales of recently launched products come through, developing new products and expanding its distribution network.

Operational Review

The Monitoring division achieved sales of £3.5m in 2013 (2012: £3.4m) with trace metal products seeing the largest increase in sales. Recurring revenues of service contracts and reagent sales accounted for £1m in 2013. Gross profit increased to £1.7m (2012: £1.6m). We enter 2014 in a strong position for further growth. We have an impressive line-up of new products ready to be launched during 2014 and a strong order pipeline. We have also secured entry into key industry product catalogues, such as the USA BlueBook, which is recognised as the number one source of products and technical support for professional water and wastewater operators in the USA.

New Product Development

The Monitoring division signed an important product development contract last July to develop a new product for the global agrochemical company United Phosphorus Inc (UPI). This substantial product development contract involves Modern Water developing and supplying a new herbicide testing system for use in rivers, streams, irrigation canals and other water ways. The contract is part of a 13-year collaboration between the two companies, which will provide UPI with an exclusive license to use and distribute the new test kits. 2013 saw the first sales of the new portable fluorometer product range, which was introduced into the Monitoring division's product portfolio in 2012. The range provides a cost-effective solution to monitoring the effects of organic pollution, identifying potentially harmful cyanobacteria and turbidity, and currently consists of the AlgaeChek, the AlgaeChek Ultra and the BODChek.

Distribution Network

In 2012 our sales team from our newly acquired monitoring businesses underwent extensive training on all products across our enhanced monitoring product range. We then extended and improved our distribution network by restructuring the team into three geographical regions. During 2013 the new structure continued to strengthen and grow our distribution network, and the division now supports sales in over 60 countries.

The first sale of our trace metal analysers in Scandinavia last January was of particular interest. Not only was it the first sale of one of our trace metal products in Scandinavia but it was also the first time an online 24/7 metal monitor (OVA) had been used for real time monitoring of metals in flue gas at a waste-to-energy power plant.

In 2012 the Chinese government announced plans to invest US\$536bn in environmental protection as part of its current five year plan, making China an important strategic market for our monitoring products. In order to maximise sales opportunities across China we decided to grant Beijing Green Science and Technology an exclusive distribution agreement to cover the sale of our products across mainland China, Hong Kong and Macau. In return we will receive a guaranteed minimum revenue for the next two years.

In April, the division held its first sales conference for distributors from across Europe and the Americas. The conference was held in the UK and was an opportunity for all of our distributors to learn more about the benefits and applications of our existing product portfolio as well as preview future product development plans.



Group Performance and Financial Review

“ We have moved towards our strategy of employing a predominantly local work force. ”

Intellectual Property

The strength and breadth of our patent portfolio increased significantly in 2013 with an additional 16 patents granted in 39 jurisdictions.

The Group now holds 115 granted patents with 55 pending applications. The Membrane Processes division holds 85 granted patents across the eight main patent families of solvent removal, improved solvent removal, secondary oil recovery, osmotic energy, separation process, evaporative cooling, cooling tower improvements and thermal desalination. The Monitoring division currently has 25 granted patents, with the remaining five patents granted for wastewater treatment technologies.

Resources

During 2013, in order to scale up the level and reach of market activities in both our Membrane Processes and Monitoring divisions, we have refocused our resources and moved towards our strategy of employing a predominately local work force. Whilst keeping control of our costs, we have equipped our operators with the skills to run our operations with support from our central technical team. At 31 December, the Group had entirely locally run operations in its key markets of China and Oman and across the Group it employed 52 permanent staff in addition to contract staff as required.

Wastewater Treatment Technologies

In addition to progress in the Group's two main divisions, Membrane Processes and Monitoring, we have also made significant progress in 2013 with Aguacure and our pioneering electro-coagulation (EC) technology. Aguacure currently has one client funded pilot project in Scandinavia and has concluded discussions for a further client funded pilot which will commence in early 2014. Our EC technology has now been successfully tested on a range of applications as diverse as municipal wastewater; mine wastewater; industrial wastewater and swimming pool filter backwash reuse.

During the year we have seen increased interest in the patented saline wastewater treatment technology which has been developed by Poseidon Water Limited (51% owned by Modern Water plc). The company is actively pursuing a major project in joint venture with a UK water company.

Financial Review

Summary

The financial position of the Group is strong, with £11.4m cash in the bank and no debt at 31 December 2013 (2012: £5.8m cash). During

the year the Group continued to incur losses, reflecting the Group being in the early stage of commercial roll out, prior to securing significant sales contracts, particularly in the Membrane division. Loss before interest, tax, depreciation and amortisation reduced to £4.0m (2012: £4.7m), operating loss reduced to £4.9m (2012: £5.6m); total comprehensive loss reduced to £4.7m (2012: £5.4m). The reduction on the prior year losses was due to increasing gross profit and other income, and a reduction in administrative expenses. The Group generated revenue of £3.5m in 2013 (2012: £3.8m). Cash burn reduced by £1.7m compared with the prior year, excluding the impact of the fund raise.

Cash Flows

The Group cash inflow for the year was £5.7m. Net cash inflow from the fund raise was £9.55m. Cash outflow after net fund raise proceeds was £3.87m (2012: £5.53m), a £1.7m improvement on prior year. This reduction in cash burn was due to increased gross profit and other income (£0.4m), a reduction in operating (£0.3m) and capital expenditure (£0.5m) and an improvement in working capital movement during the year (£0.5m).

Cash inflow from interest on term deposits was £0.1m (2012: £0.2m). Cash outflows comprised £0.1m on property, plant and equipment (2012: £0.6m), £0.1m patents (2012: £0.2m) and £3.7m operating costs (2012: £4.9m).

Share Placing

On 12 February 2013, the Company announced the conditional placing of 20,000,000 new shares to raise £10m (before expenses). This placing was approved at a General Meeting of its shareholders on 28 February 2013 and the shares were admitted to trading in two tranches, on 1 March 2013 and 4 March 2013. The net cash of £9.55m was received on 4 March 2013.

Accounting Policies

The Group financial statements have been prepared in accordance with EU Endorsed IFRS, IFRS Interpretations Committee (IFRIC) interpretations and the Companies Act 2006 applicable to companies reporting under IFRS. The key accounting policies to note are those concerned with intangible assets and share-based payments.

Capital Structure

The Group is entirely equity funded which is appropriate during the current stage of development. As the Group develops, the capital structure will be reassessed on a project by project basis.

Treasury management

The Group has adopted a low risk approach to treasury management. Cash balances are invested in fixed interest term deposit accounts, with maturity dates to suit projected liquidity requirements. Credit risk is addressed by the Group's treasury policy. Deposits are selected based on achieving the optimum balance of yield, security and liquidity. Foreign exchange risk is primarily mitigated through natural hedging of receipts and payments. See note 3 to the Accounts for further detail of financial risk management.

Principal Risks and Uncertainties

The principal risks inherent in the operation of the Group are well understood by the Board of Directors and the management team. Control measures have been established to ensure that these, and other, risks are adequately controlled both in terms of frequency and consequence. The internal control environment is described in the Corporate Governance Statement. The principal risks and uncertainties affecting the Group and the steps taken to manage these are:

Customer acceptance of the Group's technologies

The Group's success depends on customer acceptance of its products and processes. There are significant risks in predicting the size and timing of material revenue. The target customers of the Group's products and processes are often in developing countries which carry additional risks. The Group seeks to address these risks by building a track record and proving technology capabilities to future customers and industry players. The Group has increased investment in business development as product development progresses. The Group has formed a number of strategic partnerships to create local presence in target countries, overcome pre-qualification criteria on contract tendering and establish routes to market. The range of applications for the Group's products provides mitigation against the risk of failure in a specific country or application. The Group continues to invest in research and development (R&D) to mitigate the risk of the emergence of competitor technologies.

Socio-political risks

The Group operates, and is looking to secure further contracts and sales, in a number of countries around the world. This exposes the Group to a range of social and political developments and consequentially to potential changes in the operating, regulatory and legal environment. The Group operates and generates revenue in countries where political, economic and social transition is taking place. Some countries have experienced, or may experience in the future, political instability, changes to the regulatory environment, changes in taxation, expropriation or nationalisation of property, civil strife, strikes, acts of war and insurrections. Any of these conditions occurring could disrupt our operations and revenue. The Group seeks to manage these risks through diversifying the regions in which it operates and through insurance.

Scaling up the technology

The Group's membrane division and certain monitoring products are not yet well established commercially. They have been

developed over recent years and whilst proving the technology is largely complete there remain significant risks associated with commercialising technology and a portfolio of new products. There are technology and procurement risks in scaling up the products through to large scale commercial deployment. The Group seeks to mitigate these risks through the use of partners with proven manufacturing and fabrication capabilities, rather than developing in-house capabilities, and through the development and operation of pilot plants prior to full commercial deployment.

Additionally there are risks related to developing the optimum contract, royalty and licensing models to derive value from the products. The Group manages these risks through employment of executives and senior management with significant experience both in the water industry and in the development and growth of early stage companies.

IP protection

The Group's ability to generate value from its products depends in part on the development and protection of its IP. The Group assigns significant resources, both internally through the Company's General Counsel and technical staff, and externally through patent attorneys, to enhance and protect its patented and non-patented IP.

Recruitment and retention of key personnel

The Group's directors and employees are highly qualified and experienced. Recruiting and retaining key staff is critical to the Group's success. Knowledge and experience of the Group's products and customer base is retained by a relatively small number of individuals. The risk of staff loss is mitigated through its HR policies, competitive remuneration (including the Modern Water plc Incentive Plan), performance appraisals and training.

Health and safety

There are inherent health and safety risks with the deployment of the core membrane and monitoring products. The mitigation of any health and safety events involving the Group's products is key to the strategy for growth. The Group mitigates its health and safety risks through its Group Health and Safety Policy, which includes regular reporting to the Board and to the Management Team.

Financial risks

These risks and mitigating controls are described in note 3 to the Accounts.

The Strategic Report was approved by the Board of Directors on 12 March 2014 and signed on its behalf by:

Simon Humphrey
Chief Executive Officer
12 March 2014

The Environment and Our People

“ Our people are integral to the growth and success of our business. ”

Our Commitment to the Environment

Since its inception, Modern Water has been committed to building its business around protecting the environment we all live in.

As an innovative technology company we are not only environmentally conscious throughout our own business activities but we have also commercialised numerous technologies and products which help other companies around the world to improve their environmental policies and provide clean drinking water.



CASE STUDY

University Research Projects to Protect the Environment



Last year saw Modern Water continue to work with various universities around the world to aid vital research into helping the environment. One example of this

was the sale of a portable trace metal monitor to Portland State University which was used to test the level of fine particle pollution in the air and assist in meeting the revised Clean Air Act in the United States. New tougher standards that have been introduced are likely to require more stringent tests for particulate air pollution, such as those carried out by our portable trace metal monitors, which will continue to improve air quality across the United States.

Our People

As a global company, with sales in over 60 countries and offices in the UK, USA, Oman, China and South Africa, we aim to build a diverse workforce which understands the various cultures in which we operate.

Having operated in the Middle East for a number of years, in 2013 we moved towards our strategy of employing a local work force. Our staff in the Middle East is completely formed of local employees, supported by our strong central technical team.

During 2013 we strengthened both our Membrane Processes and Monitoring teams, in response to the global interest in our FO technology and to help strengthen the geographical reach of our Monitoring division. In November we also opened a new office in Shanghai to enable us to expand our operations in China.



The Board of Directors



1. Neil McDougall

Executive Chairman

Neil McDougall, who qualified as a chartered accountant, is a co-founder of the Group. As Executive Chairman, his main focus is to deliver value to the Company's shareholders by shaping Modern Water's growth strategy. He is also responsible for maintaining Modern Water's relationship with the City. Neil is Chairman of Delagua and Delagua Health. Formerly Neil was Chairman of Mid Kent Water Group plc and Chairman and CEO of Cascal NV and a director of Biwater plc. Neil has worked extensively with private equity investors, infrastructure funds and other financial institutions.

2. Simon Humphrey

Chief Executive Officer

Simon Humphrey is a co-founder of the Group and has been CEO since Modern Water's inception in December 2006. Simon oversees the day-to-day running of the Group, ensuring the Company and its investments progress successfully. He brings a host of water industry and capital investment experience to the role, and oversees the smooth operation of Modern Water's sites internationally.

3. Michael Gradon

Senior Independent Non-executive Director

Michael has over 25 years' experience in senior commercial, management and legal positions. He spent 20 years at P&O and was a main board director for eight years until its takeover in 2006 by Dubai Ports World. His roles included group commercial and legal director; Chairman of P&O's property business and Chief Executive Officer of its largest infrastructure project. He is a Non-executive Director of Exclusive Hotels, of Grosvenor Limited and of Aercep Holdings NV and a member of the committee of the All England Lawn Tennis Club and the Wimbledon Championships.

4. Mike Townend

Non-executive Director

Mike is the Chief Investment Officer at IP Group plc. He joined the IP Group's board as head of Capital Markets in 2007 from Lehman Brothers where he was Managing Director of European Equities and Head of Equity Sales to Hedge Funds. He has 20 years' experience in equity capital markets and investment process and was also a key member of the senior relationship management programme at Lehman Brothers. Prior to this, he was an Executive Director at Donaldson, Lufkin and Jenrette with responsibility primarily for building the bank's business with hedge funds and alternatives. Mike has sourced, co-led or led numerous private and public transactions. He is the IP Group representative on the boards of Modern Water plc, Evocutis plc and Revolymer plc. He is also a Non-executive Director of Green Urban Transport Limited.

