



MODERNWATER

**Modern Water plc
Interim Financial Report 2014**

OUR HIGHLIGHTS

Financial

- Increase in total revenue to £1.61m at constant exchange rates, actual revenue H1 2014: £1.51m (H1 2013: £1.49m).
- Significant increase in Monitoring order book to £0.5m as at 30 June 2014 (H1 2013: £0.01m), being two supply contracts for delivery in H2 2014.
- Reduction in overheads to £2.77m in H1 2014 (H1 2013: £2.91m).
- Operating loss in line with prior year at £2.45m (H1 2013: £2.45m).
- Group in financially strong position with cash reserves at 30 June 2014 of £8.8m (H1 2013: £13.3m) and debt free.

Operational

- Second successful year of operation at Al Najdah forward osmosis desalination plant which is now locally managed.
- Monitoring Division awarded its largest ever single contract to supply a purpose built containerised monitoring system for a power project in the Middle East to be delivered Q3 2014.
- Continued growth of the Group's substantial patent portfolio with six new patents granted across three different patent families.
- Launch of ten new monitoring products and collaboration with Luminultra Technologies to launch an additional three ATP kits.
- Key role in establishment and launch of a dedicated industry association, the International Forward Osmosis Association (IFOA).
- Launch of website in Spanish language in response to increasing demand for Modern Water products across Latin America.

REPORT TO THE SHAREHOLDERS

The Group has made good progress over the six month period in both its membrane and monitoring divisions. The membrane division successfully completed its second year of operation at Al Najdah and the Monitoring division launched ten new monitoring products. Modern Water has continued to grow its patent portfolio with six new patents granted across three different patent families, including a new patent family for Improved Solvent Removal Process.

Membrane Process Division

The first half of 2014 saw revenues in the Membrane division increase on the same period in 2013. Our first commercial forward osmosis plant at Al Najdah which produces up to 200 cubic metres of water per day is now locally managed and has also successfully completed its second year of operations.

The commercialisation of our forward osmosis technology is well underway and we continue to be a pioneer in the field. In May, Modern Water's first forward osmosis plant was featured on the BBC Horizon programme as an innovative desalination technology. Progress on the contract for the Xugong forward osmosis plant in China has been slow due to lengthy contract negotiations but we remain well placed to sign the final agreement. During 2014, our research and development team have been working hard to develop a new, improved forward osmosis membrane process which is currently being tested at our facility in Gibraltar.

In addition, Modern Water has collaborated with leading companies in the industry to form the International Forward Osmosis Association. The Association is a non-profit industry association that has been established to promote forward osmosis technology throughout industry and academia, provide a professional network for information exchange and encourage world-wide acceptance, regulation and performance standards for forward osmosis.

Monitoring Division

The last six months have been busy for our research and development team as well as our sales team with the launch of ten new monitoring products. The new technologies complement our existing range of trace metal, toxicity and environmental products. One of the most significant developments is the new range of strip tests and QuickChek strip reader which allows customers to drop samples on to a strip test, insert it into the reader and have the sample analysed in a matter of seconds.

During the first half of 2014, the Monitoring division received its largest ever order for a purpose built containerised trace metal monitoring system in the Middle East. This marks a step change in the Monitoring division's activities as it will be Modern Water's first purpose built unit of its kind and shows our ability to supply fully containerised monitoring systems anywhere in the world. The monitoring system will be delivered in the second half of 2014.

Early 2014 saw multiple trace metal analysers installed in Argentina for World Bank funded water treatment plant projects. In July we launched our website in Spanish and this has attracted further interest in our products across Latin America which we hope will turn into additional sales during the remainder of 2014.

Overview

The Group's financial position remains strong and debt free, with £8.8m of cash as at 30 June 2013 (H1 2013: £13.3m). At constant exchange rates revenue has increased to £1.61m. Actual revenue reported for H1 2014 was £1.51m (H1 2013: £1.49m). As revenue is primarily billed in US dollars the strength of sterling during the period resulted in an adverse impact on revenue of £0.1m. Operating loss is in line with prior year at £2.45m for the period (H1:2013 £2.45m).

