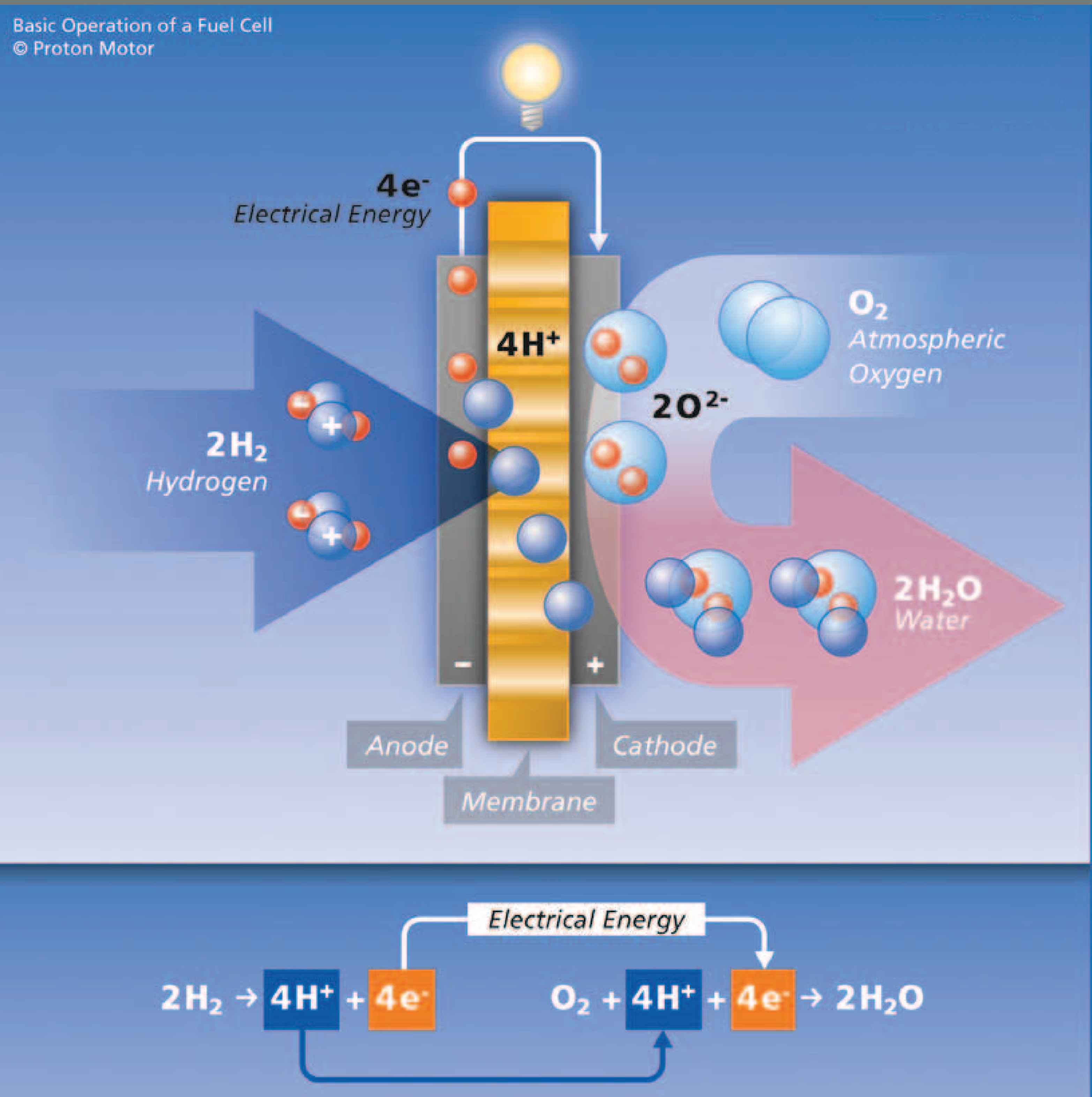
Proton Power Systems PLC

Annual Report 2010



Basic Operation of a Fuel Cell
© Proton Motor

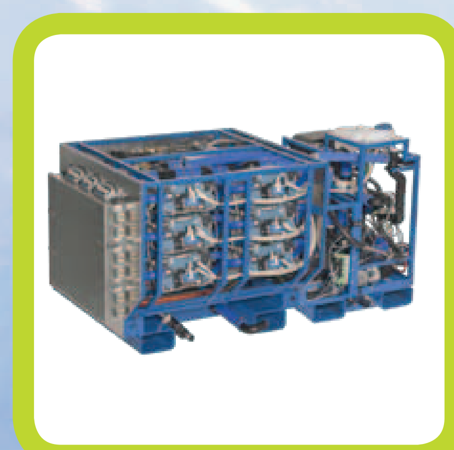










Proton Power Systems plc

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CHAIRMAN AND CEO'S STATEMENT

Overview

We are pleased to report our results for the year ended 31 December 2010, which is our fourth full year as a public company on the AIM market of the London Stock Exchange.

Business development

There has been a major shift in the attitude to hydrogen fuel cell power solutions as automotive manufacturers such as Daimler, Opel, Audi, Toyota, and Hyundai have publicly acknowledged that the future technology for automotive vehicles must include a battery and fuel cell solution.

These companies and local governments are supporting the creation of a hydrogen infrastructure and Germany in particular will take a leading role in setting up a network of up to 2000 hydrogen fuelling stations following an announcement by GM/Opel in April 2011.

This development will support the general market introduction of hydrogen fuel cell solutions as well as the Group's product strategy which includes:

- Stationary power from 5kW to 100kW for small information technology and industrial applications including back up power.
- A range extender for light duty vehicles from 8kW to 20kW.
- Mobile fuel cell based solutions for ships and buses.

Proton Power's strategy is to work closely with OEM partners for each of these product areas and the management is currently in discussions with SPower, Smith Electric Vehicles (SEV) and Skoda Electric.

The Group will continue to focus on stack and system development and integration and will cooperate with international OEM partners to further develop, licence and sell our products.

In addition Proton Power continues to work on new development projects, funded by the German Hydrogen Organisation (NOW). These are mainly in the stationary power supply area with systems from 50kW to 100kW with other German based integrators and will address the data centre market.

The Group is pleased to give a status update on the current projects which are grant funded by NOW. The Range Extender project with SEV is well under way. Proton Power has successfully equipped and tested the first Edison truck and is now working on the Newton truck which will be the main platform vehicle for a fuel cell range extender solution. SEV sees the range extender as an excellent addition to its battery powered electric vehicle where an operational range above 120 Km is required or when there is a need for additional power for cooling or on board maintenance work.

Development on the new PM400 stack for power up to 20kW is also progressing well. The new stack will be an excellent addition to the Group's portfolio and will allow Proton Power to bring down costs because of the higher integration and power.

The Group's Triple Hybrid Bus with Skoda Electric which is in use in the Czech Republic was upgraded with a system based on the latest fuel cell stack and the Alsterwasser ship in Hamburg now is back in operation.

CHAIRMAN AND CEO'S STATEMENT

Finance

Turnover increased by 273 % to £718,000 (€837,000) mainly as a result of funded projects started in April 2010. The loss for the year was £3,018,000.

The Group secured new funding in 2010 from convertible loans with a total value of €6,480,000 from the major shareholder, Roundstone Properties Limited. £1,500,000 was converted into ordinary shares in 2010 by issuing 75 million shares at 2p each. This convertible loan facility stands at €7.56 million of which €6.34 million had been draw down at the year end.

Outlook

Proton Power's current discussions with major OEM partners have highlighted that there is now a realistic opportunity for the breakthrough of fuel cell technology into the commercial domain. The range extender project with SEV is an excellent opportunity to enter a volume market. Stationary applications will also develop quickly as the electricity grid struggles to cope with increasing and variable electricity demand covered by a generation mix which now includes a significant amount of unpredictable (principally wind) renewable power.

Based on Proton Power's modular concept each success story will help the other products because the main components used are similar and cost reductions will be achieved as the Group cooperates with our suppliers and contract manufacturers.

On behalf of the Board we would like to take this opportunity to thank the Proton Power team and our advisors for their hard work and effort as well as our customers and suppliers for their confidence and support throughout the year.

John Wall FCA
Chairman

Dr Faiz Nahab
CEO

BOARD OF DIRECTORS

John Wall (aged 57), Non-Executive Chairman
John co-founded the PricewaterhouseCoopers Corporate Finance business in the UK and until his retirement in 2004 was responsible for its operations in the UK Regions, France and the Republic of Ireland. During the course of his career, John participated in over 100 major transactions with an aggregate value of approximately £1.5 billion. Since leaving PwC John has been chairman of Albany RTA Group, chairman of The Adderstone Group and a non executive at Dickinson Dees LLP. In addition to his responsibilities as non-executive chairman of Proton Power Systems plc John is chairman of the Princes Trust North East Development Committee.

Dr. Faiz Nahab (aged 67), Chief Executive Officer
Faiz has over 25 years of executive management experience in company restructuring and expansion. For more than 20 years he served as a consultant to major international companies on technical and high technology projects with focus on product sales, marketing and product development. He has a strong background in project management including project finance and control. As an entrepreneur Faiz successfully developed a medical infrastructure company and developed an expert team for installing and commissioning of industrial equipment and machinery covering areas such as clean and waste water projects, cement and urea factories. The main business of his companies is based in the Middle East with involvement in country infrastructure construction in partnership with major international partners such as MSD, Siemens AG, Carl Zeiss and others. He still holds various directorships at companies in the pharmaceutical, medical and technology sector, some of them as CEO and Chairman. Faiz had academic undergraduate education in Electronics at Southampton, postgraduate PhD at Kent University in electronics and has full membership of MIEEE.

Thomas Melczer (aged 52), Business Development Director
Thomas is also the CEO and founder of SPower Holding GmbH, Germany, which provides power supply solutions to the world market. Before that, Thomas worked for 7 years as VP International Sales for the UK based company Chloride Plc – UPS Systems Division where he was responsible for the international distribution network for Chloride UPS products. During that time, Thomas also had responsibility as the General Manager for the Germany based company Masterguard GmbH, which also manufactured UPS Systems as an affiliated company of Chloride Plc and has been involved in the setting up of companies and branch offices in different parts of the world for the Chloride Group. Prior to this Thomas worked for 23 years within Siemens AG in various positions including financial director and commercial manager for different business units within Siemens, including the Automotive, Data Network and Cable Network Divisions as well as for a Siemens/Corning Glass works JV. Thomas has undertaken some international long term appointments for Siemens AG in Africa, Latin America and North America. He also participated in a 3 year in-house training program with Siemens as Commercial Manager (Industriekaufmann) from 1977 to 1980. Thomas has extensive industrial experience with a strong financial, sales, marketing, technical and management background.

Achim Loecher (aged 51), Group Financial Director
Achim joined Proton Motor in June 2007 and the Company's Board in October 2007. As financial Director he is responsible for the Group's accounting and finance, treasury and human resource management. Achim has many years of expertise in the field of finance and possesses a broad experience in operational and strategic corporate management, fund raising, initial public

offering, pre – and post-merger management as well as management consultancy. Prior to joining Proton Motor Achim worked for over 15 years in international and national companies as a manager and member of the board. Achim studied business management at the Ludwig-Maximilians-Universität Munich and started his business career in 1988 as financial analyst for Digital Equipment Corporation in Munich.

