MODERNWATER

Modern Water plc

Interim Financial Report 2012

Our Highlights

Operational

- Installation and commissioning of Al Najdah plant, the world's first commercial Forward Osmosis (FO) desalination plant completed in September 2012.
- Successful transition of US operations, Modern Water Inc to a new standalone facility in Delaware, US.
- Licence agreements for distribution of additional Monitoring products signed with Multisensor Systems Limited and Chelsea Technologies Group Ltd.
- Monitoring division sales conference held for Asia Pacific distributors, to promote product range and develop routes to market.

Financial

- Revenue £2,037,000 (H1 2011: £430,000).
- Revenue recognised on Al Najdah contract.
- Strong increase in revenue from Monitoring division.
- Gross profit increased to £790,000 (H1 2011: £141,000), with gross margin of 39% (H1 2011: 33%).
- £8.7m cash and debt free.

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Report to Shareholders

I am pleased to report that the first half of 2012 has seen a sustained growth in revenue to £2m for the six months to 30 June 2012. Modern Water has also achieved a number of milestones:

- **Our Advanced Membrane Processes (AMP) division has completed the installation and commissioning of the world's first commercial Forward Osmosis (FO) plant in Oman in September 2012; and**
- **Our Monitoring division has more than doubled its sales on the previous six month period, through acquisition, with revenue exceeding £1.75 million (H2 2011: £0.8m, H1 2011: £0.4m).**

Advanced Membrane Processes Division

In September 2012 we completed the installation and commissioning of the world's first fully commercial FO desalination plant at Al Najdah in Oman. In July this year the plant started producing water at full capacity (200 cubic metres per day) using Modern Water's world-leading patented FO technology. The water quality exceeded contractual standards and after the initial testing period was put into the public water supply. We have now entered into the 12-month operation and maintenance (O&M) phase. Revenue of £0.25m has been recognised during the first half of 2012, being 71% of the build contract value for the plant. We expect to recognise the remainder of the revenue on the build contract and start to realise additional revenue on the O&M phase in the second half of 2012.

Modern Water's FO technology continues to attract high levels of interest from around the world as it has proven to be a reliable and robust technology and the company is currently in on-going discussions regarding further desalination projects. FO delivers significant reductions in operational costs, reduced lifetime costs and reliably produces high quality product water, even in the most challenging conditions.

Monitoring Division

The first half of 2012 was an exciting period for the Monitoring division which has seen significant growth with revenue increasing to £1.75m for the six months to 30 June 2012 (H2 2011: £0.8m). The increase in revenue has been largely due to inclusion of sales by Modern Water Inc. (MWI), following its acquisition of the water quality division of Strategic Diagnostics Inc. (SDIX) in December 2011. During the period, the MWI business transitioned from SDIX to a fully standalone facility in Delaware, US, which includes laboratories and warehousing facilities, and is the base for Modern Water's operations in the Americas.

The division is now focused on implementing its strategy for growth, developing routes to market, both directly and through its network of approximately 60 distributors, and growing its product range. In June, we held our first distributors' conference in Indonesia where our team gave detailed training on our new and existing products to more than 40 delegates. In July, Modern Water exhibited at Singapore International Water Week where we demonstrated our broad range of innovative technologies and products. Most recently, we are also pleased to have agreed terms to license new monitoring products from Multisensor Systems Limited and Chelsea Technologies Group Ltd and continue to take full advantage of opportunities for cross-selling all of our products.

Overview

We have made significant progress during the first half of 2012. A particularly noteworthy achievement is the commissioning of the world's first commercial FO desalination plant at Al Najdah which puts us in a strong position to win further desalination contracts. The Group's operating loss before depreciation, amortisation and share-based payments was £2.2m (H2 2011: £2.2m, H1 2011: £1.9m). The Group's financial position remains robust, debt free, with £8.7 million of cash as at 30 June 2012.

On behalf of the Board I would like to thank the team at Modern Water for its dedication and reiterate our commitment to deliver long-term value to our shareholders.