The Board and I would like to thank our employees who are increasingly based around the world to serve our customers. It is their commitment to developing the company which helps us to focus on delivering long-term value to our shareholders. We look forward to reporting more progress at the end of the year.

Neil McDougall
Executive Chairman
17 September 2014

GROUP STATEMENT OF COMPREHENSIVE INCOME (UNAUDITED)

SIX MONTH PERIOD ENDED 30 JUNE 2014

	Note	6 months ended 30 June 2014 £'000	6 months ended 30 June 2013 £'000	Year ended 31 December 2013 £'000
Revenue	6	1,514	1,488	3,528
Cost of sales	6	(866)	(669)	(1,805)
Gross profit	6	648	819	1,723
Administrative expenses	7	(2,765)	(2,908)	(5,847)
Other gains		—	101	146
Operating loss before interest, tax, depreciation & amortisation		(2,117)	(1,988)	(3,978)
Depreciation and amortisation		(331)	(465)	(895)
Operating loss		(2,448)	(2,453)	(4,873)
Finance income		33	113	129
Finance costs		(73)	—	(22)
Loss on ordinary activities before taxation		(2,488)	(2,340)	(4,766)
Taxation		14	23	66
Loss for the half year		(2,474)	(2,317)	(4,700)
Other comprehensive income				
Items may be subsequently reclassified to profit or loss				
Foreign currency translation differences on foreign operations		23	(26)	16
Total comprehensive loss for the half year		(2,451)	(2,343)	(4,684)
Loss attributable to:				
Owners of the parent		(2,474)	(2,317)	(4,700)
Non-controlling interests		—	—	—
		(2,474)	(2,317)	(4,700)
Total comprehensive loss attributable to:				
Owners of the parent		(2,451)	(2,343)	(4,684)
Non-controlling interests		—	—	—
		(2,451)	(2,343)	(4,684)
Loss per share attributable to the equity holders of the parent				
Basic loss per share	9	3.11p	3.20p	6.18p
Diluted loss per share	9	3.11p	3.20p	6.18p

The notes on pages 8 to 10 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 2014

	30 June 2014 £'000	30 June 2013 £'000	31 December 2013 £'000
Assets			
Non-current assets			
Property, plant and equipment	511	768	595
Intangible assets	16,732	17,069	16,892
Investments	—	—	—
	17,243	17,837	17,487
Current assets			
Inventories	1,540	1,331	1,041
Trade and other receivables	1,442	1,518	1,634
Cash and cash equivalents	8,785	13,277	11,432
	11,767	16,126	14,107
Total assets	29,010	33,963	31,594
Equity and liabilities			
Equity			
Ordinary shares	199	199	199
Share premium account	40,032	40,032	40,532
Merger reserve	13,180	13,180	13,180
Accumulated losses	(25,484)	(20,846)	(23,181)
	27,927	32,565	30,230
Non-controlling interests	126	126	126
Total equity	28,053	32,691	30,356
Liabilities			
Non-current liabilities			
Deferred tax liabilities	220	277	234
Current liabilities			
Trade and other payables	737	995	1,004
Total liabilities	957	1,272	1,238
Total equity and liabilities	29,010	33,963	31,594

The notes on pages 8 to 10 form an integral part of this condensed consolidated interim financial information.

GROUP STATEMENT OF CHANGES IN EQUITY (UNAUDITED)

SIX MONTH PERIOD ENDED 30 JUNE 2014

	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 2013							
Balance as at 1 January 2013	149	30,532	13,180	(18,660)	25,201	126	25,327
Comprehensive loss							
Loss for the period ended 30 June 2013	—	—	—	(2,317)	(2,317)	—	(2,317)
Foreign currency translation differences	—	—	—	(26)	(26)	—	(26)
Total comprehensive loss	—	—	—	(2,343)	(2,343)	—	(2,343)
Transactions with owners							
Issue of shares	50	9,500	—	—	9,550	—	9,550
Share-based payments	—	—	—	157	157	—	157
Total transactions with owners	50	9,500	—	157	9,707	—	9,707
Balance as at 30 June 2013	199	40,032	13,180	(20,846)	32,565	126	32,691
Six month period ended 30 June 2014							
Balance as at 1 January 2014	199	40,032	13,180	(23,181)	30,230	126	30,356
Comprehensive loss							
Loss for the period ended 30 June 2014	—	—	—	(2,474)	(2,474)	—	(2,474)
Foreign currency translation differences	—	—	—	23	23	—	23
Total comprehensive loss	—	—	—	(2,451)	(2,451)	—	(2,451)
Transactions with owners							
Share-based payments	—	—	—	148	148	—	148
Total transactions with owners	—	—	—	148	148	—	148
Balance as at 30 June 2014	199	40,032	13,180	(25,484)	27,927	126	28,053