Helmut Gierse (aged 61), Non-Executive Director
Helmut has over 30 years of international industry experience covering the fields of factory automation, process industry and power generation. His experience comes from his work in R&D, production, sales and marketing. His expertise has been gained from a range of industry positions at the management level, most recently as the CEO and President of the Siemens Group in Automation and Drive in Germany. Helmut is currently an independent industry consultant. Helmut studied Electronic Engineering at the Universität Erlangen in Germany. He speaks German, English, French and Spanish.

Proton Power Systems plc

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Group activities

The Group has developed a standard 19" hydrogen fuel cell module which is designed to enable it to provide customers with complete hydrogen fuel cell systems and fuel cell hybrid systems that can be integrated into their product range. The Group's fuel cell modules can be combined into larger systems to meet the power needs of particular applications from 5kW to 50kW and higher kW ratings in parallel operation. In addition to the above activities the group started to develop a mobile 8 kW fuel cell system to operate as a range extender for battery driven light duty vehicles and a new more powerful fuel cell stack for larger applications.

Milestones during the year were:

- entering into a memorandum of understanding with Smith Electric Vehicles, Newcastle, UK, to build and market electric light duty vehicles with Proton Power fuel cells as a range extender;
- receiving an Innovation Award, Zukunftspreises Alternative Antriebstechnologien 2010 from idwi (Innovationsvereinigung für die deutsche Wirtschaft) in February 2010;
- Triple Hybrid Bus nominated for Hermes Industrial Award at the Hanover Fair 2010;
- entering a co-operation agreement between SPower and Proton Motor for the development of an environmental friendly UPS;
- appointment of Thomas Melczer as director of business development and investor relation;
- appointment of Faiz Francois Nahab, Ph.D. as CEO of Proton Motor in March 2011;
- appointment of Sebastian Kriener as Head of Operation in December 2010;
- securing non refundable grant funding in relation to projects worth in total €9.2 million from the National Innovation Program ("NIP") of the German government; and
- successful trial of fuel cell range extender for Smith Electric Vehicles.

Strategy

Sales strategy

Although Proton Motor has been historically reliant on a small number of key customers, it has established strong relationships with key OEMs in its target market. The Group anticipates expanding this customer base as volume manufacturing capability increases. The Directors believe that effective execution with their OEM partners should enable Proton Motor to be recognised as a global fuel cell technology platform.

Attractive primary markets and applications for the Group's fuel cell system, identified by the Group, generally display the following characteristics:

- potential material volume sales;
- 'back-to-base' refuelling or stationary applications;
- existing power generation technology applications with notable disadvantages, for example:
  - slow recharge time of battery technology as well as additional working capital infrastructure where continuous battery use is required;
  - combustion engines emitting harmful emissions and noise pollution;
  - external electric power is generally delivered by overhead cables, for example trolley buses, and has geographical and logistical limitations;

  - applications with long backup time and space limitations (APU's).
- need to reduce industrial noise and emissions.

Manufacturing strategy
To date, the Group's fuel cell modules and fuel cell hybrid systems have been produced in relatively small volumes, on a project-by-project basis, largely utilising a combination of semi-automated processes and manual assembly. However, Proton Motor's technology development has been undertaken with the key objective of designing and manufacturing fuel cells and fuel cell hybrid systems for volume production with experienced contract manufacturers. In order to seek to achieve this, the Directors have:

- identified target markets and commercial applications;
- established further key commercial partnerships within these target markets;
- designed the Group's fuel cells and fuel cell hybrid systems to meet the engineering requirements for volume manufacturing;
- switched over to a new and more cost effective stack generation which will lead to a decrease in production costs by more than 60%.
- established quality control procedures;
- installed professional commercial test benches to ensure high quality standards for the Group's fuel cells and fuel cell systems,
- built up and installed 5kW and 50kW test systems for in house performance and lifetime tests;
- reviewed, risk assessed and secured supplier and component manufacturing relationships;
- identified and assessed major commercial factors, such as cost, availability, robustness and durability of components;
- secured and properly documented necessary regulatory and operational approvals for each application;
- selected Deutsche Mechatronics as contract manufacturer for stacks and systems and signed a framework contract in May 2009; and
- started the production of a 19" fuel cell module in cooperation with Deutsche Mechatronics.

Market and competitive environment
The Board believes the growth in the fuel cell market will be determined by the following factors:

- the ongoing depletion of fossil fuel reserves;
- current and future air quality regulation;
- growing industrial and consumer demand for alternative sources of energy;
- the potential long term competitiveness of the auto and transportation industries; and
- energy security concerns.

Initial market segments have been identified, which the Board believes, would benefit from the advantages of fuel cell hybrid systems and are target market segments for the Group. Those market segments are:

- city buses;
- passenger ferry boats;
- light duty vehicles; and
- APU's.

The Directors see significant growth and demand in those market segments for fuel cell applications.

Competitive advantages
The Directors are confident that Proton Motor's technology brings the following distinct combination of characteristics to the power systems market:

- zero harmful emissions;
- lower fuel consumption than comparable commercial alternatives;
- no recharge requirement, unlike batteries;
- silent operation;
- a standard fuel cell stack for use in multiple applications;
- a reliable, robust and durable technology; and
- successful integration of fuel cell technology into a hybrid and Triple-Hybrid© system.

Future prospects
The Group's principal objective is to expand volume manufacturing with industrial partners based on licence agreements. This will enable the Group to achieve an economically viable unit cost for its fuel cells and fuel cell hybrid systems. Also the Group will utilize the sales channels of its industrial partners to address various markets and ensure growth of sales volume. The Directors believe that the advanced stage of commercialisation of the Group's technology, coupled with the Group's preferred partnerships, will enable the business to firmly establish itself as a leading, global, fuel cell and fuel cell hybrid system provider.

Principal risks and uncertainties
Operating revenues
Although the Directors have confidence in the Group's future revenue earning potential, there can be no certainty that the Group will achieve or sustain significant revenues, profitability or positive cash flow from its operating activities. This could impair the Group's ability to sustain operations or secure any required funding. To date, the Group has incurred substantial losses and expects losses and cash expenditure to continue until it achieves volume sales production at commercial unit prices.

Further development activities

A number of the Group's relationships are also at an early stage and there is no assurance that any relationships will continue to result in revenue generating contracts with the Group. Continuing development of the Group's technology may be required and there can be no assurance that any of the Group's future technology will be commercially successful. The Group may encounter delays and incur additional research and development costs and expenses over and above those anticipated or allowed for by the Directors.

Material contracts

The Group has been, and in the short to medium term will continue to be, dependent on a limited number of key customers. A concentrated client base places considerable dependence in meeting contracted operating performance levels. If a major client or a number of clients terminate their contracts or significantly reduce or modify their business relationships with the Group, the Group may not be able to replace the shortfall in revenues.

A number of the Group's material contracts are public sector contracts which may be dependent upon public grants and/or subsidies. The Group may not have control over payment of its costs under these contracts since it is reliant upon the lead partner(s) making claims for payment to the relevant public authority. Further, under the terms and conditions of public sector contracts, there may be a risk of claims for repayment from public authorities if the terms and conditions of such contracts are breached.

Technology risk

A core component within the Group's product offering is its fuel cell module. This has undergone testing in prototype form however, as with any new technology, there are risks associated with the long-term operational life of the product above the proven 5,000 hours.

Competing power technologies

As the Group's fuel cell technology has the potential to replace existing power products, competition for the Group's products will come from current power technologies, from improvements to current power technologies and from new alternative power technologies, including other types of fuel cells or other self-contained energy systems. Each of the Group's target markets is currently serviced by existing manufacturers with existing customers and suppliers. These manufacturers use proven and widely accepted technologies such as internal combustion engines, turbines, batteries and overhead contact lines.

Additionally, there are competitors working on development of technologies other than fuel cells (such as advanced batteries, ultracapacitors and hybrid battery/internal combustion engines) in each of the Group's targeted markets. Some of these technologies may be as capable of fulfilling the existing and proposed regulatory requirements as the Group's fuel cell technology.

Many of the Group's competitors have financial resources, customer bases, businesses or other resources, which give them significant competitive advantages over the Group. Competitors and potential competitors may develop technologies and products that are less costly and/or more effective than the technology or products of the Group, or which may make those of the Group obsolete or uncompetitive.

Governmental regulation

There may be a change in government regulations or policies, which could have a material adverse effect on the Group's activities.

Commercial relationships

The success of the Group will depend on its ability to integrate the Group's fuel cell technology into products manufactured by OEMs. There is no guarantee that OEMs will manufacture appropriate products or, if they do manufacture such products, that they will choose to use the Group's fuel cell technology. Any integration, design, manufacturing or marketing problems encountered by OEMs could adversely affect the market for the Group's fuel cell technology and the Group's financial results.

Dependence on key personnel

In order to successfully implement the Group's anticipated growth, the Group will be dependent on its ability to hire and retain additional skilled and qualified personnel, particularly in relation to sales, sales support, technological development, management, marketing and technical personnel. There can be no assurance that the Group will be able to retain or hire necessary personnel.

Future funding

The Group is dependent on the continuing financial support of its main investor to meet its day-to-day working capital requirements. At this point in time there has been no indication that this financial support will be withdrawn, however, the Board recognises that the Group must show improved financial performance to warrant further financial support.

Currency exchange rate fluctuations

The Group intends to conduct much of its business overseas in currencies other than sterling and as such its financial performance is subject to the effects of fluctuations in foreign exchange rates.

Capital structure

The Group is financed by a mixture of share capital and loans, some of which are classified as equity, details of which are contained elsewhere in the financial statements. The Group has an ongoing requirement for external capital to fund its product development and day-to-day requirements. This capital requirement has been met by accepting the further investment of an existing majority shareholder on commercial terms.

By order of the Board

J Wall
Director 2 June 2011

DIRECTORS' REPORT

The Directors present their annual report and the audited financial statements of the Group for the year ended 31 December 2010. The Chairman and CEO's statement and Operating and financial review on pages 2 to 3 and 7 to 11 form part of the Directors' report

Principal activities

The Group's principal activity is the development of hydrogen fuel cells and fuel cell hybrid systems through its subsidiary Proton Motor Fuel Cell GmbH which is registered and operates in Germany.

Business review

A commentary on the Group's activities and results for the period and future prospects is included in the Chairman and CEO's statement and the Operating and financial review on pages 2 to 3 and 7 to 11 respectively.

The Group undertakes comprehensive business planning to define long-term strategic objectives and goals. Annual budgets and operational plans are prepared utilising financial and non-financial Key Performance Indicators ("KPIs"). Business performance, measured by KPIs which include monitoring of actual against budget and rolling forecasts, is reported to the Board on a monthly basis.

Non-financial key performance indicators

It is difficult to disclose non-financial key performance indicators which are not commercially sensitive, such as the number of fuel cells produced and the fuel cell production cost per kW of output, however, despite economically challenging boundary conditions, production output has slightly increased during 2010 in comparison to 2009.