Neil McDougall
Executive Chairman
12 September 2012

Group Statement of Comprehensive Income (unaudited)

Six month period ended 30 June 2012

	Note	6 months ended 30 June 2012 £000	6 months ended 30 June 2011 £000	Year ended 31 December 2011 £000
Revenue	4	2,037	430	1,242
Cost of sales		(1,247)	(289)	(782)
Gross profit		790	141	460
Administrative expenses	6	(3,628)	(2,446)	(5,151)
Other gains/(losses) – net		22	—	(242)
Operating loss		(2,816)	(2,305)	(4,933)
Finance income		54	196	356
Share of loss of joint venture		—	(20)	(28)
Loss on ordinary activities before taxation		(2,762)	(2,129)	(4,605)
Taxation	8	24	29	62
Loss and total comprehensive loss for the half year		(2,738)	(2,100)	(4,543)
Loss is attributable to:				
Owners of the Company		(2,738)	(2,100)	(4,543)
Non-controlling interests		—	—	—
		(2,738)	(2,100)	(4,543)
Loss per share attributable to the equity holders of the Company				
Basic loss per share	9	4.60p	3.54p	7.64p
Diluted loss per share	9	4.60p	3.54p	7.64p

The notes on pages 07 to 11 form an integral part of this condensed consolidated interim financial information.
Items in the statement above are all derived from continuing operations.

Group Statement of Financial Position (unaudited)

As at 30 June 2012

	Note	30 June 2012 £000	30 June 2011 £000	31 December 2011 £000
Assets				
Non-current assets				
Property, plant and equipment	10	856	886	787
Intangible assets	10	17,442	15,339	17,593
Investments		—	195	—
		18,298	16,420	18,380
Current assets				
Inventories		1,024	173	1,149
Trade and other receivables		1,509	841	976
Cash and cash equivalents		8,676	16,702	11,280
		11,209	17,716	13,405
Total assets		29,507	34,136	31,785
Equity and liabilities				
Equity				
Ordinary shares		149	149	149
Share premium account		30,532	30,532	30,532
Merger reserve		13,180	13,180	13,180
Accumulated losses		(16,013)	(11,107)	(13,422)
		27,848	32,754	30,439
Non-controlling interests		126	—	126
Total equity		27,974	32,754	30,565
Liabilities				
Non-current liabilities				
Deferred tax liabilities	8	350	407	374
Current liabilities				
Trade and other payables		1,183	975	846
Total liabilities		1,533	1,382	1,220
Total equity and liabilities		29,507	34,136	31,785

The notes on pages 07 to 11 form an integral part of this condensed consolidated interim financial information.

Group Statement of Changes in Equity (unaudited)

Six month period ended 30 June 2012

	Note	Called up share capital £000	Share premium account £000	Merger reserve £000	Retained earnings £000	Total £000	Non-controlling interests £000	Total equity £000
Six month period ended 30 June 2011								
Balance as at 1 January 2011		147	30,532	12,782	(9,133)	34,328	—	34,328
Comprehensive loss								
Loss and total comprehensive loss for the period ended 30 June 2011		—	—	—	(2,100)	(2,100)	—	(2,100)
Total comprehensive loss		—	—	—	(2,100)	(2,100)	—	(2,100)
Transactions with owners								
Issues of shares	5	2	—	398	—	400	—	400
Share-based payments	7	—	—	—	126	126	—	126
Total transactions with owners		2	—	398	126	526	—	526
Balance as at 30 June 2011		149	30,532	13,180	(11,107)	32,754	—	32,754
Six month period ended 30 June 2012								
Balance as at 1 January 2012		149	30,532	13,180	(13,422)	30,439	126	30,565
Comprehensive loss								
Loss and total comprehensive loss for the period ended 30 June 2012		—	—	—	(2,738)	(2,738)	—	(2,738)
Total comprehensive loss		—	—	—	(2,738)	(2,738)	—	(2,738)
Transactions with owners								
Issues of shares	5	—	—	—	—	—	—	—
Share-based payments	7	—	—	—	147	147	—	147
Total transactions with owners		—	—	—	147	147	—	147
Balance as at 30 June 2012		149	30,532	13,180	(16,013)	27,848	126	27,974

The notes on pages 07 to 11 form an integral part of this condensed consolidated interim financial information.

Group Statement of Cash Flows (unaudited)

Six month period ended 30 June 2012

	Note	6 months ended 30 June 2012 £000	6 months ended 30 June 2011 £000	Year ended 31 December 2011 £000
Cash flows from operating activities				
Cash used in operations	11	(2,336)	(2,131)	(4,991)
Net cash flows used in operating activities		(2,336)	(2,131)	(4,991)
Cash flows from investing activities				
Purchase of property, plant and equipment	10	(286)	(106)	(143)
Proceeds from sale of property, plant and equipment		13	23	23
Purchase of patents and development costs	10	(77)	(70)	(137)
Acquisition of subsidiaries, net of cash acquired	5	—	(411)	(3,128)
Acquisition of joint venture	5	—	—	—
Interest received		116	144	384
Net cash flows used in investing activities		(234)	(420)	(3,001)
Cash flows from financing activities				
Cash-settled share-based payments		—	—	—
Net cash flows used in financing activities		—	—	—
Net decrease in cash and cash equivalents		(2,570)	(2,551)	(7,992)
Cash and cash equivalents at start of period		11,280	19,252	19,252
Exchange (losses)/gains on bank balances		(34)	1	20
Cash and cash equivalents at end of period		8,676	16,702	11,280

The notes on pages 07 to 11 form an integral part of this condensed consolidated interim financial information.