5. Robert Clarke

Non-executive Director

Robert, who qualified as a chartered accountant, has worked in the private equity industry for more than 20 years, first at Electra Partners and subsequently as a founding partner of Motion Equity Partners. Since leaving Motion Equity Partners in 2008 he has focussed on using his experience to assist a variety of businesses in their development.

6. Tad Ostrowski

General Counsel and Company Secretary

Tad is responsible for Group secretarial and legal matters; he also manages the intellectual property portfolio. Tad has extensive international legal experience gained in-house and in private practice. He spent 10 years at Travelport, where he was General Counsel of its Global Distribution Services division for four years, leading a global legal team and serving as a member of the executive team. He previously held a number of senior legal roles within Galileo and Cendant, and served as an officer and a director of a number of Travelport companies. Before moving in-house in 2001, Tad was an associate in the corporate finance department at Richards Butler (now Reed Smith LLP) in London.

The Management Team



1. Roger Webster

Managing Director
Membrane Processes Division

Roger Webster is responsible for the Membrane Processes business. He leads the Business Development team and is responsible for the deployment, licensing and selling of the Group's technology. In his previous role with Bewater Plc and Cascad NV, Roger gained extensive international experience in Asia, the Middle East, the Americas and most recently Africa where he was Managing Director of the South African businesses. He has a wide range of management and business development experience within the water utilities sector.

2. Neil Townend

Managing Director
Monitoring Division

Neil leads the Monitoring division and is responsible for increasing sales and market penetration for Modern Water's leading water monitoring technologies. He has over 20 years technical and commercial experience in the environmental and water sectors. Neil has previously held technical positions in environmental consultancy with RPS Consulting and SGS Group and senior commercial roles in sales and marketing in Chemviron Carbon; the European operation of Calgon Carbon Corporation.

3. Peter Nicoll

Technical Director

Peter Nicoll leads the multi-disciplined technical team at Modern Water; where he has been instrumental in the development, design and successful deployment of Modern Water's FO based technologies. He is the inventor of a number of FO and related processes. A graduate of the University of Glasgow, he is a Chartered Engineer and a Fellow of the Institution of Mechanical Engineers. His previous experience includes Director of Business Development for Fichtner Consulting Engineers Ltd where he was responsible for heading up the business development and sales functions. He has extensive broad expertise in all the major desalination processes, having held a number of senior roles, both technically and commercially, at Weir Westgarth.

4. Peter Bristow

Group Financial Controller

Peter Bristow leads the finance team for Modern Water; He has a wide range of experience across a number of finance disciplines, including M&A, group and divisional finance, internal and external audit roles. He has previously held senior finance roles in organisations undergoing high levels of growth and change, including Virgin Media, Telewest Communications and Thames Water. Peter qualified as a Chartered Accountant over 15 years ago with Coopers and Lybrand.

5. Alan McQuillin

Senior Vice President,
Operations & Technology
Monitoring Division

Alan McQuillin joined Modern Water in 2011 as part of the acquisition of the Strategic Diagnostics Inc. (SDIX) Water Quality division. Alan has more than 22 years of experience in Life Sciences with SDIX, where he most recently worked as Senior Director of Quality, leading SDIX to ISO 9001:2008 certification. Other expertise includes operations management, new product development, and product management. In the new product development group he developed test kits for environmental contaminants such as PCBs, TNT, and PCP, lateral flow assays and ELISAs for the detection of GM crops, and research with the Microtox® platform.

Corporate Governance Statement

Corporate Governance

The Board of Modern Water plc is committed to integrity, business ethics and achieving good standards of corporate governance. As an AIM-listed company, Modern Water plc is not required to issue a statement of compliance with the principles and provisions of The UK Corporate Governance Code (the "Code"). However, this Corporate Governance Statement, together with the information contained in the Directors' Remuneration Report on pages 13 to 15 explains how the directors seek to apply the requirements of the Code to the Group, where practical given its size, resources and stage of development.

Board of Directors

The Board comprises two executive directors, the Executive Chairman (Neil McDougall) and the Chief Executive Officer (Simon Humphrey), and three non-executive directors (Michael Gradon, Mike Townend and Robert Clarke). Michael Gradon is the senior independent non-executive director; Robert Clarke is an independent non-executive director and Mike Townend is a representative of IP Group plc.

The business and management of the Group and its subsidiaries are the collective responsibility of the Board. At each meeting the Board considers and reviews the performance of each of the major projects. The Board has a formal written schedule of matters reserved for its review and approval. These include the approval of the annual budget, major capital expenditure, investment proposals, the interim and annual results, and a review of the overall system of internal control and risk management.

Authority for the execution of the approved policies, business plan and daily running of the business is delegated to the executive directors. In addition, there is a Management Team whose purpose is to assist the Chief Executive Officer in the performance of his duties.

Modern Water plc's Articles of Association require one third of the directors to stand for re-election each year at the Annual General Meeting. Accordingly, Simon Humphrey and Robert Clarke will retire and offer themselves for re-election at the forthcoming Annual General Meeting.

All directors have access to the advice and services of the Company Secretary who is responsible for ensuring that Board procedures and applicable rules and regulations are observed. The Board has a procedure whereby any director may seek, through the office of the Company Secretary, independent professional advice, at the Group's expense, in furtherance of his duties.

Formal agendas and reports are provided to the Board on a timely basis for Board and committee meetings and the Executive Chairman ensures that all directors are properly briefed on issues to be discussed at Board meetings. Directors are able to obtain further advice or seek clarity on issues raised at the meetings from within the Group or from external sources.

Business Ethics

We are committed to acting fairly and ethically in all countries in which we operate. We expect the same standards from all third parties who provide services for Modern Water plc and its subsidiary companies. We maintain anti-bribery, and gifts and entertainment policies, and procedures for contractual commitments to better manage risk with third parties.

Committees

The Board has a Remuneration Committee and an Audit Committee. The executive directors are not members of the committees, but attend the meetings by invitation to facilitate business, if appropriate. The Company Secretary acts as secretary to the committees. The Board does not have a Nomination Committee and Board appointments are consequently a matter for the Board as a whole. The Board is satisfied that the committees discharged their responsibilities appropriately.

Remuneration Committee

The Remuneration Committee consists of Michael Gradon (Chairman, Remuneration Committee), Robert Clarke and Mike Townend. Further details of the committee and its policies are set out in the Directors' Remuneration Report on pages 13 to 15.

Audit Committee

The Audit Committee consists of Robert Clarke (Chairman, Audit Committee), Michael Gradon and Mike Townend.

The committee reviews and makes recommendations on the appointment, reappointment and removal of the external auditors, the review of the scope and results of the external annual audit by the auditors, their cost effectiveness, independence and objectivity. The committee also reviews the nature and extent of any non-audit services provided by the external auditors. No independence issues were noted during the year. The Group Financial Controller monitors the level and nature of non-audit services and specific assignments are identified for approval by the Audit Committee as appropriate.

In addition, the Audit Committee reviews the effectiveness of internal controls, considers the need for an internal audit function and considers any major accounting issues, and reports on such matters to the Board. The Audit Committee reviews the integrity of the financial statements and formal announcements.

A whistle-blowing arrangement exists whereby matters can be confidentially reported to the committee.

Attendance

The following table shows attendance of the directors at meetings of the Board, Remuneration and Audit Committees during the year:

	Board		Remuneration		Audit	
	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend
Neil McDougall	9	9	-	-	-	-
Simon Humphrey	9	9	-	-	-	-
Michael Gradon	9	9	3	3	3	3
Mike Townend	8	9	3	3	3	3
Robert Clarke	8	9	3	3	3	3

Internal Control

The Board has overall responsibility for the Group's system of internal control and for reviewing its effectiveness. The implementation and maintenance of the risk management and internal control systems are the responsibility of the executive directors and senior management. The internal control system is designed to mitigate the principal risks, amongst others, detailed in the Directors' Report, but it does not provide absolute assurance that these risks are eliminated or against material misstatement or loss. The Board is satisfied with the controls in place for identification and management of risk and that the reporting lines have been in place throughout the year under review. The key internal controls in place during the year and up to the date of approval of the report included:

- reporting to the Board, including key financial information and commentary (Group Statement of Comprehensive Income, Group Statement of Financial Position, Group Statement of Cash Flows) and the Chief Executive Officer's report on the business, significant changes and the external marketplace, including the extent to which they represent significant risk;
- detailed corporate policies and procedures document to address key operating and compliance risk areas, including procurement, treasury, human resources, health and safety;
- clear organisational structure with defined reporting lines and delegated authorities;
- the Audit Committee;
- centralised accounts team providing financial control and support to all Group companies; and
- an annual strategy review and an annual budget approved by the Board.

The Board has considered the need for an internal audit function, but because of the size and nature of its operations does not consider it necessary at the current time.

Relations with Shareholders and Investors

The Board is regularly updated regarding meetings and communications with shareholders. An analysis of the shareholder base is presented to the Board on a quarterly basis. Research notes and broker analysis are circulated to and discussed with the Board. During the year, the Executive Chairman met with institutional investors at meetings arranged by the Group's brokers and financial PR advisers.

Copies of the Annual Report and Accounts are issued to all shareholders. Copies of the Annual Report and Accounts and the Interim Statement are available on the website: www.modernwater.com. The Group makes full use of its website to provide information to shareholders and other interested parties. The website provides a facility to receive email alert notifications of Group news and announcements to the London Stock Exchange. Shareholders are given the opportunity to raise questions at the Annual General Meeting and the directors are available both prior to and after the meeting for further discussion with shareholders. Michael Gradon, as Senior Independent Non-executive Director, is available to shareholders where contact through the normal channels of Executive Chairman, Chief Executive Officer or Company Secretary are inappropriate or have failed to resolve concerns.

Directors' Remuneration Report

Introduction

This report has been approved by the Board and the Remuneration Committee (the 'Committee'). It has been prepared to comply with the disclosure requirements of Schedule 5 to the Large and Medium Sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013. The report also provides the information required to be reported on Directors' remuneration under AIM Rule 19. The Committee is committed to maintaining high standards of corporate governance and has taken steps to comply with the principles of best practice, including the ABI Principles of Remuneration and The UK Corporate Governance Code in so far as they can be applied practically given the size of the Group.

Role of the Remuneration Committee

The Committee determines, in accordance with its terms of reference, the remuneration and other benefits, including bonuses and share-based payments, of the executive directors.

The Committee consulted with the executive directors about its remuneration proposals for the year:

Remuneration Policy

The Committee is aware that the remuneration package should be sufficiently competitive to attract, retain and motivate individuals capable of achieving the Group's objectives and thereby enhancing shareholder value. Performance-based remuneration should be clearly aligned with business strategy and objectives and be regularly reviewed. Overall arrangements should be prudent, well communicated, incentivise effectively and recognise shareholders' expectations.

Service Contracts

The Group's policy is for executive directors to have service contracts with provision for termination of no more than 12 months' notice.

Michael Gradon and Robert Clarke have letters of appointment. Appointments can be terminated by the Group or the individual giving one month's notice. The services of Mike Townend are covered in a services agreement with IP Group plc, a significant shareholder in the Company.

The details of the executive and non-executive directors' service contracts are summarised below:

	Date of contract	Notice period (months)
Executive directors		
Neil McDougall	18 May 2007	12
Simon Humphrey	18 May 2007	12
Non-executive directors		
Michael Gradon	14 March 2007	1
Mike Townend	18 May 2007	1
Robert Clarke	17 June 2010	1

Biographical details of all directors can be found on page 9.

Directors' Remuneration

Remuneration for the executive directors comprises basic salary, annual bonus, pension, share-based payments and insurance cover for medical, life and income protection. The bonus payable is determined by performance against objectives, approved by the Committee, which are set at the beginning of each year.

The Board, within the limits stipulated by the Articles of Association and with recommendation from the executive directors, determines non-executive directors' fees. The remuneration of the non-executive directors is not pensionable and the non-executive directors do not participate in any of the Group's other remuneration schemes.

Remuneration for the directors during the year was as follows:

	Basic salary, allowances and fees £000	*Bonus £000	Benefits £000	Year ended 31 December 2013 Total (ex pension) £000	Pension £000	Year ended 31 December 2013 Total (inc pension) £000	Year ended 31 December 2012 Total (ex pension) £000	Pension £000	Year ended 31 December 2012 Total (inc pension) £000
Executive directors									
Neil McDougall	**189	45	8	242	19	261	278	25	303
Simon Humphrey	138	—	5	143	14	157	163	14	177
Non-executive directors									
Michael Gradon	35	—	—	35	—	35	35	—	35
Robert Clarke	20	—	—	20	—	20	20	—	20
Mike Townend***	—	—	—	—	—	—	—	—	—
	382	45	13	440	33	473	496	39	535

* Bonuses are disclosed in the year for which the performance relates. Bonuses for 2013 annual performance are disclosed in the 2013 remuneration.

** Neil McDougall's basic annual salary reduced from £250,000/year to £225,000/year from 1 April 2013. Additionally his time commitment was reduced from four to three working days/week from 1 April 2013 and his salary accordingly pro-rated to £168,750/year.