Share capital

There have been substantial movements in the share capital of the Company during the year including the issue of share options. Full details of these movements are set out in notes 7 and 19 to the financial statements.

Post balance sheet events

On 24 February 2011 Christian Meyne resigned as CEO and his position was taken by Dr Faiz Nahab.

Research and development

A fuel cell is a device that converts the chemical energy of a fuel and an oxidant into electricity. In principle, it functions like a battery but does not require recharging so long as an ongoing fuel source, such as hydrogen, is available.

Fuel cell systems are widely regarded as a potential alternative to internal combustion engines, power from fossil fuels and battery technology. Fuel cell systems produce no noxious gases and pure hydrogen fuel cells produce no harmful emissions such as carbon dioxide. There are a number of types of fuel cell, classified by the type of electrolyte used, including alkali, molten carbonate, PEM, phosphoric acid, and solid oxide. Proton Motor has selected a PEM-based fuel cell as the Directors believe that, based on the PEM's power in operation, efficiency and operating temperature, it is the only technology able to meet the overall criteria which the Group has specified for its intended commercial applications.

The Group has always recognised the commercial importance and value of protecting its intellectual property ("IP") and, therefore, the need to protect it wherever possible by way of patents and trademarks. The Group's key IP portfolio comprises a mixture of granted patents, patent applications, trademarks, confidential information and know-how.

Fuel Cell Technology has advanced in recent years to be able to develop similar power requirements as conventional power sources with double the efficiency and at the same time zero local emissions. The new Proton Motor Fuel Cell, PM 200 is able to generate 8kW net power per 96 cell stack and has proven to be many times more reliable than the previous generation. The stack was developed over a number of years of bench testing and has already begun to be sold. The PM 200 is being prepared for small series production with Proton Motor's partners. The stack, currently being developed to be introduced into the market, has already begun field testing in 3 fuel cell fork lift trucks at an OEM fuel cell customer in Austria and in 2009 has completed over 3,500 hours of continuous rigorous bench, vibration and shock testing.

The product ranges for the PM 200 stack range from stationary to mobile power: UPS backup power, range extender for heavy duty vehicles, bus and ship applications. This wide range of applications shows the flexibility of the stack technology. Separate systems, however, have been developed for stationary and mobile power uses. The first prototype designs were completed for the UPS backup power and ship systems in 2010.

The UPS Backup power first functional prototype has passed its robustness test and is undergoing tuning and optimization in the anticipation of the next level prototype.

Proton Motor has built a number of test stands for constant operation durability testing of systems for 5kW and 50kW respectively. The goal of these stands is to test to the end of life and are planned to run well into 2011 and beyond. These reference points will be used as accelerated lessons learned as well as system optimization.

Proton Motor has updated the development system to include multiple steps to verify system performance and durability before release for customer applications such as design validation testing.

Safety, health and environment

It is Group policy to minimise risks to employees and other stakeholders associated with the Group's activities. The Chief Executive is accountable to the Board for the performance of the Group's safety programme. During the last year, the Group had no major or minor accidents or dangerous occurrences. There have also been no reportable environmental or loss of containment incidents.

Corporate and social responsibility

The Group has a continuing commitment to act ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large.

Disabled employees

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. In the event of members of staff becoming disabled every effort will be made to ensure that their employment with the Group continues and that appropriate training is arranged. It is the policy of the Group that the training, career development and promotion of disabled persons should, as far as possible, be identical with that of other employees.

Proposed dividend

The Directors do not recommend the payment of a dividend.

Policy and practice on payment of creditors

The Group does not follow any specific code or payment practice. It is the Group's policy to pay suppliers in accordance with terms and conditions agreed prior to the commencement of trading, providing that the supplier has met their contractual obligations. At 31 December 2010 the number of days trade creditors for the Group was 30 (*2009: 30*) and for the Company was 28 days (*2009: 32*).

Directors

The Directors who held office during the year and up to the date of approval of this report were as follows:

J Wall FCA	Chairman[2,3,4]
F Nahab	Non-Executive Director[1,6] (appointed Chief Executive 1 March 2011)
T Melczer	Business Development Director[6]
A Naini	Deputy Chairman & Non-Executive Director (resigned 20 May 2010)
A Loecher	Group Finance Director
H Gierse	Non-Executive Director[5]
C Meyne	Chief Executive (appointed 26 July 2010, resigned 24 February 2011)

1 Chairman of the Remuneration Committee.

2 Chairman of the Audit Committee.

3 Chairman of the Nomination Committee.

4 Member of the Remuneration Committee.

5 Member of the Audit Committee.

6 Member of the Nomination Committee.

According to the register of Directors' interests, no rights to subscribe for shares in or debentures of Group companies were granted to any of the Directors or their immediate families, or exercised by them, during the financial year except as indicated below:

	At start of year	Number of options during the year: Granted	Number of options during the year: Exercised	At end of year	Exercise Price	Date from which exercisable	Expiry date
Thomas Melczer	1,000,000	1,000,000	–	2,000,000	£0.10	2 October 2010 1 July 2012	1 October 2018 30 June 2020
Ali Naini	900,000	400,000	–	1,300,000	£0.10	2 October 2010 9 December 2011 1 July 2012	1 October 2018 8 December 2019 30 June 2020
Achim Loecher	350,000	400,000	–	750,000	£0.10	2 October 2010 22 July 2011 1 July 2012	1 October 2018 21 July 2019 30 June 2020
John Wall	700,000	800,000	–	1,500,000	£0.775 & £0.10	1 February 2009 2 October 2010 1 July 2012	31 January 2017 1 October 2018 30 June 2020
Helmut Gierse	150,000	400,000	–	550,000	£0.10	22 July 2011 1 July 2012	21 July 2019 30 June 2020
Christian Meyne	100,000	200,000	–	300,000	£0.10	22 July 2011 1 July 2012	21 July 2019 30 June 2020

Major shareholdings

As at 12 May 2011 the following shareholders held 3% or more of the ordinary share capital of the Company:

	Ordinary Shares Number	Percentage
Roundstone Properties Limited	138,831,769	76.29
Maan Abdulwahed Al-Sanea	7,625,000	4.19
Dr Gotz Heidelberg	6,285,932	3.45

Corporate governance

The Directors recognise the value of the corporate governance principles enshrined in the 2008 FRC Combined Code and have applied them as far as is practicable and appropriate for a company of this size. The Company also seeks to follow the recommendations within the 'Guidance for Smaller Quoted Companies – The Committee on Corporate Governance Report and the Combined Code' issued by the Quoted Companies Alliance.

The Board has established an Audit Committee, a Nominations Committee and a Remuneration Committee with formally delegated duties and responsibilities.

The Audit Committee receives and reviews reports from management and the Company's auditors relating to the annual and interim accounts and the accounting and internal control systems in use throughout the Group. The Audit Committee has unrestricted access to the Company's auditors.

The Nominations Committee reviews the balance and effectiveness of the Board and identifies the skills and needs of the Board and those individuals who might best provide them. It also ensures that the Board has formal and transparent appointment procedures.

The Remuneration Committee reviews the scale and structure of the executive Directors' remuneration and the terms of their service contracts. The remuneration and terms and conditions of appointment of the non-executive Directors are set by the Board. The Remuneration Committee also administers the Group's share option scheme.

Risk management objectives and policies

Risk management objectives and policies and the Group's exposure to price risk, credit risk, liquidity and cash flow risk are disclosed in notes 22 to 28.

Going concern

Until such time as the Group achieves operational cash inflows through becoming a volume producer of its products to a receptive market it will remain dependant on its ability to raise cash to fund its operations from existing and potential shareholders and the debt market. The Group is currently dependent on the continuing financial support of its main investor to meet its day-to-day working capital requirements and at this point in time there has been no indication that this financial support will be withdrawn. The Company secured new funding in 2010 from convertible loans with a total value of €6,480,000 from the major shareholder, Roundstone Properties Limited. The convertible loan facility stands €7.56 million of which €6.34 million had been draw down at the year end. Since the year end the remainder of this facility has been drawn down and the Company is in negotiations with Roundstone Properties Limited for a further extension to this facility.

After making these and other relevant enquiries, the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future and at least 12 months from the date of this report. For this reason, they have adopted the going concern basis in preparing the financial statements.

Directors' Responsibilities Statement

The Directors are responsible for preparing the Directors' 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 to prepare the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs). 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 and profit or loss of the Company and Group for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs 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 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 hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

In so far as each of the Directors is aware:

- there is no relevant audit information of which the company's auditors are unaware; and
- the Directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

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

Auditors

Grant Thornton UK LLP have expressed willingness to continue in office. In accordance with section 489(4) of the Companies Act 2006 a resolution to reappoint Grant Thornton UK LLP will be proposed at the Annual General Meeting.

By order of the Board

J Wall
Director

2 June 2011

St Ann's Wharf
112 Quayside
Newcastle upon Tyne
NE99 1SB

The Remuneration Committee

The Remuneration Committee is chaired by Faiz Nahab and its other member is John Wall. The Committee keeps itself informed of all relevant developments and best practice in the field of remuneration and corporate governance and seeks advice where appropriate. Dickinson Dees has been appointed as external adviser to the Remuneration Committee. The Committee has appropriate policies and procedures to monitor the size of potential remuneration awards.

The Remuneration Committee's remit is set out in its terms of reference. Its delegated responsibilities include setting the remuneration of all executive Directors. The remuneration of non-executive Directors is determined by the Board and is made up of an annual fee for acting as a non-executive Director of the Company and fees for chairing and for membership of a Board committee. The non-executive Directors do not take part in discussions on their own remuneration. The fees are set to reflect the time which they are required to commit to their duties, their experience and the amounts paid to non-executive Directors in comparable companies.

Remuneration policy

The Company's policy is to provide competitive remuneration packages that will attract, retain and motivate Directors and other individuals of the quality required to successfully drive the business forward. The remuneration policy is designed to support the business strategy, align executives' interests with shareholders and be cost effective. In constructing the remuneration packages, the Committee aims to achieve an appropriate balance between fixed and variable compensation for each executive. Accordingly, a significant proportion of the remuneration package depends on the attainment of demanding performance objectives, both short and long-term. The annual bonus is designed to incentivise and reward the achievement of demanding financial and non-financial corporate and individual objectives. Long-term share plans are designed to align the interests of executives with the longer-term interests of shareholders. The Remuneration Committee considers it important that this approach to remuneration should be maintained so far as possible.

Basic salary

The Committee will normally review the executive Directors' and other senior executives' remuneration annually against companies similar in size and sector. The Committee sets salaries at levels to reflect the individual's position, responsibilities, experience and performance. The Committee also considers executive salary increases in the context of salary increases across the Group's wider employee population.

Long-term share plans

The Company gained approval in advance of Admission to AIM to put in place certain long-term share plans, details of which are set out below in the section headed Proton Power Systems plc's current long-term incentive arrangements.

Proton Power System plc's current long-term incentive arrangements

The Remuneration Committee has discretion to grant awards under Proton Power Systems plc Share Option Scheme in any one year. When exercising their discretion to grant awards, the

Remuneration Committee will take into consideration the overall quantum and structure of the compensation package.

Proton Power Systems plc Share Option Scheme (the "SOS")

The SOS allows the Company to grant options to acquire shares to eligible employees. Options granted under the SOS are unapproved by HM Revenue & Customs.