Notes to the Consolidated Interim Financial Statements (unaudited)

Six month period ended 30 June 2012

1. General information

Modern Water plc ('the Company'), its subsidiaries and joint venture (together, 'the Group') invests in, develops and deploys new water technology.

The Company is a public limited company incorporated and domiciled in England and Wales, whose shares are publically traded on the AIM market of the London Stock Exchange. The registered office and principal place of business is Bramley House, The Guildway, Old Portsmouth Road, Guildford, Surrey GU3 1LR.

This condensed consolidated interim financial information was approved for issue by the Board of Directors on 12 September 2012.

These interim financial results are unaudited and do not comprise statutory accounts within the meaning of section 438 of the Companies Act 2006.

Statutory accounts for the year ended 31 December 2011 were approved by the board of directors on 14 March 2012 and delivered to the Registrar of Companies. The report of the auditors on those accounts was unqualified, did not contain an emphasis of matter paragraph and did not contain any statement under section 498 of the Companies Act 2006.

2. Basis of preparation

The principal accounting policies have been applied consistently throughout the period in the preparation of these financial statements.

This condensed consolidated interim financial information for the six months ended 30 June 2012 has been prepared in accordance with the AIM Rules for Companies of the London Stock Exchange plc and with IAS 34, 'Interim financial reporting' as adopted by the European Union.

The condensed consolidated interim financial information should be read in conjunction with the annual financial statements for the year ended 31 December 2011, which have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

3. Accounting policies

3.1 Accounting policy and disclosure changes

The accounting policies applied are consistent with those of the annual financial statements for the year ended 31 December 2011.

3.2 Taxation

Taxes on income in the interim periods are accrued using the tax rate that would be applicable to expected total annual earnings.

4. Segmental analysis

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

At the Group's current stage of development the majority of the costs (business development, technical, legal, marketing, finance, facilities and directors' expenditure) are managed and reported centrally. As the commercial activities of the Group develop, this financial information is expected to evolve.

	6 months ended 30 June 2012				6 months ended 30 June 2011			
Statement of Comprehensive Income	**Membrane £000**	**Monitoring £000**	**Central £000**	**Total £000**	Membrane £000	Monitoring £000	Central £000	Total £000
Revenue	282	1,755	—	2,037	21	409	—	430
Cost of sales	(450)	(797)	—	(1,247)	(19)	(270)	—	(289)
Gross profit/(loss)	(168)	958	—	790	2	139	—	141
Admin expenses	—	—	(3,628)	(3,628)	—	—	(2,446)	(2,446)
Other gains	—	—	22	22	—	—	—	—
Operating profit/(loss)	(168)	958	(3,606)	(2,817)	2	139	(2,446)	(2,305)
Finance income	—	—	54	54	—	—	196	196
Share of joint venture loss	—	—	—	—	—	—	(20)	(20)
Profit/(loss) before taxation	(168)	958	(3,552)	(2,763)	2	139	(2,270)	(2,129)
Taxation	—	—	24	24	—	—	29	29
Loss and total comprehensive profit/(loss) for the period	(168)	958	(3,528)	(2,738)	2	139	(2,241)	(2,100)

Notes to the Consolidated Interim Financial Statements (unaudited)

Six month period ended 30 June 2012

5. Business combinations

There were no business combinations during the reporting period. Business combinations during 2011 are detailed in the 2011 Annual Report and Accounts.

6. Administrative expenses by nature

	Note	6 months ended 30 June 2012 £000	6 months ended 30 June 2011 £000	Year ended 31 December 2011 £000
Wages and salaries		1,171	842	1,524
Social security costs		118	93	188
Pension costs		61	51	103
Other employee benefits		63	23	44
Share-based payments	7	147	126	254
Depreciation, amortisation and impairment charges	10	436	274	547
Operating lease payments		126	70	257
Research and development		228	181	473
Other administrative expenses		1,277	786	1,761
Total administrative expenses		3,628	2,446	5,151

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

7. Share-based payments

	6 months ended 30 June 2012 £000	6 months ended 30 June 2011 £000	Year ended 31 December 2011 £000
Options	1	15	16
Conditional share awards	146	111	238
Equity-settled share-based payments	147	126	254

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

7.1 Modern Water 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, conditional awards of ordinary shares (to be received once performance conditions are satisfied) and matching awards of ordinary shares (in respect of bonuses deferred by participants) to all employees, including executive directors. Activity on share options and conditional shares is detailed below.