*** The services of Mike Townend are covered through an agreement with IP Group plc, see note 26 to the Accounts.

Modern Water plc Incentive Plan ('MWIP')

The MWIP contains provisions relating to the making of awards in the form of options and conditional awards of ordinary shares.

a) Options

During the current year no options under the MWIP were granted, vested, exercised or lapsed. There are vested options outstanding over 560,877 shares. However, since vesting the Company's share price has been lower than the option exercise price and accordingly these options had not been exercised at 31 December 2013. They will lapse if they remain unexercised as at 12 June 2017.

	Grant date	Vesting date	Outstanding at 1 January 2013 number	Outstanding at 31 December 2013 number	Vested and exercisable at 31 December 2013 number	Option price	Charge to income statement in 2013	Charge to income statement in 2012
Neil McDougall	6.6.07	12.6.10	186,959	186,959	186,959	£1.19	£nil	£nil
Simon Humphrey	6.6.07	12.6.10	373,918	373,918	373,918	£1.19	£nil	£nil

b) Conditional share awards

During the current year 268,970 conditional shares were awarded to Neil McDougall and 38,970 conditional shares were awarded to Simon Humphrey. No conditional shares lapsed or vested. Prior to this, over the period from 11 September 2009 to 25 March 2013, Neil McDougall was not awarded any conditional share awards, options or other share-based payments. Over the same period Simon Humphrey was awarded 150,000 conditional shares on 24 April 2012.

The directors' participation in conditional share awards under the MWIP is as follows:

	Award date	Vesting date	Outstanding at 1 January 2013 number	Lapsed during the year number	Awarded during the year number	Outstanding at 31 December 2013 number	Share price at award date	Charge to income statement in 2013	Charge to income statement in 2012
Neil McDougall	26.3.13	26.3.16	—	—	268,970	268,970	£0.58	£10,759	—
Simon Humphrey	26.3.13	26.3.16	—	—	38,970	38,970	£0.58	£1,559	—
Simon Humphrey	24.4.12	24.4.15	150,000	—	—	150,000	£0.55	£10,500	£7,000

The extent to which awards will vest depends on the Group's share price on the vesting date. For the conditional shares awarded on 26 March 2013 and those awarded on 24 April 2012, if the share price is £1.00 or more, on the vesting date, the award will vest in full and if the share price is £0.70 or below the award does not vest at all. If the share price is between £0.70 and £1.00 the award partially vests, on a straight line basis. Vesting of the conditional shares awarded on 24 April 2012 is also subject to a non-market performance condition.

c) Enterprise Management Incentives (EMI) Options

During year 431,030 options were granted to Neil McDougall and 431,030 options to Simon Humphrey. No awards lapsed, vested or were forfeited during the year. Holdings of EMI options over ordinary shares issued through the MWIP were as follows:

	Grant date	Vesting date	Outstanding at 1 January 2013 number	Granted during year	Outstanding at 31 December 2013 number	Option price	Charge to income statement in 2013	Charge to income statement in 2012
Neil McDougall	26.3.13	26.3.16	—	431,030	431,030	£nil	£25,116	£nil
Simon Humphrey	26.3.13	26.3.16	—	431,030	431,030	£nil	£22,529	£nil

The options may be exercised after three years to the extent that certain market and non-market performance criteria are met. The extent to which the award will vest depends on performance against these performance criteria, if these are not met the options lapse.

Vesting conditions for 81,030 of Neil McDougall's options and 196,030 of Simon Humphrey's options awarded on 26 March 2013 are that if the Company's volume weighted average share price is £1.00 or more, during the first three months of 2016, the award will vest in full and if the weighted average share price is £0.70 or below the award does not vest at all. If the weighted average share price is between £0.70 and £1.00 the award partially vests, on a straight line basis.

Vesting conditions for 350,000 of Neil McDougall's options and 235,000 of Simon Humphrey's options awarded on 26 March 2013 are that if the Company's volume weighted average share price is £0.85 or more, during the first three months of 2016, the award will vest in full and if the weighted average share price is £0.58 or below the award does not vest at all. If the weighted average share price is between £0.58 and £0.85 the award partially vests, on a straight line basis. In addition vesting is subject to a non-market performance condition.

Options expire after 10 years and, in certain circumstances, are forfeited if the option holder leaves the Group before the options vest.

Directors' Interests

Directors' interests are detailed in the Directors' Report.

Share Price

The Modern Water plc closing share price was 42.75p on 31 December 2013. The share price high for 2013 was 61p and the low was 31p.

On behalf of the Board

Michael Gradon

Chairman, Remuneration Committee

12 March 2014

Directors' Report

The directors present their Annual Report together with the audited consolidated financial statements for the year ended 31 December 2013.

Corporate Structure

The Company is incorporated in England and Wales and has subsidiaries principally incorporated in England and Wales, as well as in China, Oman and the USA.

Review of the Business and Results

A detailed review of the business is set out in the Strategic Report on pages 3 to 8. This includes comments on the financial performance and position of the Group. Information on the Group's internal control environment, including the content of reporting to the Board, is included in the Corporate Governance Statement on pages 11 to 12.

Future Developments

Future developments and prospects are set out in the Strategic Report.

Research and Development

Expenditure recorded in the Statement of Comprehensive Income for R&D during the year was £123,000 (2012: £407,000). Activity included further R&D on the Group's Forward Osmosis and monitoring technologies.

Dividends

The directors do not recommend the payment of a dividend (2012: £nil).

Directors' Interests

The directors in office during the year and up to the date of signing the financial statements, are listed below together with their beneficial interests in the share capital of the Company.

	% of issued share capital	Number of ordinary shares of 0.25p
	31 December 2013	31 December 2013
Neil McDougall	7.96	6,325,000
Simon Humphrey	2.30	1,832,000
Michael Gradon	1.19	946,518
Robert Clarke	0.88	700,000
Mike Townend	0.76	605,000

Directors' and Officers' Liability Insurance

The Group maintains liability insurance for its directors and officers. Following shareholder approval, the Group has also provided an indemnity for its directors and the secretary, which is a qualifying third party indemnity provision for the purposes of the Companies Act 2006. This provision was in place during the year and up to the date of the Annual Report and Accounts.

Corporate Governance

The Annual Report includes a separate Corporate Governance Statement.

Financial Instruments

The Group's financial instruments primarily comprise cash and cash equivalents. In addition, various other financial instruments such as trade receivables and trade payables arise directly from its operations. Please refer to note 3 to the Accounts for greater details of the Group's risks and policies regarding financial instruments.

Annual General Meeting

The Annual General Meeting will be held at the offices of Modern Water plc on 23 April 2014 at 10.00am. The notice convening the Annual General Meeting is set out on pages 48 to 50 of the Annual Report and Accounts.

Independent Auditors

The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office and a resolution concerning their reappointment will be proposed at the Annual General Meeting.

Directors' Statement as to Disclosure of Information to Auditors

The directors who were members of the Board at the time of approving the Directors' Report are listed on page 9. Having made enquiries of fellow directors, each of these directors confirms that:

- to the best of each director's knowledge and belief, there is no relevant audit information of which the Group's auditors are unaware; and
- each director has taken all the steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Group's auditors are aware of that information.

By order of the Board

Tad Ostrowski
Company Secretary
12 March 2014

Statement of Directors' Responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the Group and Parent Company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

By order of the Board

Tad Ostrowski
Company Secretary
12 March 2014

Independent Auditors' Report

To the members of Modern Water plc

Report on the financial statements

Our opinion

In our opinion:

- the financial statements, defined below, give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2013 and of the Group's loss and of the Group's and Parent Company's cash flows for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the Parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

This opinion is to be read in the context of what we say in the remainder of this report

What we have audited

The Group financial statements and Parent Company financial statements (the "financial statements"), which are prepared by Modern Water plc, comprise:

- the Group and Company Statements of Financial Position as at 31 December 2013;
- the Group Statement of Comprehensive Income for the year then ended;
- the Group and Company Statements of Changes in Equity and Statements of Cash Flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in their preparation comprises applicable law and IFRSs as adopted by the European Union and, as regards the Parent Company, as applied in accordance with the provisions of the Companies Act 2006.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

What an audit of financial statements involves

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISAs UK and Ireland"). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

This includes an assessment of:

- whether the accounting policies are appropriate to the Group's and Parent Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

In addition, we read all the financial and non-financial information in the Annual Report and Accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit;
- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law have not been made. We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements audit

Our responsibilities and those of the directors

As explained more fully in the Statement of Directors' Responsibilities set out on page 18, the directors are responsible for the preparation of the Group and Parent Company financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the Group and Parent Company financial statements in accordance with applicable law and ISAs (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Stephen Wootten (Senior Statutory Auditor) for and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

Gatwick

12 March 2014

Group Statement of Comprehensive Income

Year ended 31 December 2013

	Note	2013 £000	2012 £000
Revenue	5	3,528	3,754
Cost of sales	5	(1,805)	(2,341)
Gross profit	5	1,723	1,413
Administrative expenses	8	(5,847)	(6,107)
Other gains - net	7	146	22
Operating loss before interest, tax, depreciation and amortisation		(3,978)	(4,672)
Depreciation and amortisation	8	(895)	(880)
Operating loss		(4,873)	(5,552)
Finance income	12	129	142
Finance costs	12	(22)	(77)
Loss on ordinary activities before taxation		(4,766)	(5,487)
Taxation	13.1	66	74
Loss for the year		(4,700)	(5,413)
Other comprehensive income			
Items may be subsequently reclassified to profit or loss			
Foreign currency translation differences on foreign operations		16	4
Total comprehensive loss for the year		(4,684)	(5,409)
Loss attributable to:			
Owners of the parent		(4,700)	(5,413)
		(4,700)	(5,413)
Total comprehensive loss attributable to:			
Owners of the parent		(4,684)	(5,409)
		(4,684)	(5,409)
Loss per share for the year (attributable to owners of the parent)			
Basic loss per share	14.1	6.18p	9.10p
Diluted loss per share	14.2	6.18p	9.10p

Modern Water plc has taken advantage of the exemption provided under Section 408 of the Companies Act 2006 not to disclose the parent company statement of comprehensive income.

Group and Company Statements of Financial Position

As at 31 December 2013

	Note	Group		Company	
		2013 £000	2012 £000	2013 £000	2012 £000
Assets					
Non-current assets					
Property, plant and equipment	15	595	923	—	—
Intangible assets	16	16,892	17,289	—	—
Investments	17	—	—	15,918	15,825
		17,487	18,212	15,918	15,825
Current assets					
Inventories	18	1,041	1,077	—	—
Trade and other receivables	19	1,634	1,659	6,870	7,764
Cash and cash equivalents	20	11,432	5,751	10,247	5,139
		14,107	8,487	17,117	12,903
Total assets		31,594	26,699	33,035	28,728
Equity and liabilities					
Equity					
Ordinary shares	24	199	149	199	149
Share premium account	24	40,032	30,532	40,032	30,532
Merger reserve		13,180	13,180	13,180	13,180
Accumulated losses		(23,181)	(18,660)	(20,542)	(15,256)
		30,230	25,201	32,869	28,605
Non-controlling interests		126	126	—	—
Total equity		30,356	25,327	32,869	28,605
Liabilities					
Non-current liabilities					
Deferred tax liabilities	13.3	234	300	—	—
Current liabilities					
Trade and other payables	21	1,004	1,072	166	123
		1,004	1,072	166	123
Total liabilities		1,238	1,372	166	123
Total equity and liabilities		31,594	26,699	33,035	28,728

The financial statements on pages 21 to 47 were approved by the Board of directors on 12 March 2014 and signed on its behalf by:

Simon Humphrey
Chief Executive Officer
12 March 2014

Modern Water plc
Registered number: 05963927

Group and Company Statements of Changes in Equity

Year ended 31 December 2013

Group	Note	Ordinary shares £000	Share premium account £000	Merger reserve £000	(Accumulated losses)/ Retained earnings £000	Total £000	Non-controlling interest £000	Total Equity £000
Balance as at 1 January 2012		149	30,532	13,180	(13,422)	30,439	126	30,565
Comprehensive loss								
Loss for the year		—	—	—	(5,413)	(5,413)	—	(5,413)
Foreign currency translation differences		—	—	—	4	4	—	4
Total comprehensive loss		—	—	—	(5,409)	(5,409)	—	(5,409)
Transactions with owners								
Share-based payments	10	—	—	—	171	171	—	171
Total transactions with owners		—	—	—	171	171	—	171
Balance as at 1 January 2013		149	30,532	13,180	(18,660)	25,201	126	25,327
Comprehensive loss								
Loss for the year		—	—	—	(4,700)	(4,700)	—	(4,700)
Foreign currency translation differences		—	—	—	16	16	—	16
Total comprehensive loss		—	—	—	(4,684)	(4,684)	—	(4,684)
Transactions with owners								
Issue of shares	24	50	9,500	—	—	9,550	—	9,550
Share-based payments	10	—	—	—	163	163	—	163
Total transactions with owners		50	9,500	—	163	9,713	—	9,713
Balance as at 31 December 2013		199	40,032	13,180	(23,181)	30,230	126	30,356
Company								
Balance as at 1 January 2012		149	30,532	13,180	(11,180)	32,681	—	32,681
Comprehensive loss								
Loss and total comprehensive loss for year		—	—	—	(4,247)	(4,247)	—	(4,247)
Total comprehensive loss		—	—	—	(4,247)	(4,247)	—	(4,247)
Transactions with owners								
Share-based payments	10	—	—	—	171	171	—	171
Total transactions with owners		—	—	—	171	171	—	171
Balance as at 1 January 2013		149	30,532	13,180	(15,256)	28,605	—	28,605
Comprehensive loss								
Loss and total comprehensive loss for year		—	—	—	(5,449)	(5,449)	—	(5,449)
Total comprehensive loss		—	—	—	(5,449)	(5,449)	—	(5,449)
Transactions with owners								
Issue of shares	24	50	9,500	—	—	9,550	—	9,550
Share-based payments	10	—	—	—	163	163	—	163
Total transactions with owners		50	9,500	—	163	9,713	—	9,713
Balance as at 31 December 2013		199	40,032	13,180	(20,542)	32,869	—	32,869

The merger reserve resulted from the acquisitions of Surrey Aquatechnology Limited on 12 June 2007 and Cogent Environmental Limited on 2 February 2011 and represents the fair value of equity-based consideration.