Share options were granted over 4,100,000 shares on 1 July 2010 to four Directors, one former Director, eleven staff of Proton Motor Fuel Cell GmbH and to one consultant of the Company at an option price of 10 pence. These options will normally become exercisable following the end of a period of two years from the date of grant. The maximum number of shares over which options may be granted to an employee under the SOS may not be greater than 10 per cent of the Company's issued share capital at the date of grant when added to options or awards granted in the previous 10 years. The exercise of options can take place at any time after the second anniversary of the date of grant. Options can not, in any event, be exercised after the tenth anniversary of the date of grant.

Directors' service agreements and letters of appointment

It is the Company's policy to minimise the termination obligations of Directors' contracts recognising however the market requirements for executive Directors' contracts. The arrangements set out below reflect the Company's policy.

One new executive director was appointed during the year.

The appointments of non-executive Directors may be terminated by either party without notice and are subject to the provisions of the Company's Articles. The terms of appointment of the non-executive Directors are available for inspection at the Company's registered office during normal business hours and at the AGM.

The Remuneration Committee has considered the financial consequences of early termination of Directors' service contracts. If the Company terminates the employment of an executive Director by exercising its right to pay in lieu of notice, or terminates the employment other than in accordance with the terms of his service agreement, the Company is required to make a payment equal to the aggregate of the executive Director's basic salary and the value of his contractual benefits for the notice period.

Directors' emoluments

Information on the remuneration of each Director for the full year is set out in the following table:

Name	Salary £'000	Pension Contributions £'000	Total 2010 £'000	Total 2009 £'000
T Melczer*	115	–	115	78
A Loecher*	96	–	96	91
J Wall	15	–	15	40
C Meyne*	36[1]	–	36	–
A Naini	–	–	–	15

*   paid by Proton Motor Fuel Cell GmbH

1   for period following appointment as a Director

Details of the Directors' interest in the SOS are given in the Directors' Report.

On behalf of the Board

F Nahab

Chairman of the Remuneration Committee   2 June 2011

NOMINATIONS COMMITTEE REPORT

The Company recognised that the Board should be structured to reflect the requirements for listed companies in accordance with the Combined Code.

No new non-executive Directors were appointed to the Board of Proton Power Systems plc during the year.

On 5 November 2008 the Company's Articles of Association were amended to permit any person who is solely and beneficially interested in at least 9% of the issued share capital of the Company to nominate a person to act as a Director. Such a shareholder may appoint a separate Director for each complete multiple of 9% interest in the Company. Thomas Melczer and Faiz Nahab are the nominee appointees of Roundstone Properties Limited.

The Nominations Committee was chaired by John Wall and its other members are Faiz Nahab and, Thomas Melczer.

J Wall
Chairman of the Nominations Committee 2 June 2011

Non-audit services

The fees paid to Grant Thornton UK LLP for audit and non-audit services are set out in note 6 on page 40.

The Audit Committee has developed a policy on the provision by the external auditors of non-audit services. The objective of the Audit Committee's policy is to ensure that the provision of such services does not impair the external auditor's independence or objectivity. In this context, the Audit Committee will consider:

- whether the skills and experience of the audit firm make it a suitable supplier of the non-audit service;
- whether there are safeguards in place to ensure that there is no threat to objectivity and independence in the conduct of the audit resulting from the provision of such services by the external auditor;
- the nature of the non-audit services, the related fee levels and the fee levels individually and in aggregate, relative to the audit fee; and
- the criteria which govern the compensation of the individuals performing the audit.

The policy covers amongst other things:

- monitoring the external auditors' independence (e.g. that the auditors and their immediate family have no family, financial or employment relationship with the Company), and checking that the Group engagement partner and audit senior manager do not work on the audit for a period in excess of that permitted;
- the identification of three categories of accounting services: audit-related services, which the Company's auditors provide (such as interim and full-year reporting); prohibited services, which the Company's auditors may never provide; and potential services, which the Company's auditors may in certain circumstances provide, subject to the policy (such as tax advisory services or services where the auditors are acting as the Company's reporting accountants). Prohibited services are those which would result in:
  - the external auditors auditing their own firm's work;
  - the external auditors making management decisions for the Company;
  - a mutuality of interest being created; or
  - the external auditors being put in the role of advocate for the Company.
- reporting at each meeting of the Audit Committee on non-audit services being provided by the auditors.

J Wall
Chairman of the Audit Committee 2 June 2011

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF PROTON POWER SYSTEMS PLC

We have audited the financial statements of Proton Power Systems Plc for the year ended 31 December 2010 which comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated and parent Company balance sheets, the consolidated and parent Company statements of changes in equity, the consolidated and parent Company statement of cash flows and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 16, the Directors are responsible for the preparation of the 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 financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 December 2010 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRS as adopted by the European Union;
- the parent Company financial statements have been properly prepared in accordance with IFRS 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.

Opinion on other matter prescribed by the Companies Act 2006

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

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF PROTON POWER SYSTEMS PLC

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- 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; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Grant Thornton UK LLP

Andrew Wood
Senior Statutory Auditor
for and on behalf of Grant Thornton UK LLP
Statutory Auditor, Chartered Accountants

Leeds
2 June 2011

Proton Power Systems plc

CONSOLIDATED INCOME STATEMENT
for the year ended 31 December 2010

	Notes	2010 £'000	2009 £'000
Continuing operations			
Revenue	2,3,4	**718**	193
Cost of sales		**(3,188)**	(3,150)
Gross loss		**(2,470)**	(2,957)
Fair value gain on embedded derivatives		**1,818**	53
Other operating income		**409**	20
Administrative expenses		**(1,974)**	(1,844)
Operating loss		**(2,217)**	(4,728)
Finance income		**2**	5
Finance costs		**(803)**	(165)
Loss for the year attributable to equity holders of the parent	5	**(3,018)**	(4,888)
Loss per share (expressed as pence per share)			
Basic	9	**(1.8)**	(5.3)
Diluted	9	**(1.8)**	(5.3)

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	2010 £'000	2009 £'000
Loss for the period	**(3,018)**	(4,888)
Other comprehensive income		
Exchange differences on translating foreign operations	**(51)**	(487)
Other comprehensive income	**(51)**	(487)
Total comprehensive income for the period	**(3,069)**	(5,375)
Attributable to equity holders of the parent	**(3,069)**	(5,375)

Proton Power Systems plc

BALANCE SHEETS
as at 31 December 2010

		Group		Company	
	Note	2010 £'000	2009 £'000	2010 £'000	2009 £'000
Assets					
Non-current assets					
Intangible assets	10	**247**	759	**–**	–
Property, plant and equipment	11	**647**	793	**–**	–
Investment in subsidiary	12	**–**	–	**6,597**	4,012
		894	1,552	**6,597**	4,012
Current assets					
Inventories		**131**	105	**–**	–
Trade and other receivables	13	**594**	266	**13**	16
Cash and cash equivalents	14	**268**	187	**3**	1
		993	558	**16**	17
Total assets		**1,887**	2,110	**6,613**	4,029
Liabilities					
Current liabilities					
Trade and other payables	15	**437**	1,429	**43**	35
Borrowings	16	**6,380**	2,832	**6,380**	2,832
Embedded derivatives on convertible loans	17	**5,669**	477	**5,669**	477
Total liabilities		**12,486**	4,738	**12,092**	3,344
Net (liabilities) / assets		**(10,599)**	(2,628)	**(5,479)**	685
Equity					
Equity attributable to equity holders of the parent company					
Ordinary shares	19	**5,100**	4,350	**5,100**	4,350
Share premium		**8,474**	7,052	**8,474**	7,052
Merger reserve		**15,656**	15,656	**15,656**	15,656
Reverse acquisition reserve		**(13,862)**	(13,862)	**–**	–
Share option reserve		**385**	328	**385**	328
Other equity reserve		**–**	232	**–**	232
Foreign translation reserve		**3,359**	(28)	**–**	–
Capital contributions		**1,165**	1,224	**–**	–
Retained earnings		**(30,876)**	(17,580)	**(35,094)**	(26,933)
Total equity		**(10,599)**	(2,628)	**(5,479)**	685

These financial statements were approved by the Board of Directors on 2 June 2011 and were signed on its behalf by:

J Wall

J Wall FCA
Director

Proton Power Systems plc

STATEMENTS OF CHANGES IN EQUITY

Group	Share Capital	Share Premium	Merger Reserve	Reverse Acquisition Reserves	Share Option Reserve	Other Equity Reserve	Translation Reserve	Capital Contribution Reserves	Retained Earnings	Total Equity
	Attributable to equity holders of the Company									
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Balance at 1 January 2009	3,570	6,275	15,656	(13,862)	346	–	(304)	1,324	(12,029)	976
Share based payments debit	–	–	–	–	(18)	–	–	–	–	(18)
Proceeds from share issues	780	780	–	–	–	(500)	–	–	–	1,060
Proceeds from issues of compound financial instruments	–	–	–	–	–	732	–	–	–	732
Share issue costs		(3)	–	–	–	–	–	–	–	(3)
Transactions with owners	**780**	**777**	**–**	**–**	**(18)**	**232**	**–**	**–**	**–**	**1,771**
Loss for the year	–	–	–	–	–	–	–		(4,888)	(4,888)
Other comprehensive income:										
Currency translation differences	–	–	–	–	–	–	276	(100)	(663)	(487)
Total comprehensive income for the year	**–**	**–**	**–**	**–**	**–**	**–**	**276**	**(100)**	**(5,551)**	**(5,375)**
Balance at 31 December 2009	**4,350**	**7,052**	**15,656**	**(13,862)**	**328**	**232**	**(28)**	**1,224**	**(17,580)**	**(2,628)**
Balance at 1 January 2010	4,350	7,052	15,656	(13,862)	328	232	(28)	1,224	(17,580)	(2,628)
Share based payments debit	–	–	–	–	57	–	–	–	–	57
Proceeds from share issues	750	1,422	–	–	–	(232)	–	–	–	1,940
Deemed distribution (see note 21)	–	–	–	–	–	–	–	–	(6,899)	(6,899)
Transactions with owners	**750**	**1,422**	**–**	**–**	**57**	**(232)**	**–**	**–**	**(6,899)**	**(4,902)**
Loss for the year	–	–	–	–	–	–	–	–	(3,018)	(3,018)
Other comprehensive income:										
Currency translation differences	–	–	–	–	–	–	3,387	(59)	(3,379)	(51)
Total comprehensive income for the year	**–**	**–**	**–**	**–**	**–**	**–**	**3,387**	**(59)**	**(6,397)**	**(3,069)**
Balance at 31 December 2010	**5,100**	**8,474**	**15,656**	**(13,862)**	**385**	**–**	**3,359**	**1,165**	**(30,876)**	**(10,599)**

STATEMENTS OF CHANGES IN EQUITY

Company	Share Capital £'000	Share Premium £'000	Merger Reserve £'000	Share Option Reserve £'000	Other Equity Reserve £'000	Retained Earnings £'000	Total Equity £'000
	Attributable to equity holders of the Company						
Balance at 1 January 2009	3,570	6,275	15,656	346	–	(21,164)	4,683
Proceeds from share issues	780	780	–	–	(500)	–	1,060
Proceeds from issues of compound financial instruments	–	–	–	–	732	–	732
Share issue costs	–	(3)	–	–	–	–	(3)
Share based payments debit	–	–	–	(18)		–	(18)
Transactions with owners	**780**	**777**	**–**	**(18)**	**232**	**–**	**1,771**
Loss for the year	–	–	–	–	–	(5,769)	(5,769)
Total comprehensive income for the year	–	–	–	–	–	(5,769)	(5,769)
Balance at 31 December 2009	**4,350**	**7,052**	**15,656**	**328**	**232**	**(26,933)**	**685**
Balance at 1 January 2010	**4,350**	**7,052**	**15,656**	**328**	**232**	**(26,933)**	**685**
Proceeds from share issues	750	1,422	–	–	(232)	–	1,940
Deemed distribution (note 21)	–	–	–	–		(6,899)	(6,899)
Share based payments debit	–	–	–	57	–	–	57
Transactions with owners	**750**	**1,422**	**–**	**57**	**–**	**(6,899)**	**(4,902)**
Loss for the year	–	–	–	–	–	(1,262)	(1,262)
Total comprehensive income for the year	–	–	–	–	–	(1,262)	(1,262)
Balance at 31 December 2010	**5,100**	**8,474**	**15,656**	**385**	**–**	**(35,094)**	**(5,479)**

Share premium account

Costs directly associated with the issue of the new shares have been set off against the premium generated on issue of new shares.