The notes on pages 8 to 10 form an integral part of this condensed consolidated interim financial information.

GROUP STATEMENT OF CASH FLOWS (UNAUDITED)

SIX MONTH PERIOD ENDED 30 JUNE 2014

	Note	6 months ended 30 June 2014 £'000	6 months ended 30 June 2013 £'000	Year ended 31 December 2013 £'000
Cash flows from operating activities				
Cash used in operations	10	(2,632)	(2,043)	(3,723)
Net cash flows used in operating activities				
Cash flows from investing activities				
Purchase of property, plant and equipment		(67)	(66)	(144)
Proceeds from sale of property, plant and equipment		—	5	10
Purchase of patents and development costs		(32)	(33)	(81)
Interest received		99	69	93
Net cash flows used in investing activities				
Cash flows from financing activities				
Proceeds from issuance of ordinary shares		—	9,550	9,550
Net cash flows used in financing activities				
Net (decrease)/increase in cash and cash equivalents				
		(2,632)	7,482	5,705
Cash and cash equivalents at start of period		11,432	5,751	5,751
Exchange (losses)/gains on bank balances		(15)	44	(24)
Cash and cash equivalents at end of period				
		8,785	13,277	11,432

The notes on pages 8 to 10 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 2014

1 General information

Modern Water plc ('the Company') and its subsidiaries (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 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.

This condensed consolidated interim financial information was approved for issue by the Board of Directors on 17 September 2014. These interim financial results are unaudited and do not comprise statutory accounts within the meaning of section 435 of the Companies Act 2006.

Statutory accounts for the year ended 31 December 2013 were approved by the board of directors on 12 March 2014 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 and going concern

2.1 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 2014 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 2013, which have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

2.2 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 these financial statements.

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 2013.

4 Principal risks and uncertainties

A detailed explanation of the principal risks and uncertainties affecting the Group, and the steps taken to manage them, is set out in the Directors' Report section of the Group's 2013 Annual Report and Accounts, which is available on the Group's website at www.modernwater.com. The principal risks and uncertainties are summarised as follows:

- customer acceptance of the Group's technologies;
- competitor technology;
- socio-political risks;
- scaling up the technology;
- IP protection;
- recruitment and retention of key personnel;
- health and safety; and
- financial risks.

There have been no significant changes in the nature of these risks that will affect the next six months of the financial year.

5 Critical accounting estimates and judgements

The preparation of financial statements in conformity with International Financial Reporting Standards 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. Estimates are continually evaluated and are based on historical experience and other factors, such as expectations of future events, and are believed to be reasonable under current circumstances. Actual results may differ from these estimates. The key sources of estimation uncertainty during the current year were consistent with the prior year, as detailed in the Group's 2013 Annual Report and Accounts.

NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

SIX MONTH PERIOD ENDED 30 JUNE 2014

6 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.