Group and Company Statements of Cash Flows

Year ended 31 December 2013

	Note	Group		Company	
		2013 £000	2012 £000	2013 £000	2012 £000
Cash flows from operating activities					
Cash used in operations	25	(3,723)	(4,903)	(4,532)	(5,615)
Net cash flows used in operating activities		(3,723)	(4,903)	(4,532)	(5,615)
Cash flows from investing activities					
Purchase of property, plant and equipment	15	(144)	(585)	—	—
Proceeds from sale of property, plant and equipment		10	14	—	—
Purchase of patents and development costs	16	(81)	(152)	—	—
Interest received		93	176	77	176
Net cash flows (used in)/generated from investing activities		(122)	(547)	77	176
Cash flows from financing activities					
Proceeds from issuance of ordinary shares		9,550	—	9,550	—
Net cash flows generated from financing activities		9,550	—	9,550	—
Net increase/(decrease) in cash and cash equivalents		5,705	(5,450)	5,095	(5,439)
Cash and cash equivalents at the beginning of the year	20	5,751	11,280	5,139	10,580
Exchange (losses)/gains on bank balances		(24)	(79)	13	(2)
Cash and cash equivalents at the end of the year	20	11,432	5,751	10,247	5,139

Notes to the Consolidated Financial Statements

1. General information

Modern Water plc is a public limited company incorporated and domiciled in England and Wales, whose shares are publicly traded on the Alternative Investment Market (AIM), a market operated by the London Stock Exchange. The registered office and principal place of business is Bramley House, The Guildway, Old Portsmouth Road, Guildford, Surrey GU3 1LR.

The consolidated and Company financial statements of Modern Water plc (the 'Company') and its subsidiaries (together the 'Group') for the year ended 31 December 2013 were authorised for issue by the Board of directors on 12 March 2014 and the statement of financial position was signed by the Chief Executive Officer (Simon Humphrey).

The principal accounting policies adopted by the Group and Company are set out below.

2. Summary of significant accounting policies

The principal accounting policies have been applied consistently throughout the current and prior year, unless otherwise stated, in the preparation of these financial statements.

2.1 Basis of preparation and changes in accounting policy and disclosures

The financial statements of Modern Water plc have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU, IFRS Interpretations Committee (IFRIC) interpretations and the Companies Act 2006 applicable to companies reporting under IFRS. The financial statements have been prepared under the historical cost convention.

The preparation of financial statements in conformity with IFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 4.

Under Section 479C of the Companies Act 2006, exemptions from an audit of the accounts for the financial year ending 31 December 2013 have been taken by Aguacure Ltd (05893786), Cymtox Limited (05025552), Modern Water Monitoring Limited (06701882), MW Monitoring Limited (07495046), MW Monitoring IP Limited (07810737), Modern Water Holdings Limited (07588452) and Surrey Aquatechnology Limited (05698169). As required, the Company guarantees all outstanding liabilities to which the subsidiary companies listed above are subject at the end of the financial year, until they are satisfied in full and the guarantee is enforceable against the parent undertaking by any person to whom the subsidiary companies listed above is liable in respect of those liabilities.

2.1.1 Going concern

The directors are required by company law to be satisfied that the Group has adequate resources to continue in business for the foreseeable future. A review has been conducted and the directors have concluded that such resources are available, and that the going concern basis is justified in the preparation of the financial statements.

2.1.2 Changes in accounting policy and disclosures

a) New and amended standards adopted by the Group

The following standards have been adopted by the group for the first time for the financial year beginning on or after 1 January 2013 and have a material impact on the group:

- Amendment to IAS 1, 'Financial statement presentation' regarding other comprehensive income. The main change resulting from these amendments is a requirement for entities to group items presented in 'other comprehensive income' (OCI) on the basis of whether they are potentially reclassifiable to profit or loss subsequently (reclassification adjustments).
- Amendments to IAS 36, 'Impairment of assets', on the recoverable amount disclosures for non-financial assets. This amendment removed certain disclosures of the recoverable amount of CGUs which had been included in IAS 36 by the issue of IFRS 13. The amendment is not mandatory for the group until 1 January 2014, however the group has decided to early adopt the amendment as of 1 January 2013.
- Annual improvements 2011, these annual improvements address six issues in the 2009-11 reporting cycle. It includes changes to IFRS 1, 'First time adoption', IAS 1, 'Financial statement presentation', IAS 16, 'Property plant and equipment', IAS 32, 'Financial instruments; Presentation', IAS 'Interim financial reporting'.

b) New standards, amendments and interpretations issued but not effective for the financial year beginning 1 January 2013 and not adopted early

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2013, and have not been applied in preparing these consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements of the Group, except the following set out below:

Notes to the Consolidated Financial Statements

Continued

2. Summary of significant accounting policies (continued)

- IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 was issued in November 2009 and October 2010. It replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. The group is yet to assess IFRS 9's full impact. The Group will also consider the impact of the remaining phases of IFRS 9 when completed by the Board.

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the Group.

2.1.3 Parent company financial statements

Modern Water plc has taken advantage of the exemption provided under section 408 of the Companies Act 2006 not to disclose the parent company statement of comprehensive income. The loss attributed to the parent company in the year was £5,449,000 (2012 loss of: £4,247,000).

2.2 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries).

a) Subsidiaries

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible, are considered when assessing whether the company controls an entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group.

The group applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred to the former owners of the acquiree and the equity interests issued by the Group. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The Group recognises any non-controlling interest in the acquiree on an acquisition-by-acquisition basis, either at fair value or at the non-controlling interest's proportionate share of the recognised amounts of acquiree's identifiable net assets.

Acquisition costs are expensed as incurred.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is re-measured to fair value at the acquisition date through profit or loss.

Any contingent consideration to be transferred by the group is recognised at fair value at the acquisition date.

Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognised in accordance with IAS 39 either in the income statement or as a change to other comprehensive income.

Contingent consideration that is classified as equity is not re-measured, and its subsequent settlement is accounted for within equity.

Goodwill is initially measured as the excess of the aggregate of the consideration transferred in relation to the fair value of the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognised in the income statement.

Inter-company transactions, balances, income and expenses on transactions between group companies are eliminated. Profits and losses resulting from inter-company transactions that are recognised in assets are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

b) Joint ventures

Joint ventures are entities over which the company exercises joint control with other parties under a formal arrangement. Investments in joint ventures are accounted for using the equity method of accounting. The cost of investment in joint ventures is measured at the fair value of the assets given and liabilities incurred or assumed at the date of exchange. The Company's investment includes goodwill identified on acquisition, net of any accumulated impairment losses.

The Group's share of its joint ventures' post-acquisition profits or losses is recognised in the statement of comprehensive income and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in a joint venture equals or exceeds its interest in the joint venture, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the joint venture.

Unrealised gains on transactions between the Group and its joint venture are eliminated to the extent of the Group's interest in the joint venture. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of joint ventures are changed where necessary to ensure consistency with the policies adopted by the Group.

c) Transactions with non-controlling interests

The Group treats transactions with non-controlling interests as transactions with the equity owners of the Group. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of the net assets of the subsidiary is recorded in equity.

When the Group ceases to have control or significant influence, any retained interest in the entity is re-measured to fair value with the change in carrying amount recognised in the income statement. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to the income statement.

2.3 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Board that makes strategic decisions.

2.4 Foreign currency translation

a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in sterling (£), which is the Group's presentation currency and the Company's functional currency.

b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the income statement within 'finance income or cost'.

c) Group companies

The results and financial position of all the Group entities (none of which has the currency of a hyper-inflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions); and
- all resulting exchange differences are recognised in other comprehensive income.

2.5 Property, plant and equipment

All property, plant and equipment is shown at cost less accumulated depreciation and impairment. Cost includes expenditure that is attributable to the acquisition of the items. Depreciation on assets is calculated using the straight-line method to allocate the cost of each asset to its residual value over its estimated useful economic life, as follows:

Leasehold improvements	–	remaining term of the lease
Plant and machinery	–	three to five years
Motor vehicles	–	three to five years
Office equipment	–	three to five years
Furniture, fixtures and fittings	–	three to five years

Notes to the Consolidated Financial Statements

Continued

2. Summary of significant accounting policies (continued)

The assets' residual values and useful economic lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Subsequent costs are capitalised only when it is probable that they will result in future economic benefits flowing to the Group and when they can be measured reliably. All other repairs and maintenance expenditure is charged to the income statement in the period in which it is incurred.

2.6 Intangible assets

a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/joint venture/associate at the date of acquisition:

- goodwill on acquisitions of subsidiaries is included in 'intangible assets'; and
- goodwill on acquisitions of joint ventures is included in 'investments in joint ventures' and is tested for impairment as part of the overall balance.

Separately recognised goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill related to the entity sold.

Goodwill is not subject to amortisation, but is tested for impairment annually to identify whether there have been events or a change in circumstances to indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and the value in use. For the purposes of assessing impairments, assets are grouped at the lowest levels for which there are identifiable cash flows in Cash Generating Units (CGUs). The allocation is made to those CGUs or groups of CGUs that are expected to benefit from the business combination in which the goodwill arose. Due to the pre-revenue stage of most of the Group's technologies, value in use has been assessed based on the present value of applying the Group's technologies to potential contracts in the future and an assessment of the expected number of such contracts.

b) Patents

Separately acquired patents are recognised at the historical cost. They have a finite useful economic life and are subsequently carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of patents over their estimated useful economic lives of 20 years from patent filing.

Patented technology acquired as part of a business combination is recognised at fair value at the acquisition date and amortised over the useful economic life of the technology, estimated as the remaining life of the patents.

c) Research and development

Expenditure on research activities is recognised as an expense in the period in which it is incurred. Any internally-generated development costs are recognised as an asset only if all of the following are met:

- an asset is created that can be identified;
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Where no internally generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred. Internally generated intangible assets are amortised on a straight-line basis over three years.

Development costs identified as a result of a business combination are accounted for in accordance with IAS 38, brought on to the consolidated statement of financial position at the date of acquisition and amortised on a straight-line basis between 10 and 20 years.

Patented technology acquired as part of a business combination is recorded at the fair value on acquisition and amortised on a straight-line basis over the useful economic life of the asset.

2.7 Impairment of intangible assets, investments, property, plant and equipment

Purchased goodwill has an indefinite useful economic life, is not subject to amortisation and is tested annually for impairment as described in notes 2.6 and 16.

Assets that are subject to amortisation or depreciation are tested for impairment when events or a change in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and the value in use. For the purposes of assessing impairments, assets are grouped at the lowest levels for which there are identifiable cash flows (CGUs). Due to the pre-revenue stage of most of the Group's technologies, value in use has been assessed based on the present value of applying the Group's technologies to potential contracts in the future and an assessment of the expected number of such contracts.

2.8 Investments

Investments are stated at cost less any provision for impairment. Investment assets are tested annually for impairment, see note 17.

2.9 Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

2.10 Financial instruments

Financial assets and liabilities are recognised in the Group's statement of financial position when the Group becomes a party to the contractual provisions of the instrument.

a) Cash and cash equivalents

Cash at bank comprises cash available on demand. Short-term deposits with a maturity from inception of one year or less placed with financial institutions are classified as cash equivalents if they can be converted to cash at any time without significant penalties.

b) Trade receivables

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets.

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. Specific bad and doubtful debt provisions are established against trade receivables that are greater than six months overdue where management considers that there is a risk that the customer will not settle the receivable balance.

c) Trade payables

Trade payables are not interest bearing and are initially measured at their fair value and subsequently measured at amortised cost.

2.11 Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour and other direct costs but excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. Provisions, if necessary, are made for slow-moving, obsolete and defective inventories.

2.12 Share Capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new ordinary shares or options are shown in equity as a deduction, net of tax, from the proceeds.

2.13 Employee benefits

a) Pension obligations

The Group has a defined contribution pension plan for directors and staff. The scheme is administered by an insurance company to which the Group pays fixed contributions and the Group has no further payment obligations once the contributions have been paid. The contributions are recognised as an employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

b) Share-based payments

Share-based incentive arrangements are provided to directors and employees. The Group operates a number of share-based payment schemes under the Modern Water plc Incentive Plan (MWIP) which is described in note 10.