Merger reserve

The merger reserve of £15,656,000 arises as a result of the acquisition of Proton Motor Fuel Cell GmbH and represents the difference between the nominal value of the share capital issued by the Company and their fair value at 31 October 2006, the date of the acquisition.

Reverse acquisition reserve

The reverse acquisition reserve (Group only) arises as a result of the method of accounting for the acquisition of Proton Motor Fuel Cell GmbH by the Company. In accordance with IFRS 3 the acquisition has been accounted for as a reverse acquisition.

Share option reserve

The Group operates an equity settled share-based compensation scheme. The fair value of the employee services received for the grant of the options is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted. At each balance sheet date the Company revises its estimate of the number of options that are expected to vest. The original expense and revisions of the original estimates are reflected in the income statement with a corresponding adjustment to equity. The share option reserve represents the balance of that equity.

Other equity reserve

Other equity reserve represents the residual element on initial recognition of compound financial instruments measured at fair value less the debt component.

STATEMENTS OF CASH FLOWS
for the year ended 31 December 2010

	Group Year ended 31 December		Company Year ended 31 December	
	2010	2009	2010	2009
	£'000	£'000	£'000	£'000
Cash flows from operating activities				
Loss for the period	**(3,018)**	(4,888)	**(1,261)**	(5,769)
Adjustments for:				
Depreciation and amortisation	**955**	434	**2,175**	5,329
Interest income	**(2)**	(5)	**–**	(1)
Interest expenses	**803**	165	**701**	164
Share based payments	**57**	(18)	**57**	(18)
Movement in inventories	**(26)**	32	**–**	–
Movement in trade and other receivables	**(327)**	4	**2**	9
Movement in trade payables	**(1,051)**	(457)	**12**	(66)
Movement in fair value of embedded derivatives	**(1,818)**	(53)	**(1,818)**	(53)
Net cash used in operations	**(4,427)**	(4,786)	**(132)**	(405)
Interest paid	**(1)**	(1)	**–**	–
Net cash used in operating activities	**(4,428)**	(4,787)	**(132)**	(405)
Cash flows from investing activities				
Capital contribution to subsidiary	**–**	–	**(4,760)**	(4,786)
Purchase of intangible assets	**(313)**	(202)	**–**	–
Purchase of property, plant and equipment	**(83)**	(639)	**–**	–
Interest received	**2**	5	**–**	1
Net cash used in investing activities	**(394)**	(836)	**(4,760)**	(4,785)
Cash flows from financing activities				
Proceeds from issue of share capital	**–**	1,057	**–**	1,057
Proceeds from issue of loan instruments	**4,894**	3,934	**4,894**	3,934
Net cash generated from financing activities	**4,894**	4,991	**4,894**	4,991
Net increase/(decrease) in cash and cash equivalents	**72**	(632)	**2**	(199)
Effect of foreign exchange rates	**9**	47	**–**	–
Opening cash and cash equivalents	**187**	772	**1**	200
Closing cash and cash equivalents	**268**	187	**3**	1

1. General information

Proton Power Systems plc ("the Company") and its subsidiary (together "the Group") design, develop, manufacture and test fuel cells and fuel cell hybrid systems as well as the related technical components. The Group's design, research and development and production facilities are located in Germany.

The Company is a public limited liability company incorporated in England & Wales. The address of its registered office is: St Ann's Wharf, 112 Quayside, Newcastle upon Tyne, NE99 1SB. The Company's initial public offering took place at the Alternative Investment Market of the London Stock Exchange on 31 October 2006 and its shares are listed on this exchange.

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) as adopted by the European Union.

The consolidated financial statements for the year ended 31 December 2010 (including comparatives) were approved and authorised for issue by the board of directors on 2 June 2011.

2. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied.

Development of the Group

Proton Power Systems plc was incorporated on 7 February 2006 and on 31 October 2006 acquired the entire share capital of Proton Motor Fuel Cell GmbH. As a result of this transaction, the shareholders in Proton Motor Fuel Cell GmbH received shares in the Company.

In preparing the consolidated financial statements, Proton Motor Fuel Cell GmbH has been deemed to be the acquirer and the Company, the legal parent, has been deemed to be the acquiree. Under IFRS 3 "Business Combinations", the acquisition of Proton Motor Fuel Cell GmbH by the Company has been accounted for as a reverse acquisition and the consolidated IFRS financial information of the Company is therefore a continuation of the financial information of Proton Motor Fuel Cell GmbH.

As permitted by Section 408 of the Companies Act 2006, no separate income statement is presented in respect of the parent Company. The loss for the financial period dealt within the accounts of the parent Company was £1,262,000.

Basis of preparation

The consolidated financial statements of Proton Power Systems plc have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and with those parts of the Companies Act 2006 applicable to those companies under IFRS. The consolidated financial statements have been prepared under the historical cost convention and on the basis that the Group continues to be a going concern. Until such time as the Group achieves operational cash inflows through becoming a volume producer of its products to a receptive market it will remain dependant on its ability to raise cash to fund its operations from existing and potential shareholders and the debt market.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 3.

Basis of consolidation

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 one 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 Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated but considered an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Share-based payments

The Company issues equity-settled share-based payments to certain employees of the Group. A fair value for the equity settled share awards is measured at the date of grant. The Group measures the fair value using the valuation technique most appropriate to value each class of award being a Black-Scholes pricing model. The fair value determined at the grant date is expensed on a straight-line basis over the vesting period, based on the Group's estimate of the shares that will eventually vest and adjusted for the effect of non-market based vesting conditions.

The value of shares issued to settle fees and finance costs has been measured by reference to the fair value of services provided.

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 the British Pound ("Sterling"), which is the Group's presentation currency. Given the Company's listing on the Alternative Investment Market of the London Stock Exchange, the Directors consider that it is more appropriate to present the financial statements in Sterling.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. 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.

Non-monetary items that are measured in terms of historical cost in a foreign currency are not re-translated.

(c) Group companies

The results and financial position of all the Group entities (none of which has the currency of a hyperinflationary 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 as other comprehensive income.

Cost of investment

The cost of an acquisition is measured at the fair values, on the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued, plus any costs directly attributable to the acquisition. At each balance sheet date, the Company reviews the carrying amount of the investment to determine whether there is any indication that the investment has suffered an impairment loss. Any impairment loss is recognised as an expense immediately.

Property, plant and equipment

Property, plant and equipment are stated at acquisition cost or, as the case may be, production cost, reduced by accumulated depreciation and impairment losses. Costs of acquisition / costs of production include the expenses directly attributable to the acquisition. All repairs and maintenance are reported in the income statement as expenditure in the financial year in which they were incurred. The costs of production include all directly attributable costs, as well as the appropriate proportion of the overheads relating to production.

Depreciation is charged on the basis of the economic life of the assets on a straight line basis as follows:

● Office equipment, furniture & equipment	10% – 33%
● Technical equipment & machinery	20%
● Leasehold property improvements	over the life of the lease

Additions in the financial year are depreciated from the time of their acquisition.

The residual values and the useful lives of property, plant and equipment are reviewed at each financial year-end and, if applicable, are adjusted. When the carrying amount of an asset exceeds its recoverable amount, the carrying amount is reduced to the recoverable amount. To determine the recoverable amount, the Group's management estimates expected future cash flows from each cash generating unit and determines a suitable interest rate in order to calculate the present value of those cash flows.

Gains and losses arising from the disposal of assets are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognized in the income statement.

Intangible assets

Intangible assets are capitalised at acquisition cost and amortised over their estimated economic life of the assets of 3 years, on a straight-line basis.

A self-developed intangible asset is recognized if the following criteria are fulfilled:

- identification of the self-developed asset is possible;
- the technical feasibility of completing the self-developed asset so that it will be available for use or sale;
- the availability of adequate technical, financial and other resources to complete the development and to use or sell;
- probability that the expected future economic benefits that are attributable to the self-developed intangible asset will flow to the entity; and
- the development costs of the asset can be measured reliably.

Self-developed intangible assets are amortized over the assumed economic life of the assets, on a straight-line basis. If a self-developed intangible asset is not recognized in accordance with IAS 38, the development costs are expensed in the period in which they are incurred.

Amortization starts at the first-time usage of the asset. The capitalized costs include all directly attributable costs, as well as reasonable parts of the overheads relating to production. If applicable, received government grants are deducted from the capitalized development costs in accordance with IAS 20.24. Amortisation is charged to administrative expenses.

Self-developed intangible assets are tested for impairment annually. Insofar as there are indications of an impairment for other intangible assets, the planned amortizable intangible assets shall be subjected to an impairment test and, if necessary, the carrying amount reduced to the recoverable amount within the meaning of IAS 36.

Impairment of non-financial assets

At each balance sheet date, the Group reviews the carrying amount of its property, plant and equipment and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. An intangible asset with an identifiable life is tested for impairment annually and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than the carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount in which case the reversal of the impairment loss is treated as a revaluation increase.

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 design costs, raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

Customer-specific contracts

Accounting for customer-specific contracts is carried out in accordance with IAS 11. If the result of a construction contract can be reliably estimated, the revenue and expenses are reported in accordance with the percentage of completion as per the reporting date. This is usually determined from the ratio of the costs of the contract incurred up to the reporting date in comparison with the estimated overall costs of the contract, unless this would lead to a distortion in the presentation of the percentage of completion. Insofar as the result of a contract cannot be reliably estimated, the proceeds of the contract are to be recorded only in the amount of the costs of the contract incurred which are likely to be collectible.

Where it is probable that the total cost of the construction contract will exceed the total contract revenue the expected loss is recognised immediately as an expense in the income statement.