(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 Total Shareholder Return (TSR) performance criteria are met. If the increase is not met the options lapse.

During the period the performance criteria on options over 50,000 shares were not met and the options therefore lapsed. No options were granted, exercised, vested or forfeited during the period.

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.

The total number of options outstanding at 30 June 2012 was 560,877 (WAEP 119p), these options had vested and were exercisable, but at above the current market price.

Notes to the Consolidated Interim Financial Statements (unaudited)

Six month period ended 30 June 2012

7. Share-based payments continued

(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:

	2012
At 1 January	* 2,150,000
Conditionally awarded during period	** 1,050,000
Forfeited	(50,000)
At 30 June	3,150,000

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.

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

Grant date	** 24 April 2012	* 13 December 2011	* 20 April 2011
Share price at date of award	54.6p	50.03p	50.5p
Exercise price	£nil	£nil	£nil
Assumed volatility at date of award (median of historical 50 day moving average)	48%	46%	43%
Vesting period (years)	3.0	3.0	3.0
Expected dividend yield	0%	0%	0%
Risk-free discount rate	2.0%	2.0%	2.0%
Fair value per share awarded	28p	20p	20p

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

* 1,500,000 shares conditionally awarded during 2009 and 2010 will vest in full if the share price is £1.40 or more on the vesting date. If the share price is £1.00 or below the award does not vest at all. If the share price is between £1.00 and £1.40 the award partially vests, on the basis of 2.5% of the award for each £0.01 above a share price of £1.00. 650,000 shares conditionally awarded during 2011 will vest in full if the share price is £1.00 or more on the vesting date. If the share price is £0.80 the award does not vest at all. If the share price is between £0.80 and £1.00 the award partially vests, on the basis of 5% of the award for each £0.01 above a share price of £0.80. 50,000 of these shares were forfeited during the period.

** 1,050,000 shares conditionally awarded during the period 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 the basis of 3.33% of the award for each £0.01 above a share price of £0.70.

8. Taxation

During the period there were no taxable profits.

The deferred tax liability of £350,000 at 30 June 2012 (2011: £407,000) arises from taxable temporary differences on intangibles recognised on business combinations and is expected to unwind over the useful economic life of these assets. £24,000 has been credited to the Group Statement of Comprehensive Income to 30 June 2012 (2011: £29,000).

At the balance sheet date the Group had a deferred tax asset in respect of unutilised trading losses. This asset has not been recognised as its utilisation is not yet sufficiently certain.

Notes to the Consolidated Interim Financial Statements (unaudited)

Six month period ended 30 June 2012

9. Loss per share

9.1 Basic

Basic loss per share 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.

	6 months ended 30 June 2012 £000	6 months ended 30 June 2011 £000	Year ended 31 December 2011 £000
Loss attributable to equity holders of the Company	2,738	2,100	4,543
Weighted average number of ordinary shares in issue (thousands)	59,505	59,398	59,452
Basic loss per share	4.60p	3.54p	7.64p

9.2 Diluted

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

10. Capital expenditure

	Property, plant and equipment £000	Intangible assets (inc goodwill) £000	Total £000
Six month period ended 30 June 2012			
Opening net book amount at 1 January 2012	787	17,593	18,380
Additions	286	77	363
Disposals	(9)	—	(9)
Depreciation/amortisation	(208)	(228)	(436)
Closing net book amount at 30 June 2012	856	17,442	18,298

11. Net cash flows from operating activities

	Note	6 months ended 30 June 2012 £000	6 months ended 30 June 2011 £000	Year ended 31 December 2011 £000
Operating loss		(2,816)	(2,305)	(4,933)
Adjustments for:				
Depreciation of property, plant and equipment	10	208	184	371
Amortisation of intangible assets	10	228	90	176
(Profit)/loss on disposal of property, plant and equipment		(4)	(6)	1
Foreign exchange gain on operating activities		—	—	(1)
Loss on revaluation		—	—	276
Equity-settled share-based payments	7	147	126	254
Movements in working capital:				
Decrease/(increase) in inventories		125	(69)	(353)
Increase in trade and other receivables		(561)	(15)	(240)
Increase/(decrease) in trade and other payables		337	(136)	(542)
Cash used in operations		(2,336)	(2,131)	(4,991)

Notes to the Consolidated Interim Financial Statements (unaudited)

Six month period ended 30 June 2012

12. Related party transactions

IP Group plc holds 20.86% of the ordinary share capital of the Company and appoints a non-executive director, 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 period were £15,000 and as at 30 June 2012 £7,500 (30 June 2011: £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.

MODERNWATER

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