The fair value of the services received in exchange for the share-based payment is recognised as an expense with a corresponding credit to equity, where the payment is equity-settled, if cash settled then the cost is accrued in the balance sheet. Where equity-settled the total amount to be expensed over the vesting period is determined by reference to the fair value of the options and bonus shares granted at the date of grant using either a Black-Scholes or Monte Carlo pricing model. Where cash-settled the total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted at the date of grant and then reassessed at each subsequent reporting date using the Black-Scholes model. The annual charge is modified to take account of awards granted to employees who leave the Group during the performance or vesting period and forfeit their rights to the share options and in the case of non-market related performance conditions, where it becomes unlikely they will vest.

The grant by the Company of share-based payments to the employees of subsidiary undertakings in the Group is treated as a capital contribution. The fair value of employee services received, measured by reference to the grant date fair value, is recognised over the vesting period as an increase to investment in subsidiary undertakings, with a corresponding credit to equity.

Notes to the Consolidated Financial Statements

Continued

2. Summary of significant accounting policies (continued)

2.14 Taxation

The current income tax charge is calculated on the basis of the tax laws applicable to the current year and enacted or substantively enacted at the balance sheet date in the countries where the Company's subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation, and establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination, which at the time of the transaction affects neither the accounting nor the taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

2.15 Revenue and income recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods, services and royalty income in the ordinary course of the Group's activities. Revenue is shown net of trade and early settlement discounts, value added tax (VAT) and similar sales taxes.

a) Royalties

Royalty income is recognised as revenue on an accruals basis in accordance with the substance of the relevant agreements. Royalty income is therefore recognised in the year on the basis of royalty statements provided by distributors.

b) Provision of goods and services

Revenue from the provision of goods and services is recognised when the risks and rewards of ownership have been transferred to the customer. The risks and rewards of ownership are deemed to have been transferred when the goods are delivered and the services provided to the customer. Where the customer wishes to delay taking delivery of the goods, agrees to be invoiced for the goods, and the goods are on hand ready for delivery and usual payment terms apply, transfer of the risks and rewards is deemed to occur when the goods are ready to be shipped to the customer. Goods in transit are deemed to be owned by the customer if the customer arranges transit, or by the Group if the Group arranges transit. Revenue for services revenue is generally for the installation and servicing of products and the training of customer staff. Revenue for services is recognised once the service has been completed.

(c) Interest

Income is recognised as interest accrues, using the effective interest method. Interest income is included in finance income in the statement of comprehensive income.

d) Grants

Grants are recognised when there is reasonable assurance that the entity will comply with the conditions related to them and that the grants will be received.

Grants related to income are recognised over the periods necessary to match them with the related costs which they are intended to compensate, on a systematic basis. Grants relating to income are recognised as other income in the statement of comprehensive income. Unutilised grants are held in accruals and deferred income in the Group Statement of Financial Position.

Grants relating to assets are deducted from the carrying value of the asset. The statement of comprehensive income is affected by a reduced depreciation charge over the useful economic life of the asset.

3. Financial risk management

The Group is subject to a number of financial risks, principally market risk (interest rate risk and foreign exchange risk); credit risk; liquidity risk; and capital risk. The Group's policy aims to mitigate these risks through a conservative approach to treasury management:

a) Market risk**(i) Interest risk**

The Group's interest rate risk arises from variable interest rates on finance income and investing cash flows from the cash deposits. The Group's policy is to invest in fixed interest term deposits, thereby mitigating uncertainty over the future interest receipts. As the Group has no borrowings it only has limited interest rate risk.

(ii) Foreign exchange risk

During 2013 the majority of the Group's costs were in pounds sterling and US dollars therefore it was appropriate to hold funds in pounds sterling and US dollars. The Group does have a major supplier who invoices in Australian dollars and for these payments the Group maintains an Australian dollar bank account, purchasing Australian dollars when a commitment is certain or when there is a favourable exchange rate. In addition to sterling and US dollar accounts, the Group does maintain Australian dollar and Euro accounts for customer receipts and to hold currency to hedge against future commitments in those currencies.

b) Credit risk

The Group is exposed to credit risk from placing significant deposits with counterparties. The Group's policy is to restrict counterparties to institutions that are Moody's A rated when the deposit is placed; ratings can change during the term of the deposit. Cash balances by counterparty credit rating are listed in note 20. Additionally the Group is exposed to credit risk from customers. This risk is mitigated in the Monitoring Division through new customers being required to pay in advance for their first purchase. Customer's seeking credit undergo a credit application process and are subject to credit limits. Accounts receivable balances are monitored and actively managed on a regular basis.

c) Liquidity risk

The Group's liquidity risk arises from cash being on deposit with counter parties and therefore not available at short notice to meet requirements. The Group's policy is to maintain rolling cash flow forecasts and place cash on deposit with a range of maturity dates to meet forecast liquidity requirements. The maximum duration for a term deposit is 12 months from the date of deposit.

d) Capital risk

Capital risk relates to the long term funding requirements for the Group. The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital. At the Group's current stage of development it is appropriate for it to be wholly funded by equity. As the Group develops, this capital structure will be reviewed.

4. Critical accounting estimates and judgements

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities are addressed below:

a) Estimated impairment of goodwill

The Group tests annually whether goodwill has suffered any impairment, in accordance with the accounting policy stated in note 2.6. The recoverable amounts of cash generating units (CGU) have been determined based on the higher of fair value less costs of disposal and value-in-use calculations. These calculations require the use of estimates. No impairment charge was considered necessary for 2013. The recoverable amounts exceed the £13.4m carrying value of the goodwill. There is sufficient headroom between the recoverable amount and the carrying value to allow for movement in the key assumptions before impairment is required. Detail of the impairment tests and the key assumptions is included in note 16.

b) Acquired intangible assets

The Group is carrying significant intangible assets (patented technology and research and development) arising from business combinations in prior years, in accordance with the accounting policy stated in note 2.6. Estimation of the fair values of acquired intangible assets requires assumptions as to replacement cost, value, future useful economic life and future cash flows for impairment tests. There is a high degree of judgement required in making these assumptions which impact both the initial fair value acquired and the carrying value as at the balance sheet date.

c) Share-based payments

The fair value calculation of share-based payments requires several assumptions and estimates. Their details are included in note 10. Such assumptions and estimates could change and could affect the amount recorded.

5. Segmental analysis**5.1 Reportable segments**

The chief operating decision-maker is deemed to be the Board, for whom monthly financial information is provided by division to gross profit and direct overheads; below this financial information is reported in a consolidated group format. For management reporting purposes the group is organised into two operating segments (i) membranes; and (ii) monitoring, which matches this divisional split.

Administrative expenses directly attributable to the two main operating divisions (business development and technical expenditure) are reported as expenditure in the respective division. A significant proportion of the Group's expenditure (legal, marketing, finance, facilities and directors' expenditure) is managed and reported centrally. As the commercial activities of the Group develop, this financial information is expected to evolve.

Notes to the Consolidated Financial Statements

Continued

5. Segmental analysis (continued)

Statement of Comprehensive Income	2013				2012			
	Membrane £000	Monitoring £000	Central £000	Total £000	Membrane £000	Monitoring £000	Central £000	Total £000
Revenue	36	3,492	—	3,528	378	3,376	—	3,754
Cost of sales	(8)	(1,797)	—	(1,805)	(562)	(1,779)	—	(2,341)
Gross profit / (loss)	28	1,695	—	1,723	(184)	1,597	—	1,413
Administrative expenses	(1,629)	(1,891)	(2,154)	(5,674)	(1,747)	(2,009)	(2,180)	(5,936)
Share-based payments	—	—	(173)	(173)	—	—	(171)	(171)
Other gains - net	—	59	87	146	—	—	22	22
Operating loss before interest, tax, depreciation and amortisation	(1,601)	(137)	(2,240)	(3,978)	(1,931)	(412)	(2,329)	(4,672)
Depreciation and amortisation	—	—	(895)	(895)	—	—	(880)	(880)
Operating loss	(1,601)	(137)	(3,135)	(4,873)	(1,931)	(412)	(3,209)	(5,552)
Finance income	—	—	129	129	—	—	142	142
Finance costs	—	—	(22)	(22)	—	—	(77)	(77)
Loss before taxation	(1,601)	(137)	(3,028)	(4,766)	(1,931)	(412)	(3,144)	(5,487)
Taxation	—	—	66	66	—	—	74	74
Loss for the year	(1,601)	(137)	(2,962)	(4,700)	(1,931)	(412)	(3,070)	(5,413)

The Monitoring division recognised £106,000 (2012: £135,000) revenue from royalties and £3,386,000 (2012: £3,241,000) from sale of goods and services. The Membrane division recognised £nil (2012: £334,000) from the sale of desalination equipment and £36,000 (2012: £44,000) from sale of water.

5.2 Geographical information

The Group operates in four main geographical regions, based on customer location.

Revenue	2013			2012		
	Membranes £000	Monitoring £000	Total £000	Membranes £000	Monitoring £000	Total £000
Americas	—	1,449	1,449	—	1,390	1,390
Europe	—	708	708	—	632	632
Middle East and Africa	36	71	107	378	60	438
Asia Pacific	—	1,264	1,264	—	1,294	1,294
Total	36	3,492	3,528	378	3,376	3,754

The Group has non-current assets in four countries (2012: four), based on location of the assets.

	2013			2012		
	Property, plant and equipment £000	Intangible assets including goodwill £000	Total £000	Property, plant and equipment £000	Intangible assets including goodwill £000	Total £000
UK	212	16,892	17,104	259	17,289	17,548
US	342	—	342	413	—	413
Oman	13	—	13	139	—	139
Gibraltar	28	—	28	112	—	112
Total	595	16,892	17,487	923	17,289	18,212

Assets and liabilities are presented to the chief operating decision maker in a consolidated group format. Assets and liabilities are not presented by segment.

5.3 Major customers

Within the Monitoring division revenue sales to one customer totalled £821,000 (2012: £664,000), representing 24% (2012: 20%) of the division's revenue. No other customer represented more than 10% of the division's revenue. All revenue in the Membrane division came from a single customer (2012: 100%).

6. Business combinations

There were no business combinations during the current or prior year.

7. Other gains - net

	2013 £000	2012 £000
Grant income	87	22
Other income	59	—
Total	146	22

The grant income relates to work performed on European Union (EU) funded electro-coagulation projects.

8. Administrative expenses by nature

	Note	2013 £000	2012 £000
Employee benefits expense	9	2,658	2,666
Share-based payments	10	173	171
Operating lease payments	23.1	384	348
Research and development		123	407
Auditors' remuneration	11	112	120
Loss on disposal of property, plant, equipment and intangible assets		40	—
Other administrative expenses		2,357	2,395
Total administrative expenses before depreciation and amortisation charges		5,847	6,107
Depreciation and amortisation charges	15,16	895	880
Total administrative expenses including depreciation and amortisation charges		6,742	6,987

9. Employee benefits expense

	Note	2013		2012	
		Group £000	Company £000	Group £000	Company £000
Staff costs for the year, including executive directors, amounted to:					
Wages and salaries		2,157	501	2,180	482
Social security costs		238	55	235	58
Other pension costs		120	33	122	39
Other benefits		143	13	129	13
Total employee benefits expense		2,658	602	2,666	592
Equity-settled share-based payments	10	163	70	171	40
Cash-settled share-based payments	10	10	—	—	—
		2,831	672	2,837	632

Other benefits include private health insurance, life insurance and income protection.

Notes to the Consolidated Financial Statements

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9. Employee benefits expense (continued)

	2013		2012	
	Group Number FTE	Company Number FTE	Group Number FTE	Company Number FTE
Monthly average number of employees by activity (including executive directors):				
Executive directors	2	2	2	2
Technical	28	—	27	—
Business development	16	—	15	—
Finance, legal and administration	8	—	8	—
Total	54	2	52	2

Key management personnel are considered to be the executive directors.

The aggregate amount of emoluments, excluding employers pension contributions, paid to executive directors in respect of qualifying services was £385,000 (2012: £441,000). The highest paid director received, including bonus, £242,000 (2012: £278,000), excluding pension contributions. There were no gains made by directors on the exercise of share options (2012: £nil). No money was received by directors under long term incentive schemes (2012: £nil). The two executive directors in total received £45,000 in cash bonuses relating to 2013 performance (2012: £40,000). The highest paid director received a £45,000 cash bonus relating to 2013 performance (2012: £20,000). The Group paid £33,000 (2012: £39,000) to the two executive directors in respect of money purchase pension schemes, with the highest paid director receiving £19,000 (2012: £25,000). Total remuneration for non-executive directors was £55,000 (2012: £55,000). See the remuneration table on page 14 of Directors' Remuneration Report for further details.

In addition to the above costs for permanent staff, the Group utilises the services of contract and agency staff as circumstances require.

10. Share-based payment plans

	2013		2012	
	Group £000	Company £000	Group £000	Company £000
Options	—	—	1	—
Conditional share awards	17	23	170	40
EMI options	146	47	—	—
Equity-settled share-based payments	163	70	171	40
Cash-settled share-based payments	10	—	—	—
Total share-based payments charged to the income statement	173	70	171	40
Equity-settled share-based payments	163	70	171	40
Capital contribution relating to share-based payments	—	93	—	131
Total share-based payments changes in equity	163	163	171	171

The share-based payment plans are described below. The number of shares issued under these plans is limited to 10% of the issued ordinary share capital of the company.