Trade receivables

Trade and other receivables are recorded at the time of their initial recognition at fair value and subsequently at amortized cost less any impairment in value that may be necessary. An impairment in value in the case of trade and other receivables is recognized if there are objective indications that the amount of the debt due cannot be collected in full. The impairment in value is recognized in the income statement. Insofar as the reasons for value adjustments made in previous periods no longer exist, corresponding write-ups shall be made.

Deposits with financial institutions

Deposits with financial institutions are measured at their fair value.

Share capital

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

Trade and other payables

Trade and other payables, payables in respect of shareholders as well as other payables, are initially valued at fair value and subsequently at amortised cost.

Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

Where it is deemed that a host debt instrument contains an embedded derivative, the embedded derivative is recognised separately, initially at fair value, then fair valued through the profit and loss.

Equity

Share capital represents the nominal value of shares that have been issued. Share premium includes any premiums received on issue of share capital. Any transaction costs associated with the issuing of shares are deducted from share premium, net of any related income tax benefits.

Taxes on income and revenue

Tax expenses are the aggregate amount of current taxes and deferred taxes. Current taxes are measured in respect of the taxable profit (tax loss) for a period. Current tax is measured using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax liabilities are the future tax expense (tax income) on the differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Deferred tax liabilities are recognized for all taxable temporary differences and deferred tax assets to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part, or all, of that deferred tax asset to be utilized. Deferred tax liabilities and assets are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted by the balance sheet date. Deferred taxes are recognized in the income statement, except to the extent that it relates to items previously charged or credited to equity.

Employee benefits
The Company makes discretionary contributions to the personal pension plans of employees. The contributions are expensed on an accruals basis.

Other provisions
Other provisions are made insofar as there is a constructive obligation arising from past events and it is probable that an outflow of resources will be required to settle the obligation and the amount has been reliably estimated. The valuation of the provisions is reviewed at each reporting date. Provisions for guarantees are made in relation to individual cases.

Recognition of revenue and expenses
Revenue comprises revenue from the sale of goods and the rendering of services. Revenue is measured by reference to the fair value of consideration received or receivable by the Group for goods supplied and services provided, excluding VAT, rebates and trade discounts. Revenue is recognised at the point that the goods or services have been provided to the customer. Recognition of revenues from interest and interest expenses is made on an accrual basis. Financing costs are recorded as expenses in the period in which they are incurred. Research costs are expensed in the period in which they are incurred in accordance with IAS 38.54. Expenses for development costs that fulfil the criteria of IAS 38.57 are capitalized (see Intangible assets above). Amortization over the assumed economic life begins when the asset is available for use in accordance with IAS 38.97.

Royalty income
Royalty income is recognised on an accrual basis in accordance with the substance of the relevant agreements.

Government grants
Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions. Government grants relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs that they are intended to compensate. Government grants for expenses already incurred are recognized as income in the period in which the corresponding claim is created.

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 (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

Compound financial instruments
Compound financial instruments are measured at fair value. The debt component is initially recognised at fair value and subsequently measured at amortised cost using the effective interest method. The residual element on initial recognition is recognised as other equity.

Derivative financial instruments
All derivative financial instruments are accounted for at fair value through profit and loss.

Standards, amendments and interpretations not yet applied by Proton Power Systems plc
The IASB and IFRIC have issued additional standards and interpretations which are effective for periods starting after the date of these financial statements. The following standards and interpretations have yet to be adopted by the Group:

- IFRS 9 Financial Instruments (effective 1 January 2013).
- IAS 24 (Revised 2009) Related Party Disclosures (effective 1 January 2011).
- Amendment to IAS 32 Classification of Rights Issues (effective 1 February 2010).
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments (effective 1 July 2010).
- Prepayments of a Minimum Funding Requirement - Amendments to IFRIC 14 (effective 1 January 2011).
- Improvements to IFRS issued May 2010 (some changes effective 1 July 2010, others effective 1 January 2011).
- Disclosures - Transfers of Financial Assets - Amendments to IFRS 7 (effective 1 July 2011).
- Deferred Tax: Recovery of Underlying Assets - Amendments to IAS 12 Income Taxes (effective 1 January 2012).
- Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters - Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards (effective 1 July 2011).

IFRS 9-13, Amendments to IFRS 7, Amendments to IAS 12 and Amendments to IFRS 1 are not yet adopted by the EU and therefore no disclosure is required under IAS 8.

The revised standards will be adopted in the Group's consolidated financial statements, where relevant for the period beginning 1 January 2011, although are not anticipated to have a significant impact on the Group.

3. 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. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial period are discussed below.

Recognition of development costs
Self developed intangible assets are recognised where the Group can estimate that it is probable that future economic benefits will flow to the entity. See Note 10.

Classification and fair value of financial instruments

The Group uses judgement to determine the classification of certain financial instruments, in particular convertible loans advanced during the year. Judgement is applied to determine whether the instrument is a debt, equity or compound instrument and whether any embedded derivatives exist within the contracts.

Judgements have been made regarding whether the conversion feature meets the "fixed for fixed" test in each instrument. In the case of each instrument it is deemed it is not met on the basis that the loan is in Euros and shares are in Sterling. A judgement has also been made as to whether a loss arises on recognition of the fair value of the embedded derivatives or whether it is a deemed distribution. Given the transaction is with a shareholder it has been judged that this constitutes a deemed distribution.

The Group uses valuation techniques to measure the fair value of these financial instruments. In applying these valuation techniques, management use estimates and assumptions that are, as far as possible, consistent with observable market data. Where applicable market data is not observable, management uses its best estimate about the assumptions that market participants would make. These estimates may vary from the actual prices that would be achieved in an arm's length transaction at the reporting date.

4. Segmental information

An operating segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other operating segments for which discreet financial information is available and is regularly reviewed by the Chief Operating Decision Maker ("CODM").

Based on an analysis of risks and returns, the Directors consider that the Group has only one identifiable operating segment, green energy.

All non current assets are located in Germany.

Revenue from external customer

	2010 £'000	2009 £'000
UK	–	–
Rest of Europe	**718**	193
	718	193

The results as reviewed by the CODM for the only identified segment are as presented in the financial statements with the exception of the revaluation gain on the fair value of the embedded derivative of £1,818,000 (2009: £20,000) and the associated impact on the balance sheet.

5. Loss on ordinary activities before taxation

	2010 £'000	2009 £'000
Loss on ordinary activities before taxation is stated after charging		
Depreciation and other amounts written off property, plant and equipment and intangible assets:		
Owned	**955**	434
Hire of other assets – operating leases	**233**	214
Pension contributions	**24**	25
Foreign exchange loss	**–**	35
after crediting		
Foreign exchange gains	**(89)**	–
Grants from public bodies	**(526)**	(107)
Change in fair value of embedded derivatives	**(1,818)**	(53)
Write off of lapsed loan obligation	**(350)**	–

6. Auditor's remuneration

	2010 £'000	2009 £'000
Audit services		
Fees payable to the Company's auditor for the audit of the parent company and consolidated accounts	**21**	17
Fees payable to the Company's auditor and its associates for other services:		
All other services	**7**	7
	28	24

7. Staff numbers and costs

The average number of persons employed by the Group (including Directors) during the year, analysed by category, was as follows:

	Number of employees			
	Group		Company	
	2010	2009	2010	2009
Development and construction	**34**	37	**–**	–
Administration and sales	**15**	13	**5**	5
	49	50	**5**	5

The aggregate payroll costs of these persons were as follows:

	Group		Company	
	2010	**2009**	**2010**	**2009**
	£'000	**£'000**	**£'000**	**£'000**
Wages and salaries	**1,861**	2,188	**15**	55
Share based payments	**57**	3	**36**	43
Share options forfeited	**–**	(21)	**–**	–
Social security costs	**373**	363	**1**	6
Other pension costs	**24**	25	**–**	–
	2,315	2,558	**52**	104

Share based payments

The Group has incurred an expense in respect of 4,100,000 (2009: 1,170,000) share options during the year issued to employees as follows:

	Group		Company	
	2010	**2009**	**2010**	**2009**
	£'000	**£'000**	**£'000**	**£'000**
Share options	**7**	3	**4**	–
Shares	**–**	–	**–**	–
	7	3	**4**	–

Details of share options granted during 2010 are disclosed in the Directors' report on page 15 and the Remuneration report on pages 18 to 20. The cost of these options to the Group is being written off over a two year period from the date of grant at which point they become exercisable.

At 31 December 2010 the Group operated a single share option scheme ("SOS"). The SOS allows the Company to grant options to acquire shares to eligible employees. Options granted under the SOS are unapproved by HM Revenue & Customs. The maximum number of shares over which options may be granted to an employee under the SOS may not be greater than 10 per cent of the Company's issued share capital at the date of grant when added to options or awards granted in the previous 10 years. The exercise of options can take place at any time after the second anniversary of the date of grant. Options can not, in any event, be exercised after the tenth anniversary of the date of grant.

All share-based employee remuneration will be settled in equity. The Group has no legal or constructive obligation to repurchase or settle options. Share options and weighted average exercise price are as follows for the reporting periods presented:

	2010		2009	
	Number	Weighted average exercise price	Number	Weighted average exercise price
		£		£
Opening balance	**3,985,000**	**0.145**	3,160,000	0.200
Granted	**4,100,000**	**0.100**	1,170,000	0.100
Forfeited	**–**	**–**	(345,000)	0.373
Closing balance	**8,085,000**	**0.122**	3,985,000	0.145

At 31 December 2010 206,350 of the above options were exercisable at an exercise price of 77.5p and 79p.

The fair values of options granted were determined using the Black-Scholes valuation model. Significant inputs into the calculation include a weighted average share price and exercise prices as illustrated above. Furthermore, the calculation takes into account future dividends of nil and volatility rates of between 50% and 94%, based on expected share price. Risk-free interest rate was determined between 4.000% and 5.125% for the various grants of options. It is assumed that options granted under the SOS have an average remaining life of 11 months (2009: 14 months).

The underlying expected volatility was determined by reference to the historical data, of the Company. No special features inherent to the options granted were incorporated into measurement of fair value.

Directors' remuneration

Details of Directors' remuneration are given in the Remuneration report on pages 18 to 20.

The remuneration of key management of the Group was as follows:

	Group	
	2010 £'000	2009 £'000
Wages and salaries including social security contributions	**262**	247
Share-based payment charge	**46**	46
	308	293

The Company has no key management other than Directors.

8. Taxation

Due to losses within the Group, no expenses for tax on income were required in either the current or prior periods.

	2010 £'000	2009 £'000
Tax reconciliation		
Loss before tax	**(3,018)**	(4,888)
Expected tax credit at 30.98 % (2009: 29.65%)	**(935)**	(1,449)
Expenses not deductible / Income not chargeable for tax purposes	**(552)**	(3)
Tax losses carried forward	**1,487**	1,452
Tax charge	**–**	–

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 year.

Diluted loss per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. The Company has one category of dilutive potential ordinary shares, share options; however, these have not been included in the calculation of loss per share because they are anti dilutive for these periods.