Statement of Comprehensive Income	6 months ended 30 June 2014				6 months ended 30 June 2013			
	Membrane £'000	Monitoring £'000	Central £'000	Total £'000	Membrane £'000	Monitoring £'000	Central £'000	Total £'000
Revenue	53	1,461	—	1,514	22	1,466	—	1,488
Cost of sales	(22)	(844)	—	(866)	(5)	(664)	—	(669)
Gross profit/(loss)	31	617	—	648	17	802	—	819
Administrative expenses	—	—	(2,765)	(2,765)	—	—	(2,908)	(2,908)
Other gains	—	—	—	—	—	—	101	101
Operating profit/(loss) before tax depreciation and amortisation	31	617	(2,765)	(2,117)	17	802	(2,807)	(1,988)
Depreciation and amortisation	—	—	(331)	(331)	—	—	(465)	(465)
Operating profit/(loss)	31	617	(3,096)	(2,448)	17	802	(3,272)	(2,453)
Finance income	—	—	33	33	—	—	113	113
Finance costs	—	—	(73)	(73)	—	—	—	—
Profit/(loss) before taxation	31	617	(3,136)	(2,488)	17	802	(3,159)	(2,340)
Taxation	—	—	14	14	—	—	23	23
Profit/(loss) for the period	31	617	(3,122)	(2,474)	17	802	(3,136)	(2,317)

7 Administrative expenses by nature

	Note	6 months ended 30 June 2014 £'000	6 months ended 30 June 2013 £'000	Year ended 31 December 2013 £'000
Wages and salaries		1,148	1,091	2,157
Social security costs		123	129	238
Pension costs		58	61	120
Other employee benefits		69	75	143
Share-based payments	8	148	157	173
Operating lease payments		185	178	384
Research and development		158	145	123
Other administrative expenses		876	1,072	2,515
Total administrative expenses before depreciation and amortisation		2,765	2,908	5,847
Depreciation, amortisation and impairment charges		331	465	895
Total administrative expenses including depreciation and amortisation		3,096	3,373	6,742

NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

SIX MONTH PERIOD ENDED 30 JUNE 2014

8. Share-based payments

	6 months ended 30 June 2014 £'000	6 months ended 30 June 2013 £'000	Year ended 31 December 2013 £'000
Options (including EMI)	106	66	146
Conditional share awards	42	91	17
Equity-settled share-based payments	148	157	163
Cash-settled share-based payments	—	—	10
Total share-based payments charged to the income statement	148	157	173

9. Loss per share

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

	6 months ended 30 June 2014 £'000	6 months ended 30 June 2013 £'000	Year ended 31 December 2013 £'000
Loss attributable to equity holders of the Company	2,474	2,317	4,700
Weighted average number of ordinary shares in issue (thousands)	79,505	72,654	76,108
Basic loss per share	3.11p	3.20p	6.18p

10. Net cash flows used in operating activities

	6 months ended 30 June 2014 £'000	6 months ended 30 June 2013 £'000	Year ended 31 December 2013 £'000
Loss on ordinary activities before taxation	(2,488)	(2,340)	(4,766)
Adjustments for:			
Depreciation of property, plant and equipment	139	240	445
Amortisation of intangible assets	192	225	450
Loss on disposal of property, plant and equipment	—	31	40
Net finance income	40	(113)	(107)
Share-based payments	148	157	173
Movements in working capital:			
(Increase)/Decrease in inventories	(515)	(213)	28
Decrease in trade and other receivables	55	170	47
(Decrease) in trade and other payables	(203)	(200)	(33)
Cash used in operations	(2,632)	(2,043)	(3,723)

11. Related party transactions

IP Group plc held 20.0% of the ordinary share capital of the Company as at 30 June 2014 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 period were £15,000 (2013: £15,000) and as at 30 June 2014 £7,500 (31 December 2013: £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.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

SIX MONTH PERIOD ENDED 30 JUNE 2014

The directors confirm that, to the best of their knowledge, these condensed consolidated interim financial statements have been prepared in accordance with IAS34 as adopted by the European Union. The interim management report includes a fair review of the information required by the FCA's Disclosure and Transparency Rules (4.2.7 R and 4.2.8 R), namely:

- an indication of important events that have occurred during the first six months of the financial year and their impact on the condensed set of financial statements and a description of the principal risks and uncertainties for the remaining six months of the financial year; and
- material related-party transactions in the first six months and any material changes in the related-party transactions described in the last annual report.

The directors of Modern Water plc are listed in the Modern Water plc Annual Report and Accounts 2013. A list of the current directors is maintained on the Company's website www.modernwater.com.

Neil McDougall
Executive Chairman

Simon Humphrey
Chief Executive Officer

17 September 2014