The Group incurred £173,000 (2012: £171,000) in share-based payments of which £70,000 (2012: £40,000) was recognised in the Company's Statement of Comprehensive Income for its employees and a further £103,000 (2012: £131,000) to the employees of subsidiary undertakings. The payment to the employees of the Company's subsidiaries for equity-settled share-based payments of £93,000 (2012: £131,000) is recognised as a capital contribution in the Company balance sheet (note 17). The payment for cash-settled share-based payments of £10,000 (2012: £nil) is recognised as an accrual in the balance sheet.

Modern Water plc Incentive Plan (MWIP)

The MWIP was adopted on 1 June 2007 and contains provisions relating to the making of awards in the form of options and conditional awards of ordinary shares (to be received once performance conditions are satisfied).

a) Options

Under this scheme share options are granted to senior management. The exercise price is equal to the market price on the date of the grant. The options may be exercised if certain TSR performance criteria are met. If the performance criteria are not met the options lapse. No options were granted, exercised, lapsed or forfeited in the year. The directors' and employees' holdings of options over ordinary shares issued under MVVIP were as follows:

Date of grant	Earliest exercise date	Expiry Date	Exercise price	Number of options				Outstanding at 31 December 2013	Vested and exercisable at 31 December 2013
				Outstanding at 1 January 2013	Granted in year	Exercised in year	Lapsed in year		
Neil McDougall*	12.06.10	12.06.17	119.0p	186,959	—	—	—	186,959	186,959
Simon Humphrey*	12.06.07	12.06.17	119.0p	373,918	—	—	—	373,918	373,918
2013 Total Options				560,877	—	—	—	560,877	560,877
2013 Weighted Average Exercise Price				119p	—	—	—	119p	119p
2012 Total Options				610,877	—	—	(50,000)	560,877	560,877
2012 Weighted Average Exercise Price				112p	—	—	100p	119p	119p

TSR performance criteria required on the earliest exercise date. If this is not met the options lapse.

*The options vested in thirds 12, 24 and 36 months from AIM admission. Each tranche vested subject to total shareholder return being at least equal to 10% for the 12 months preceding the relevant tranche vesting date.

The weighted average remaining contractual life for the share options outstanding at 31 December 2013 is three years and five months (2012: four years and five months). The exercise price for options outstanding at the end of the year was £1.19 (2012: £1.19). 560,877 options were exercisable as at 31 December 2013 (2012: 560,877).

The fair value of the equity-settled share options granted is estimated as at the date of grant using a Black-Scholes model, taking into account the terms and conditions upon which the options were granted.

b) Conditional share awards

The conditional share awards are provisional awards of ordinary shares in Modern Water plc, which vest three years after the date of the award to the extent that performance conditions have been met. The extent to which the award will vest depends on the Group's share price on the vesting date. The movement in the number of conditional shares awarded is set out below:

	2013	2012
At 1 January	2,250,000	2,150,000
Conditionally awarded during year	*307,940	*1,050,000
Lapsed	(450,000)	(900,000)
Forfeited	(400,000)	(50,000)
At 31 December	1,707,940	2,250,000

Vesting criteria required on vesting date three years after grant date are set out below:

* 1,050,000 shares conditionally awarded during 2012 and 307,940 shares conditionally awarded during 2013 will vest in full if the share price is £1.00 or more on the vesting date. If the share price is £0.70 the award does not vest at all. If the share price is between £0.70 and £1.00 the award partially vests, on a straight line basis.

450,000 shares conditionally awarded in 2010 lapsed due to the vesting criteria not being met, a further 400,000 were forfeited due to an employee leaving the Group. The weighted average remaining contractual life for the conditional share awards outstanding at 31 December 2013 is one year and two months (2012: one year and seven months). The fair value of the award is estimated as at the date of award using a Monte Carlo model, taking into account the terms and conditions upon which the shares were awarded.

Notes to the Consolidated Financial Statements

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10. Share-based payment plans (continued)

The following table lists the inputs into the model used for the shares awarded in the year and the prior year.

Grant date	26 March 2013	24 April 2012
Share price at date of award	58.0p	53.5p
Exercise price	£nil	£nil
Assumed volatility at date of award (median of historical 50 day moving average)	23%	39%
Vesting period (years)	3.0	3.0
Expected dividend yield	0%	0%
Risk-free discount rate	1.0%	2.0%
Fair value per share awarded	16p	21p

c) Enterprise Management Incentives (EMI) options

Under this scheme share options are granted at nil exercise price to senior management. The options may be exercised after three years to the extent that certain market and non-market performance criteria are met. The extent to which the award will vest depends on performance against these performance criteria, if these are not met the options lapse. Options expire after 10 years and, in certain circumstances, are forfeited if the option holder leaves the Group before the options vest.

	2013
At 1 January	—
Granted	2,047,060
At 31 December	2,047,060

The fair value of the award is estimated as at the date of award using Monte Carlo (where there are market conditions) and Black-Scholes models (where there are no market conditions), taking into account the terms and conditions upon which the shares were awarded. The weighted average fair value of EMI options granted during the year was 39p (2012: £nil). The following table lists the inputs into the model used for the options granted in the year:

Grant date	26 March 2013
Share price at date of award	58.0p
Number of options	2,047,060
Exercise price	£nil
Assumed volatility at date of award (median of historical 50 day moving average)	23%
Vesting period (years)	3.0
Expected dividend yield	0%
Risk-free discount rate	1.0%
Weighted average fair value per share awarded	39p

d) Cash-settled options

Under this scheme the Company grants employees the right to receive a cash award, subject to the fulfilment of certain vesting conditions, equal to the vesting date market value of the notional shares awarded to the employees.

The options may be exercised after three years to the extent that certain non-market performance criteria are met. The extent to which the award will vest depends on performance against these performance criteria, if these are not met the options lapse. Options expire after 10 years and, in certain circumstances, are forfeited if the option holder leaves the Group before the options vest.

	2013
At 1 January	—
Granted	200,000
At 31 December	200,000

The fair value of the award is estimated as at the date of award using a Black-Scholes model, taking into account the terms and conditions upon which the shares were awarded. The weighted average fair value of cash settled options granted during the year was 52.88p (2012: £nil). The following table lists the inputs into the model used for the cash-settled options granted in the year:

Grant date	11 June 2013	26 March 2013
Share price at date of award	47.75p	58.0p
Number of options	100,000	100,000
Exercise price	£nil	£nil
Assumed volatility at date of award (median of historical 50 day moving average)	23%	23%
Vesting period (years)	3.0	3.0
Expected dividend yield	0%	0%
Risk-free discount rate	1.0%	1.0%
Fair value per share awarded	47.75p	58p

11. Auditors' remuneration

	2013 £000	2012 £000
Audit of Company and consolidated financial statements	34	30
Audit of subsidiaries	45	40
Total audit	79	70
Tax compliance services	29	43
Tax advisory services	4	7
Services relating to taxation	33	50
Total non audit services	33	50
Total fees	112	120

12. Finance income and costs

	2013 £000	2012 £000
Finance income:		
Bank interest receivable	129	142
Total finance income	129	142
Finance costs:		
Foreign exchange losses	(22)	(77)
Total finance costs	(22)	(77)
Net finance income	107	65

13. Taxation

13.1 Tax on loss on ordinary activities

	2013 £000	2012 £000
Deferred tax:		
Origination and reversal of temporary differences	(45)	(47)
Impact of change in the UK tax rate	(21)	(27)
Total deferred tax	(66)	(74)

Notes to the Consolidated Financial Statements

Continued

13. Taxation (continued)

13.2 Reconciliation of the total tax charge

The tax on the Group's loss before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to losses of the consolidated entities as follows:

	2013 £000	2012 £000
Loss on ordinary activities before taxation	4,766	5,487
Loss multiplied by the weighted average tax rate of 23.25% (2012: 24.5%)	1,108	1,344
Expenses not deductible for tax purposes	(40)	(45)
Capital allowances and other timing differences	(87)	(91)
Adjustment in respect of prior years	51	—
Re-measurement of deferred tax – changes in UK tax rate	21	27
Losses not utilised	(987)	(1,161)
Tax credit	66	74

13.3 Deferred tax liabilities

	2013 £000	2012 £000
Intangible assets in business combinations		
At 1 January	300	374
Credited to the statement of comprehensive income	(66)	(74)
At 31 December	234	300

The deferred tax liability arises from taxable temporary differences on intangible assets recognised on business combinations and is expected to unwind over the useful economic life of these assets.

The analysis of deferred tax liabilities is as follows:

	2013 £000	2012 £000
To be recovered after more than 12 months	208	245
To be recovered within 12 months	26	55
Deferred tax liabilities	234	300

Deferred tax assets of £4,691,000 at 31 December 2013 (31 December 2012: £4,161,000) in respect of unutilised trading losses have not been recognised, as utilisation is not yet sufficiently certain. No deferred tax assets relating to short term timing differences or depreciation in excess of capital allowances have been recognised, due to uncertainty over the timing of the recovery of these assets.

14. Loss per share

14.1 Basic

Basic loss per share (LPS) is calculated by dividing the loss attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year:

	2013	2012
Loss attributable to equity holders of the Company (£'000)	4,700	5,413
Weighted average number of ordinary shares in issue (thousands)	76,108	59,505
Basic loss per share	6.18p	9.10p

14.2 Diluted

As the Group is loss making, the diluted loss per share is equal to the basic loss per share.

15. Property, plant and equipment

Group	Leasehold improvements £000	Plant and machinery £000	Motor Vehicles £000	Office equipment £000	Furniture, fixtures and fittings £000	Total £000
At 1 January 2012						
Cost	133	1,179	47	267	131	1,757
Accumulated depreciation	(107)	(571)	(14)	(181)	(97)	(970)
Net book amount	26	608	33	86	34	787
Year ended 31 December 2012						
Opening net book amount	26	608	33	86	34	787
Exchange differences	(5)	(3)	—	(3)	—	(11)
Additions	265	138	13	99	70	585
Disposals	(3)	—	(10)	—	(1)	(14)
Depreciation charge	(31)	(310)	(11)	(42)	(30)	(424)
Closing net book amount	252	433	25	140	73	923
At 31 December 2012						
Cost	390	1,314	46	363	200	2,313
Accumulated depreciation	(138)	(881)	(21)	(223)	(127)	(1,390)
Net book amount	252	433	25	140	73	923
Year ended 31 December 2013						
Opening net book amount	252	433	25	140	73	923
Exchange differences	(2)	(3)	—	—	—	(5)
Additions	12	110	—	12	10	144
Disposals	—	(20)	—	—	(2)	(22)
Depreciation charge	(61)	(295)	(12)	(50)	(27)	(445)
Closing net book amount	201	225	13	102	54	595
At 31 December 2013						
Cost	400	1,401	46	375	208	2,430
Accumulated depreciation	(199)	(1,176)	(33)	(273)	(154)	(1,835)
Net book amount	201	225	13	102	54	595

There were no property, plant and equipment assets recognised in the Company's Statement of Financial Position as at 31 December 2013 (2012: none).

Notes to the Consolidated Financial Statements

Continued

16. Intangible assets

Group	Goodwill £000	Patent and Trademark costs £000	Development costs £000	Research and Development, and patented technology acquired as part of a business combination £000	Customer contracts acquired as part of a business combination £000	Total £000
At 1 January 2012						
Cost	13,434	642	131	4,007	180	18,394
Accumulated amortisation	—	(146)	(131)	(508)	(16)	(801)
Net book amount	13,434	496	—	3,499	164	17,593
Year ended 31 December 2012						
Opening net book amount	13,434	496	—	3,499	164	17,593
Additions	—	152	—	—	—	152
Amortisation charge	—	(46)	—	(331)	(79)	(456)
Closing net book amount	13,434	602	—	3,168	85	17,289
At 31 December 2012						
Cost	13,434	794	131	4,007	180	18,546
Accumulated amortisation	—	(192)	(131)	(839)	(95)	(1,257)
Net book amount	13,434	602	—	3,168	85	17,289
Year ended 31 December 2013						
Opening net book amount	13,434	602	—	3,168	85	17,289
Additions	—	81	—	—	—	81
Disposals	—	(28)	—	—	—	(28)
Amortisation charge	—	(40)	—	(332)	(78)	(450)
Closing net book amount	13,434	615	—	2,836	7	16,892
At 31 December 2013						
Cost	13,434	847	131	4,007	180	18,599
Accumulated amortisation	—	(232)	(131)	(1,171)	(173)	(1,707)
Net book amount	13,434	615	—	2,836	7	16,892

Additions to patent costs arise from legal and other fees incurred in securing patents. These are valued at the actual costs related to prosecuting the patents.

The goodwill carrying value by CGU is summarised below:

Group	2013 £000	2012 £000
Surrey Aquatechnology Limited	11,902	11,902
Poseidon Water Limited	140	140
Cymtox Limited	629	629
Modern Water Monitoring Limited (previously Cogent Environmental Limited)	663	663
AguaCure Ltd	100	100
Total Group goodwill	13,434	13,434

Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

The goodwill impairment review indicated that the recoverable amounts are in excess of the carrying value. The forecasts indicate sufficient headroom between the recoverable amount and carrying value to allow for movement in the key assumptions before impairment is required. Therefore no goodwill impairment was recorded in the year.