	2010		2009	
	Basic £'000	Diluted £'000	Basic £'000	Diluted £'000
Loss attributable to equity holders of the Company	**(3,018)**	**(3,018)**	(4,888)	(4,888)
Weighted average number of ordinary shares in issue (thousands)	**159,868**	**159,868**	92,521	92,521
Shares issuable (weighted) – share options (thousands)	**–**	**6,041**	–	3,178
Adjusted weighted average number of ordinary shares	**159,868**	**165,909**	92,521	95,699
	Pence per share	Pence per share	Pence per share	Pence per share
Loss per share (pence per share)	**(1.8)**	**(1.8)**	(5.3)	(5.3)

10. Intangible assets – Group

	Copyrights, trademarks and other intellectual property rights	Development costs	Total
	£'000	£'000	£'000
Cost			
At 1 January 2009	61	1,507	1,568
Exchange differences	(3)	(52)	(55)
Additions	8	250	258
Disposals	–	(474)	(474)
At 31 December 2009	**66**	**1,231**	**1,297**
At 1 January 2010	66	1,231	1,297
Exchange differences	(3)	(59)	(62)
Additions	31	282	313
At 31 December 2010	**94**	**1,454**	**1,548**
Amortisation			
At 1 January 2009	49	736	785
Exchange differences	(3)	4	1
Charged in year	6	220	226
Eliminated re disposals	–	(474)	(474)
At 31 December 2009	**52**	**486**	**538**
At 1 January 2010	52	486	538
Exchange differences	(3)	(24)	(27)
Impairment	—	364	364
Charged in year	17	409	426
At 31 December 2010	**66**	**1,235**	**1,301**
Net book value			
At 31 December 2010	**28**	**219**	**247**
At 31 December 2009	14	745	759
At 1 January 2009	12	771	783

Self-developed intangible assets in the amount of £313,000 (2009: £258,000) are recognized in the reporting year, because the prerequisites of IAS 38 have been fulfilled.

The useful life of self-developed intangible assets is 3 years from completion of the asset.

For self-developed intangible assets brought into use no indications of impairment in value that would trigger an impairment test arose in the reporting year. Self-developed intangible assets costing £22,000 have not yet been brought into use and have been reviewed for impairment.

There are no individually significant intangible assets.

11. Property, plant and equipment – Group

	Leasehold property	Technical equipment & machinery	Office & other equipment	Self-constructed plant & machinery	Total
	£'000	£'000	£'000	£'000	£'000
Cost					
At 1 January 2009	105	307	607	336	1,355
Reclassification	–	336	–	(336)	–
Exchange differences	7	(15)	(41)	1	(48)
Additions	142	433	47	12	634
At 31 December 2009	**254**	**1,061**	**613**	**13**	**1,941**
At 1 January 2010	254	1,061	613	13	1,941
Exchange differences	(12)	(51)	(29)	(1)	(93)
Additions	14	44	25	–	83
Disposals	–	–	(22)	(12)	(34)
At 31 December 2010	**256**	**1,054**	**587**	**–**	**1,897**
Depreciation					
At 1 January 2009	36	243	537	177	993
Reclassification	–	177	–	(177)	–
Exchange differences	(1)	(14)	(38)	–	(53)
Charge for year	13	165	30	–	208
At 31 December 2009	**48**	**571**	**529**	**–**	**1,148**
At 1 January 2010	**48**	**571**	**529**	**–**	**1,148**
Exchange differences	(2)	(28)	(25)	–	(55)
Charge for year	21	109	35	–	165
Disposals	–	–	(8)	–	(8)
At 31 December 2010	**67**	**652**	**531**	**–**	**1,250**
Net book value					
At 31 December 2010	**189**	**402**	**56**	**–**	**647**
At 31 December 2009	206	490	84	13	793
At 1 January 2009	69	64	70	159	362

The economic life of leasehold property improvements as well as of technical equipment and machinery is 5 years.

12. Investment in subsidiary undertaking

Company	2010 £'000	2009 £'000
Shares in Group undertaking		
Cost		
At beginning of year	**28,676**	23,890
Additions	**4,760**	4,786
At end of year	**33,436**	28,676
Impairment		
At beginning of year	**24,664**	19,335
Charge for the year	**2,175**	5,329
At end of year	**26,839**	24,664
Net book value		
At end of year	**6,597**	4,012

On 31 October 2006 the Company acquired the entire share capital of Proton Motor Fuel Cell GmbH, a company incorporated in Germany. The cost of investment comprises shares issued to acquire the company valued at the listing price of 80p per share, together with costs relating to the acquisition and subsequent capital contributions made to the subsidiary.

Following a review of the Company's assets the Board has concluded that there are sufficient grounds for its investment in the subsidiary undertaking to be subject to an impairment charge under IAS 36. In arriving at the charge in the year of £2.175m (2009: £5.329m) the Board has determined the recoverable amount by reference to the fair value of the asset demonstrated by the market price of the Group's equity on AIM.

13. Trade and other receivables

	Group		Company	
	2010 £'000	2009 £'000	2010 £'000	2009 £'000
Trade receivables	**566**	196	**–**	–
Other debtors	**9**	28	**1**	3
Prepayments and accrued income	**19**	42	**12**	13
	594	266	**13**	16

The Directors consider that the carrying amount of trade and other receivables approximates to their fair values.

In addition some of the unimpaired trade receivables are past due as at the reporting date. The age of financial assets past due but not impaired is as follows:

	Group	
	2010	**2009**
	£'000	**£'000**
Not more than 3 months	**407**	32

14. Cash and cash equivalents

	Group		Company	
	2010	**2009**	**2010**	**2009**
	£'000	**£'000**	**£'000**	**£'000**
Cash at bank and on hand	**268**	187	**3**	1

15. Trade and other payables

	Group		Company	
	2010	**2009**	**2010**	**2009**
	£'000	**£'000**	**£'000**	**£'000**
Trade payables	**186**	809	**12**	1
Bank overdraft	**–**	5	**–**	5
Payments on account on contracts	**–**	101	**–**	–
Social security and other taxes	**–**	1	**–**	1
Other creditors	**50**	77	**–**	–
Accruals and deferred income	**201**	436	**31**	28
	437	1,429	**43**	35

The Directors consider that the carrying amount of trade and other payables approximates to their fair values.

16. Borrowings

	Group		Company	
	2010 £'000	2009 £'000	2010 £'000	2009 £'000
Loan				
Current and total borrowings	**6,380**	2,832	**6,380**	2,832

During the year the Group and Company entered into several extensions to an existing convertible loan agreement taking the facility to €8,100,000. Further drawn downs under this agreement during the year were €5,680,000. During the year the company converted €540,000 of the existing loans to 25m new ordinary shares of 1p each at a price of 2p per share. The conversion rate of £1/€1.08 was fixed in an extension of the initial loan agreement in November 2009. Also during the year the company converted £1,000,000 of an existing loan to 50m new ordinary shares of 1p each at a price of 2p per share.

Total draw downs under existing facilities were €8,080,000 at the period end with a balance of €7,540,000 outstanding. These instruments are classified as a debt host instrument with an embedded derivative being the conversion feature. The embedded derivative has been fair valued and the residual value of the instrument has been recognised as debt. The debt has subsequently been measured at amortised cost.

The loans carry interest at 10% per annum and are repayable on 30 July 2012. In the event that the convertible loans are converted, rather than repaid, no interest is payable.

17. Embedded derivatives

	Group		Company	
	2010 £'000	2009 £'000	2010 £'000	2009 £'000
Embedded derivatives on convertible loan	**5,669**	477	**5,669**	477

The embedded derivatives relate to the conversion features attached to convertible loans as disclosed under note 16. The derivatives are initially recognised at fair value and fair valued at each subsequent accounting reference date.

The embedded derivatives fall within the fair value hierarchy level 3 which means that inputs for the liability are not all based on observable market data (unobservable inputs). Details of movements in the fair value of embedded derivatives are given in note 28.

18. Deferred income tax – Group

	2010 £'000	2009 £'000
Accelerated capital allowances	**65**	222
Losses carried forward	**(65)**	(222)
	–	–

Deferred tax assets are recognised for tax loss carry-forwards to the extent that the realisation of the related benefit through future taxable profits is probable. The Group did not recognise deferred income tax assets of £6,834,000 (2009: £6,071,000) in respect of losses amounting to £2,579,000 (2009: £1,589,000) and €25,124,000 (2009: €21,027,000).

19. Share capital

The share capital of Proton Power Systems plc consists of fully paid Ordinary shares with a par value of £0.01 (2009; £0.01) and Deferred Ordinary shares with a par value of £0.01. All Ordinary shares are equally eligible to receive dividends and the repayment of capital and represent one vote at the shareholders' meeting of Proton Power Systems plc. Deferred Ordinary shares have no rights other than the repayment of capital in the event of a winding up. None of the parent's shares are held by any company in the Group.

During the year 75m ordinary shares of 1p each were issued at 2p per share. This comprised:

- On 18 January 2010 the company converted £1,000,000 of an existing convertible loan to 50m new ordinary shares of 1p each at a price of 2p per share.
- On 14 October 2010 the company converted €540,000 (£500,000) of the existing convertible loans to 25m new ordinary shares of 1p each at a price of 2p per share. The conversion rate of £1/€1.08 was fixed in an extension of the initial loan agreement in November 2009.

Details of share options in issue are given in Note 7.

The number of shares in issue at the balance sheet date is 181,990,863 (2009: 106,990,893). Ordinary shares of 1p each (2009: 1p each) and 327,963,452 (2009: 327,963,452) Deferred Ordinary shares of 1p each.

Proceeds received in addition to the nominal value of the shares issued during the year have been included in share premium, less registration and other regulatory fees and net of related tax benefits.

On 23 July 2009 each of the 81,990,863 Ordinary shares of 5p each in the capital of the Company in issue were sub-divided into five shares of 1p each, of which upon the occurrence of such sub-division, one share shall be a new ordinary share of 1p each and four shares shall be converted into and reclassified as four Deferred Ordinary shares of 1p each having the following rights and being subject to the following restrictions:-

- no right to participate in any dividends declared, made or paid by the Company;
- the right on a return of assets in a winding up to the repayment of the capital paid up on such shares after the rights of all holders of Ordinary shares have been discharged in full and the sum of £10,000,000 has been paid in respect of each issued Ordinary share in the capital of the Company but no other right to participate in the assets of the Company, but so that none of the rights and restrictions attached to such Deferred Ordinary shares shall be or be deemed to be varied or abrogated in any way by the passing or coming into effect of any special resolution of the Company to reduce its share capital (including a special resolution to reduce the capital paid up on, and cancel, such Deferred Ordinary shares);

- no right to receive notice of or to attend at any general meeting of the Company;

	2010				2009			
	Ordinary shares		Deferred ordinary shares		Ordinary shares		Deferred ordinary shares	
	No.'000	£'000	No.'000	£'000	No.'000	£'000	No.'000	£'000
Shares issued and fully paid								
At the beginning of the year	**106,991**	**1,070**	**327,963**	**3,280**	71,391	3,570	–	–
Share issue	**75,000**	**750**	**–**	**–**	35,600	780	–	–
Reclassified under share reorganisation	**–**	**–**	**–**	**–**	–	(3,280)	327,963	3,280
	181,991	**1,820**	**327,963**	**3,280**	106,991	1,070	327,963	3,280

20. Commitments

Neither the Group nor the Company had any capital commitments at the end of the financial year, for which no provision has been made. Total future lease payments under non-cancellable operating leases are as follows:

	2010		2009	
	Land and buildings	Other	Land and buildings	Other
Group	£'000	£'000	£'000	£'000
Operating leases which expire:				
Within one year	**5**	**–**	**7**	–
In the second to fifth years inclusive	**–**	**–**	**–**	–
After more than five years	**1,668**	**–**	**2,138**	–
	1,673	**–**	**2,145**	–

21. Related party transactions

During the year ended 31 December 2010 the Group and Company entered into the following related party transactions:

	Group Year ended 31 December		Company Year ended 31 December	
	2010 £'000	2009 £'000	2010 £'000	2009 £'000
Income / (expenses)				
Roundstone Properties Limited effective loan interest	**(802)**	(164)	**(802)**	(164)

At 31 December 2010 the Group and Company had the following balances with related parties:

	Group Year ended 31 December		Company Year ended 31 December	
	2010	**2009**	**2010**	**2009**
	£'000	**£'000**	**£'000**	**£'000**
Amounts owing from / (due to)				
Roundstone Properties Limited borrowing and embedded derivatives (see Note 16)	**(12,049)**	(3,309)	**(12,049)**	(3,309)

Further borrowings were drawn down during the year which contained embedded derivatives. In accordance with IAS 39 these have been fair valued resulting in a deemed distribution.