The recoverable amounts are determined using the higher of the cash generating unit's (CGU) fair value less costs of disposal (FV) and value in use (VIU) calculations. The fair value less costs of disposal method calculates the fair value of each CGU based on the Company's share price and the selling prices of comparable businesses. The VIU use of this method requires the estimation of future cash flows before tax and the selection of a suitable discount rate in order to calculate the present value of these cash flows. The cash flow calculations analyse the present value of applying Modern Water's patented Forward Osmosis, wastewater and water monitoring technology to potential contracts in the future.

Modern Water is in the early commercial development stage, with the exception of the established businesses of Modern Water Inc and Modern Water Monitoring Limited, in developing markets. The Group is currently working to secure and increase revenue generating contracts in both the Membrane and Monitoring divisions. Forecast sales and profit are dependent on the size of the markets, penetration and speed of uptake. The early stage of adoption means that there remains a significant level of judgement involved in making assumptions for sales.

The key assumption for the Surrey Aquatechnology Limited (SAL) value in use calculation is the securing of future commercial contracts. The key to securing these contracts is the delivery of opex and capex savings for Forward Osmosis plants compared with traditional desalination technology. Management estimate these savings based on results from the existing operational plants. The value in use calculation uses a 25 year timeframe consistent with the industry standard for Build Own Operate Transfer (BOOT) contracts. A discount rate of 15% (2012: 15%) has been used when calculating the net present value of these calculations.

SAL has significant headroom between the carrying value of SAL goodwill and the cash flow generated from winning a number of contracts. In order for a material impairment to arise, revenues would have to be 15% below forecast.

The key assumption for both Poseidon Water Limited and Aguacure Ltd value in use calculations is the securing of wastewater contracts over the next five years. Management estimate the sales volume based on the current business plan, which was approved by the Board. The business plan was based on forecasts from potential customers. A discount rate of 20% (2012: 20%) and 20% (2012: 20%) respectively has been applied.

The discount rates applied to each CGU for the value in use projections are between 15% and 20% as outlined above (2012: 15% to 20%). All assumptions have been reviewed at the end of the year and revised where necessary.

There were no intangible assets recognised in the Company's Statement of Financial Position as at 31 December 2013 (2012: none).

Notes to the Consolidated Financial Statements

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17. Investments

Company	Investment in subsidiary £000
Year ended 31 December 2012	
Opening book amount	15,694
Capital contribution relating to share-based payments	131
Closing book amount	15,825
Year ended 31 December 2013	
Opening book amount	15,825
Capital contribution relating to share-based payments	93
Closing book amount	15,918

Subsidiary undertakings, which contribute to the group result	Principal activities	% Shareholding	Status
Modern Water Services Limited	Technical, business development, finance, legal and admin services to the Group companies	100	Subsidiary
Surrey Aquatechnology Limited	Desalination technology	100	Subsidiary
Modern Water Holdings Limited	Holding company for water treatment operating companies and investments	100	Subsidiary
Modern Water Technologies LLC	Project and operating company in Oman	70	Subsidiary
MW Monitoring Limited	Holding company for monitoring instrumentation business	100	Subsidiary
Modern Water Inc	Toxicity and environmental monitoring products	100	Subsidiary
MW Monitoring IP Limited	Owners of IP for toxicity and environmental monitoring products	100	Subsidiary
Modern Water Monitoring Limited	Water and soil monitoring products	100	Subsidiary
Cymtox Limited	Toxicity monitoring applications	100	Subsidiary
Aguacure Ltd	Electro-coagulation wastewater treatment systems	100	Subsidiary
Poseidon Water Limited	Saline wastewater treatment systems	51	Subsidiary
Modern Water (Nominees) Limited	Acquisition and allocation of shares for the Group	100	Subsidiary

Modern Water Inc is a Delaware corporation. Modern Water Technologies LLC is a company registered in Oman. All other subsidiaries are incorporated in England and Wales. Shares held are all ordinary share capital.

The Group had no investments in the current or prior year.

18. Inventories

	Group		Company	
	2013 £000	2012 £000	2013 £000	2012 £000
Raw materials	217	255	—	—
Work in progress	37	14	—	—
Finished goods	787	808	—	—
Total inventories	1,041	1,077	—	—

The cost of inventories recognised as expense and included in 'cost of sales' amounted to £1,307,000 (2012: £1,858,000). The carrying value of inventories is net of a £82,000 provision for slow moving and obsolete inventories (2012: £30,000).

19. Trade and other receivables

	Group		Company	
	2013 £000	2012 £000	2013 £000	2012 £000
Trade receivables	1,077	1,079	—	—
Provision	(43)	—	—	—
Trade receivables – net	1,034	1,079	—	—
Value added tax	73	96	5	10
Accrued income	67	31	67	31
Other receivables	46	26	—	—
Amounts due from subsidiary undertakings	—	—	6,788	7,714
Amounts due from non-controlling interests	126	126	—	—
Prepayments	288	301	10	9
Total trade and other receivables	1,634	1,659	6,870	7,764

Accrued income includes interest due on term deposits. The amounts due from subsidiary undertakings are unsecured, bear no interest and are repayable on demand.

As at 31 December Group trade receivables of £334,000 (2012: £710,000) were past due, of which £43,000 was provided against (2012: £nil). The ageing of these receivables is as follows:

	Group	
	2013 £000	2012 £000
Up to 3 months past due date	218	369
3 to 6 months past due date	61	341
More than 6 months past due date	55	—
Trade receivables past due date	334	710
Trade receivables not yet due and not considered impaired	743	369
Total trade receivables	1,077	1,079

The carrying amounts of the Group's trade receivables are denominated in the following currencies:

	Group	
	2013 £000	2012 £000
UK pound sterling	151	66
US dollar	846	632
Omani Rial	36	341
Australian dollar	4	15
Euro	40	25
	1,077	1,079

Movements on the Group's provision for impairment of trade receivables are as follows:

	Group	
	2013 £000	2012 £000
At 1 January	—	28
Provision for receivables impairment	43	—
Receivables written off during the year as uncollectible	—	(28)
	43	—

The Company had no trade and other receivables past due but not impaired (2012: £nil). The directors believe that the carrying value of the Company's receivables from subsidiary undertakings is supported by their expected future cash flows.

Notes to the Consolidated Financial Statements

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20. Cash

20.1 Cash and cash equivalents

	Group		Company	
	2013 £000	2012 £000	2013 £000	2012 £000
Cash and cash equivalents				
Cash at bank	6,432	3,751	5,247	3,139
Short-term deposits	5,000	2,000	5,000	2,000
Cash at bank and in hand	11,432	5,751	10,247	5,139

20.2 Credit quality of cash and cash equivalents

		Group		Company	
		2013 £000	2012 £000	2013 £000	2012 £000
Short term	Long term				
P-1	AA	1,369	946	240	355
P-1	A	2,556	2,021	2,500	2,000
P-2	A	5,007	2,784	5,007	2,784
NP	Caa	2,500	—	2,500	—
Cash at bank and in hand		11,432	5,751	10,247	5,139

The credit quality of the cash and cash equivalents is assessed using Moody's short and long term ratings. The cash held at the Caa rated counterparty is a term deposit with the Co-operative Bank Plc which matures on 25 March 2014.

21. Trade and other payables

	Group		Company	
	2013 £000	2012 £000	2013 £000	2012 £000
Current				
Trade payables	331	365	2	40
Social security	51	59	15	20
Accruals and deferred income	622	648	149	63
Total trade and other payables	1,004	1,072	166	123

22. Financial instruments by category

The accounting policies for financial instruments have been applied to the line items below. The fair value of the assets and liabilities is equal to their carrying value.

Group	2013	2012
	Loans and receivables £000	Loans and receivables £000
Assets as per statement of financial position		
Trade and other receivables*	1,273	1,262
Cash and cash equivalents	11,432	5,751
Total	12,705	7,013

	Financial liabilities amortised at cost £000	Financial liabilities amortised at cost £000
Liabilities as per statement of financial position		
Trade and other payables**	953	1,013
Total	953	1,013

Company	2013	2012
	Loans and receivables £000	Loans and receivables £000
Assets as per statement of financial position		
Trade and other receivables*	6,855	7,745
Cash and cash equivalents	10,247	5,139
Total	17,102	12,884

	Financial liabilities amortised at cost £000	Financial liabilities amortised at cost £000
Liabilities as per statement of financial position		
Trade and other payables**	151	103
Total	151	103

* excludes prepayments and VAT

** includes accruals, but excludes any VAT and social security

Included in the cash and cash equivalents of the Group and Company at 31 December 2013 was the equivalent of £537,000 (2012: £380,000) denominated in US dollars, £202,000 (2012: £85,000) denominated in euros and £228,000 in Omani Rials (2012: £170,000). The balance was denominated in pounds sterling (£). See note 19 for denomination of trade receivables by currency.

23. Commitments and contingencies

23.1 Group operating leases

Future aggregate minimum lease payments under non-cancellable operating leases as at 31 December are as follows:

	Group	
	2013 £000	2012 £000
Not later than one year	359	332
After one year but not more than five years	783	1,046
Later than five years	—	—
Group operating leases	1,142	1,378

The Group's operating leases relate to property and office equipment, and have remaining terms up to five years. The amount recognised as an expense in the year is £384,000 (2012: £348,000). The Company does not have any operating lease commitments (2012: none).

Notes to the Consolidated Financial Statements

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23. Commitments and contingencies (continued)

23.2 Contractual commitments

The Group consolidates some of its purchases and as such has a contractual commitment with one supplier to place orders for goods and services to the value of AUS\$2m per annum from 2014 to 2015.

23.3 Contingent liabilities

Neither the Group nor the Company had any contingent liabilities at the balance sheet date (2012: £nil).

24. Share capital and premium

Company	Authorised ordinary shares of 0.25p each Number	Allotted and fully paid ordinary shares Number	£000	Allotted and fully paid ordinary shares £000	Share premium £000	Total £000
At 1 January 2012	100,000,000	59,505,256	250	149	30,532	30,681
At 31 December 2012	100,000,000	59,505,256	250	149	30,532	30,681
New share placing	—	20,000,000	—	50	9,500	9,550
At 31 December 2013	100,000,000	79,505,256	250	199	40,032	40,231

On 12 February 2013, the Company announced the conditional placing of 20,000,000 new shares of 0.25p each. The shares were admitted to trading in two tranches, on 1 March 2013 and 4 March 2013.

25. Net cash flows used in operating activities

Note	Group		Company	
	2013 £000	2012 £000	2013 £000	2012 £000
Loss on ordinary activities before taxation	(4,766)	(5,487)	(5,449)	(4,247)
Adjustments for:				
Depreciation of property, plant and equipment	15	445	424	—
Amortisation of intangible assets	16	450	456	—
Loss on disposal of property, plant, equipment and intangible assets		40	—	—
Net finance income	12	(107)	(65)	(126)
Share-based payments	10	173	171	70
Movements in working capital:				
Decrease in inventories	18	28	42	—
Decrease/(increase) in trade and other receivables	19	47	(735)	930
(Decrease)/increase in trade and other payables	21	(33)	291	43
Cash used in operations		(3,723)	(4,903)	(4,532)

26. Related party transactions

IP Group plc held 20.0% of the ordinary share capital of the Company as at 31 December 2013 and appoints a non-executive director; and it is therefore deemed a related party. A service agreement dated 1 December 2006 was made between the Company and IP Group plc, whereby IP Group plc provides strategic, business development and administrative services to the Company. Fees for the year were £30,000 (2012: £30,000) and as at 31 December 2013 £7,500 (2012: £7,500) was outstanding under this agreement.

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation in the Group accounts, but require disclosure in the Company accounts.

An agreement dated 30 November 2006 was made between the Company and Surrey Aquatechnology Limited for the provision of administrative services for fees of £6,000 per annum. At 31 December 2013, fees of £6,000 (2012: £6,000) were outstanding under this agreement.

An agreement dated 14 December 2006 was made between the Company and Cymtox Limited for the provision of administrative services for fees of £14,463 per annum. At 31 December 2013, fees of £14,000 (2012: £14,000) were outstanding under this agreement.

An agreement dated 14 December 2006 was made between the Company and Poseidon Water Limited for the provision of administrative services for fees of £50,760 per annum. At 31 December 2013, fees of £55,000 (2012: £55,000) were outstanding under this agreement. Additionally the Company had receivable balances at 31 December 2013 with its subsidiary companies to fund working capital and acquisition of investments as follows:

- Modern Water Services Limited – £17,045,000 (2012: £14,638,000). This has been fully provided against as at 31 December 2013;
- Surrey Aquatechnology Limited – £1,199,000 (2012: £1,081,000);
- MW Monitoring Limited - £4,693,000 (2012: £4,370,000);
- Modern Water Monitoring Limited – £2,315,000 (2012: £1,647,000). This has been fully provided against as at 31 December 2013;
- Cymtox Limited – £269,000 (2012: £251,000);
- AguaCure Ltd – £181,000 (2012: £187,000);
- Poseidon Water Limited – £105,000 (2012: £92,000);
- Modern Water Holdings Limited – £265,000 (2012: £7,000).

Compensation paid to key management is detailed in the Directors' Remuneration Report.

Notice of Annual General Meeting

Modern Water plc

(Incorporated and registered in England and Wales with registered number 5963927)

THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. IF YOU ARE IN ANY DOUBT AS TO ANY ASPECT OF THE CONTENTS OF THIS DOCUMENT OR THE ACTION YOU SHOULD TAKE YOU ARE RECOMMENDED TO CONSULT AN INDEPENDENT ADVISER AUTHORISED UNDER THE FINANCIAL SERVICES AND MARKETS ACT 2000.

Notice of Annual General Meeting

Notice is hereby given that the Annual General Meeting of Modern Water plc will be held at the offices of the Company, Bramley House, The Guildway, Old Portsmouth Road, Guildford, Surrey GU3 1LR, on Wednesday 23 April 2014 at 10.00am to consider and, if thought fit, to pass the following resolutions, of which resolutions 1 to 6 will be proposed as ordinary resolutions, and resolutions 7 and 8 will be proposed as special resolutions.

Ordinary resolutions

1. To receive and adopt the directors' report, the accounts and the Auditors' report for the financial year ended 31 December 2013.
2. To approve the directors' remuneration report for the year ended 31 December 2013.
3. To re-appoint PricewaterhouseCoopers LLP as Auditors of the Company to hold office from the conclusion of this meeting until the conclusion of the next general meeting of the Company at which accounts are laid before the shareholders, and to authorise the directors to fix their remuneration.
4. To re-elect as a director of the Company Mr Simon Humphrey, who retires by rotation.
5. To re-elect as a director of the Company Mr Robert Clarke, who retires by rotation.
6. **THAT** the directors be generally and unconditionally authorised in accordance with section 551 of the Companies Act 2006 ("the Act") to exercise all the powers of the Company to allot equity securities (as defined in section 560 of the Act):
 - a. up to an aggregate nominal amount of £66,254 (being one third of the nominal value of the issued share capital of the Company as at 12 March 2014); and in addition
 - b. up to a further aggregate nominal amount of £66,254 (being one third of the nominal value of the issued share capital of the Company as at 12 March 2014) in connection with a rights issue in favour of holders of shares in proportion, as nearly as is practicable, to their existing holding, and holders of other equity securities (to the extent that this is required by the rights of those securities or is permitted by those rights and considered necessary by the directors), subject only to such exclusions or other arrangements as the directors may deem necessary or expedient to deal with fractional entitlements, treasury shares, record dates, shares represented by depositary receipts, legal or practical difficulties arising under the laws of any territory or the requirements of any relevant regulatory body or any stock exchange, or any other matter.

This authority shall operate in substitution for and to the exclusion of all previous authorities given to the directors pursuant to section 551 of the Act, and shall expire on the conclusion of the Company's 2015 Annual General Meeting (or if earlier 22 July 2015), except that the Company may before such expiry make any offer or agreement which would or might require relevant securities to be allotted after such expiry and, notwithstanding such expiry, the directors may allot relevant securities pursuant to any such offer or agreement.

Special resolutions

7. **THAT** subject to the passing of resolution 6 the directors be empowered in accordance with section 570 of the Companies Act 2006 ("the Act") to allot equity securities (as defined in section 560 of the Act), payment for which is to be wholly in cash, pursuant to the authority conferred by resolution 6 as if section 561 of the Act did not apply to any such allotment provided that this power shall be limited to:
- a. the allotment of equity securities in connection with a rights issue, or any other pre-emptive offer, in favour of holders of shares in proportion, as nearly as is practicable, to their existing holding, and holders of other equity securities (to the extent that this is required by the rights of those securities or is permitted by those rights and considered necessary by the directors), subject only to such exclusions or other arrangements as the directors may deem necessary or expedient to deal with fractional entitlements, treasury shares, record dates, shares represented by depositary receipts, legal or practical difficulties arising under the laws of any territory or the requirements of any relevant regulatory body or any stock exchange, or any other matter;
 - b. the allotment (otherwise than pursuant to sub-paragraph a. above) of equity securities up to an aggregate nominal value of £39,752.63 (being 20% of the nominal value of the issued share capital of the Company as at 12 March 2014).

This power shall operate in substitution for and to the exclusion of any previous power given to the directors pursuant to section 570 or 571 of the Act and shall expire at the same time as the authority in resolution 6, except that the Company may before such expiry make any offer or agreement which would or might require equity securities to be allotted after such expiry and, notwithstanding such expiry, the directors may allot equity securities pursuant to any such offer or agreement.

8. **THAT** a general meeting of the Company other than an Annual General Meeting may be called on not less than 14 clear days' notice.

By order of the Board

Tad Ostrowski
 Company Secretary
 Modern Water plc
 12 March 2014

Registered office
 Bramley House
 The Guildway
 Old Portsmouth Road
 Guildford
 Surrey GU3 1LR

Incorporated in England and Wales with registered number 5963927

Notes

1. Members are entitled to appoint a proxy to exercise all or any of their rights to attend and to speak and vote on their behalf at the meeting. A shareholder may appoint more than one proxy in relation to the Annual General Meeting provided that each proxy is appointed to exercise the rights attached to a different share or shares held by that shareholder. A proxy need not be a shareholder of the Company. A proxy form to make such appointment and give proxy instructions accompanies this notice. If you do not have a proxy form and believe that you should have one, or if you require additional forms, please contact the Company's registrars, Capita Asset Services on 0871 664 0300 (calls cost 10p per minute plus network extras) or, if telephoning from overseas, on +44 208 639 3399. Lines are open 8.30am - 5.30pm Monday to Friday.
2. To be valid any proxy form or other instrument appointing a proxy must be received by post or (during normal business hours only) by hand not less than 48 hours before the time fixed for the meeting.
3. The return of a completed proxy form, other such instrument or any CREST Proxy Instruction (as described in paragraph 8 below) will not prevent a shareholder attending the Annual General Meeting and voting in person if he/she wishes to do so.
4. Any person to whom this notice is sent who is a person nominated under section 146 of the Companies Act 2006 to enjoy information rights (a "nominated person") may, under an agreement between him/her and the shareholder by whom he/she was nominated, have a right to be appointed (or to have someone else appointed) as a proxy for the Annual General Meeting. If a nominated person has no such proxy appointment right or does not wish to exercise it, he/she may, under any such agreement, have a right to give instructions to the shareholder as to the exercise of voting rights.
5. The statement of the rights of shareholders in relation to the appointment of proxies in paragraph 1 above does not apply to nominated persons. The rights described in that paragraph can only be exercised by shareholders of the Company.
6. To be entitled to attend and vote at the Annual General Meeting (and for the purpose of the determination by the Company of the votes they may cast), shareholders must be registered in the register of members of the Company at 6pm on 21 April 2014 or, if the meeting is adjourned, 48 hours prior to the time fixed for the adjourned meeting. Changes to the register of members after that time shall be disregarded in determining the right of any person to attend and vote at the meeting.
7. CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so by using the procedures described in the CREST Manual. CREST Personal Members or other CREST sponsored members, and those CREST members who have appointed a service provider(s), should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf.
8. In order for a proxy appointment or instruction made using the CREST service to be valid, the appropriate CREST message (a "CREST Proxy Instruction") must be properly authenticated in accordance with CRESTCo's specifications, and must contain the information required for such instruction, as described in the CREST Manual. The message, regardless of whether it constitutes the appointment of a proxy or is an amendment to the instruction given to a previously appointed proxy must, in order to be valid, be transmitted so as to be received by the issuer's agent (ID RA10). For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp applied to the message by the CREST Application Host) from which the issuer's agent is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST. After this time any change of instructions to proxies appointed through CREST should be communicated to the appointee through other means.
9. CREST members and, where applicable, their CREST sponsors, or voting service providers should note that CRESTCo does not make available special procedures in CREST for any particular message. Normal system timings and limitations will, therefore, apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member; or sponsored member; or has appointed a voting service provider; to procure that his CREST sponsor or voting service provider(s) take(s)) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where applicable, their CREST sponsors or voting system providers are referred, in particular, to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.
10. The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.
11. As at 12 March 2014 (being the day on which the board approved this notice) the Company's issued share capital consisted of 79,505,256 ordinary shares, carrying one vote each. Therefore the total voting rights in the Company as at that time were 79,505,256.

Form of proxy Modern Water plc

Company Number: 5963927

Please read carefully the notice of meeting and explanatory notes set out below before completing this form.
Please complete this form in BLOCK CAPITALS.

I/We (name) _____

of (address) _____

being a member(s) of the above named Company hereby appoint the Chairman of the meeting or (see notes 1, 5 and 7)

(name) _____

of (address) _____

as my/our proxy to vote for me/us and on my/our behalf at the Annual General Meeting of the Company to be held at the offices of the Company, Bramley House, The Guildway, Old Portsmouth Road, Guildford GU3 1LR at 10.00am on 23 April 2014 and at any adjournment thereof.

I/we direct my/our proxy to vote as indicated by an "X" in the appropriate column (note 2).

Ordinary resolutions		For	Against	Withheld
1.	To receive and adopt the directors' report, the audited statement of accounts and Auditors' report of the Company for the financial year ended 31 December 2013			
2.	To receive and approve the directors' remuneration report for the year ended 31 December 2013			
3.	To reappoint PricewaterhouseCoopers LLP as Auditors of the Company and to authorise the directors of the Company to fix their remuneration			
4.	To re-elect Simon Humphrey as a director of the Company, who is retiring by rotation and offering himself for re-election			
5.	To re-elect Robert Clarke as a director of the Company, who is retiring by rotation and offering himself for re-election			
6.	To authorise the directors to allot equity securities up to a nominal amount of £66,254, and in addition, by way of fully pre-emptive rights issue, up to a nominal amount of £66,254			
Special resolutions		For	Against	Withheld
7.	To authorise the directors to allot equity securities for cash, disapplying the statutory pre-emption rights, up to a nominal amount of £39,752.63 (being 20% of the issued capital)			
8.	To call a general meeting (other than AGM) on not less than 14 days' notice			

Signature(s) and/or common seal (notes 3 and 4) _____

Date _____ 2013

Notes

- A proxy need not be a member of the Company. Completion and return of this form of proxy does not preclude a member from subsequently attending and voting at the meeting. If you wish to appoint a proxy other than the Chairman of the meeting, please cross out the words "the Chairman of the meeting or" and write the full name and address of your proxy in the space provided. The change should be initialled.
- If you do not indicate how you wish your proxy to vote on any resolution or on any other matter (including any amendment to any resolution), the proxy will exercise his/her discretion as to how he/she votes and as to whether or not he/she abstains from voting in such manner as he/she thinks fit.
- This form must be signed and dated by the shareholder or his/her attorney duly authorised in writing. In the case of a corporation this form of proxy must be executed under its common seal or under the hand of an officer or attorney duly authorised in writing.
- A form of proxy, to be valid, must be signed and dated and must be lodged, together with the power of attorney or other authority (if any) under which it is signed, or a duly certified copy of such power or authority, with the Company's registrars at: Capita Asset Services PXS, 34 Beckenham Road, Beckenham, Kent BR3 4TU not less than 48 hours before the time fixed for the meeting.
- In the case of joint holders, the signature of any one of them will suffice but the names of all joint holders should be stated. The vote of the senior who tenders a vote (whether in person or by proxy) will be accepted to the exclusion of the votes of the other holders. For this purpose, seniority is determined by the order in which the names stand in the register of members in respect of the joint holding.
- Any alteration to this form must be initialled.
- Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, the time by which a person must be entered on the register of members in order to have the right to attend and vote at the Annual General Meeting is 6pm on 21 April 2014 or, if the meeting is adjourned, 48 hours prior to the time fixed for the adjourned meeting. Changes to the register of members after that time shall be disregarded in determining the right of any person to attend and vote at the meeting.

Business Reply Plus
Licence Number
RLUB-TBUX-EGUC

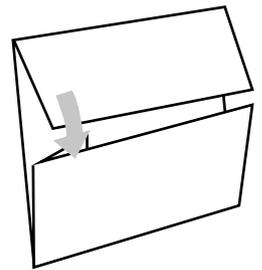


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PXS 1
34 Beckenham Road
BECKENHAM
BR3 4ZF

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Registered office

Bramley House
The Guildway
Old Portsmouth Road
Guildford
Surrey
GU3 1LR

Company number

Registered in England and Wales number 05963927

Further details can be found on the Modern Water website:

www.modernwater.com

Nominated adviser and broker

[Numis Securities Limited](#)

The London Stock Exchange Building
10 Paternoster Square
London
EC4M 7LT

Independent auditors

[PricewaterhouseCoopers LLP](#)

Chartered Accountants and Statutory Auditors
The Portland Building
25 High Street
Crawley
RH10 1BG

Solicitors

[Norton Rose Fullbright LLP](#)

3 More London Riverside
London
SE1 2AQ

Registrars

[Capita Asset Services](#)

The Registry
34 Beckenham Road
Beckenham
BR3 4TU

Principal bankers

[HSBC Bank plc](#)

HSBC House
Mitchell Way
Southampton
Hampshire
SO18 2XU



MODERNWATER

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Registered number: 05963927