During the year the Company made capital contributions to its Proton Motor Fuel Cells GmbH of £4,761,000 (2009: £4,786,000).

22. Risk management objectives and policies

The Group's activities expose it to a variety of financial risks:

- foreign exchange risk;
- interest rate risk;
- credit risk;
- liquidity risk; and
- market risk

The Group's overall risk management programme focuses on the unpredictability of cash flows from customers and seeks to minimise potential adverse effects on the Group's financial performance. The Board has established an overall treasury policy and has approved procedures and authority levels within which the treasury function must operate. The Directors conduct a treasury review at least monthly and the Board receives regular reports covering treasury activities. Treasury policy is to manage risks within an agreed framework whilst not taking speculative positions.

The Group's risk management is co-ordinated at Proton Motor Fuel Cell GmbH in close co-operation with the Board of Directors, and focuses on actively securing the Group's short to medium term cash flows by minimising the exposure to financial markets. Long term financial investments are managed to generate lasting returns.

23. Foreign currency sensitivity

The Group operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the Euro and Sterling. Foreign exchange risk arises from the Group's conversion of its subsidiary's results to the reporting currency of Sterling.

The Group does not hedge either economic exposure or the translation exposure arising from the profits, assets and liabilities of Euro business.

Euro denominated financial assets and liabilities, translated into Sterling at the closing rate, are as follows:

	Year ended 31 December 2010		Year ended 31 December 2009	
	€'000	**£'000**	**€'000**	**£'000**
Financial assets	986	845	457	411
Financial liabilities	(8,298)	(7,110)	(4,249)	(3,823)
Short-term exposure	(7,312)	(6,265)	(3,792)	(3,412)

The following table illustrates the sensitivity of the net result for the year and equity with regard to the Group's financial assets and financial liabilities and the Sterling/Euro exchange rate. It assumes a +/- 12.47% change of the Sterling/Euro exchange rate for the year ended at 31 December 2010 (2009: 16.56%). This percentage has been determined based on the average market volatility in exchange rates in the previous 12 months. The sensitivity analysis is based on Group's foreign currency financial instruments held at each balance sheet date.

If the Euro had strengthened against Sterling by 12.47% (2009: 16.56%) then this would have had the following impact:

	Year ended 31 December 2010 £'000	**Year ended 31 December 2009 £'000**
Net result for the year	**(781)**	(565)
Equity	**(781)**	(565)

If the Euro had weakened against Sterling by 12.47% (2009: 16.56%) then this would have had the following impact:

	Year ended 31 December 2010 £'000	**Year ended 31 December 2009 £'000**
Net result for the year	**781**	565
Equity	**781**	565

Exposures to foreign exchange rates vary during the year depending on the volume of overseas transactions. Nonetheless, the analysis above is considered to be representative of Group's exposure to currency risk.

24. Interest rate sensitivity

The Group's policy is to minimise interest rate cash flow risk exposures on long-term financing. Longer-term borrowings are therefore usually at fixed rates. At 31 December 2010, the Group is exposed to changes in market interest rates through its bank deposits, which are subject to variable interest rates. All financial liabilities have fixed rates.

The following table illustrates the sensitivity of the net result for the year and equity to a possible change in interest rates of +1.5% and -0.1% (*2009: +1.5% and -0.1%*), with effect from the beginning of the year. These changes are considered to be reasonably possible based on observation of current market conditions. The calculations are based on the Group's financial instruments held at each balance sheet date. All other variables are held constant.

	Year ended 31 December 2010		Year ended 31 December 2009	
	£'000	£'000	£'000	£'000
			+1.5%	-0.1%
Group				
Net result for the year	**4**	**–**	3	–
Equity	**4**	**–**	3	–
Company				
Net result for the year	**–**	**–**	–	–
Equity	**–**	**–**	–	–

25. Credit risk analysis

Credit risk is managed on a Group basis. Credit risk arises from cash and deposits with banks, as well as credit exposures to customers, including outstanding receivables and committed transactions. For banks and financial institutions, only independently rated parties with a minimum rating of 'A' are accepted. If customers are independently rated, these ratings are used. Otherwise, if there is no independent rating, risk control assesses the credit quality of the customer, taking into account its financial position, past experience and other factors. Individual risk limits are set based on internal or external ratings in accordance with limits set by the Board.

No credit limits were exceeded during the reporting period, and management does not expect any losses from non-performance by these counterparties. The Directors do not consider there to be any significant concentrations of credit risk.

The Group's exposure to credit risk is limited to the carrying amount of financial assets recognised at the balance sheet date, as summarised below:

	Group		Company	
	2010 £'000	2009 £'000	2010 £'000	2009 £'000
Cash and cash equivalents	268	187	3	1
Trade and other receivables	574	224	1	16
Short-term exposure	842	411	4	17

The Group continuously monitors defaults of customers and other counterparties, identified either individually or by group and incorporates this information into its credit risk controls.

Where available at reasonable cost, external credit ratings and/or reports on customers and other counterparties are obtained and used. The Group's policy is to deal only with creditworthy counterparties.

The Group's management considers that all the above financial assets that are not impaired for each of the reporting dates under review are of good credit quality, including those that are past due.

None of the Group's financial assets are secured by collateral or other credit enhancements.

In respect of trade and other receivables, the Group is not exposed to any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics. The credit risk for liquid funds and other short-term financial assets is considered negligible, since the counterparties are reputable banks with high quality external credit ratings.

26. Liquidity risk analysis

Prudent liquidity risk management includes maintaining sufficient cash and the availability of funding from an adequate amount of committed credit facilities. The Group maintains cash to meet its liquidity requirements.

The Group manages its liquidity needs by carefully monitoring scheduled debt servicing payments for long-term financial liabilities as well as cash-outflows due in day-to-day business. Liquidity needs are monitored in various time bands, on a day-to-day and week-to-week basis, as well as on the basis of a rolling 30-day projection. Long-term liquidity needs for a 180-day and a 360-day lookout period are identified monthly.

As at 31 December 2010, the Group's liabilities have contractual maturities which are summarised below:

	Within 6 months £'000	6 to 12 months £'000	1 to 5 years £'000
Trade payables	186	–	–
Other short term financial liabilities	50	–	–
Borrowings and embedded derivatives on convertible loans	–	–	6,680

This compares to the maturity of the Group's financial liabilities in the previous reporting period as follows:

	Within 6 months £'000	6 to 12 months £'000	1 to 5 years £'000
Trade payables	809	–	–
Other short term financial liabilities	83	–	–
Borrowings and embedded derivatives on convertible loans	–	–	3,430

The above contractual maturities reflect the gross cash flows, which may differ to the carrying values of the liabilities at the balance sheet date. Borrowings and embedded derivatives on convertible loans have been combined as they relate to the same instruments. Contractual maturities have been assumed based on the assumption that the lender does not convert the loans into equity before the repayment date.

27. Financial Instruments

The assets of the Group and Company are categorised as follows:

As at 31 December 2010	Group			Company		
	Loans and receivables	Non-financial assets / financial assets not in scope of IAS 39	Total	Loans and receivables	Non-financial assets / financial assets not in scope of IAS 39	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Intangible assets	–	247	247	–	–	–
Property, plant and equipment	–	647	647	–	–	–
Investment in subsidiary	–	–	–	–	6,597	6,597
Inventories	–	131	131	–	–	–
Trade and other receivables	575	19	594	1	12	13
Cash and cash equivalents	268	–	268	3	–	3
	843	1,044	1,887	4	6,609	6,613

As at 31 December 2009	Group			Company		
	Loans and receivables	Non-financial assets / financial assets not in scope of IAS 39	Total	Loans and receivables	Non-financial assets / financial assets not in scope of IAS 39	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Intangible assets	–	759	759	–	–	–
Property, plant and equipment	–	793	793	–	–	–
Investment in subsidiary	–	–	–	–	4,012	4,012
Inventories	–	105	105	–	–	–
Trade and other receivables	224	42	266	3	13	16
Cash and cash equivalents	187	–	187	1	–	1
	411	1,699	2,110	4	4,025	4,029

The liabilities of the Group and Company are categorised as follows:

As at 31 December 2010	Group				Company			
	Financial liabilities at amortised cost	Financial liabilities valued at fair value through profit and loss	Liabilities not within the scope of IAS 39	Total	Financial liabilities at amortised cost	Financial liabilities valued at fair value through profit and loss	Liabilities not within the scope of IAS 39	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Trade and other payables	236	–	201	437	12	–	31	43
Borrowings	6,380	–	–	6,380	6,380	–	–	6,380
Embedded derivatives on convertible loans	–	5,669	–	5,669	–	5,669	–	5,669
	6,616	5,669	201	12,486	6,392	5,669	31	12,092

Note: all financial liabilities valued at fair value through profit and loss were designated as such on initial recognition.

As at 31 December 2009	Group				Company			
	Financial liabilities at amortised cost	Financial liabilities valued at fair value through profit and loss	Liabilities not within the scope of IAS 39	Total	Financial liabilities at amortised cost	Financial liabilities valued at fair value through profit and loss	Liabilities not within the scope of IAS 39	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Trade and other payables	891	–	538	1,429	6	–	29	35
Borrowings	2,832	–	–	2,832	2,832	–	–	2,832
Embedded derivatives on convertible loans	–	477	–	477	–	477	–	477
	3,723	477	538	4,738	2,838	477	29	3,344

Financial liabilities measured at fair value based on level 3.

28. Financial liabilities measured at fair value based on Level 3

	Fair value measurement at the end of the reporting period	
	Financial liabilities at fair value through profit or loss	Total
	Embedded derivatives	
	£'000	£'000
Opening balance at 1 January 2009	–	–
Issues	(530)	(530)
Total gains or losses		
– in profit or loss	53	53
– in other comprehensive income	–	–
Closing balance at 31 December 2009	(477)	(477)
Total gains for the period included in profit or loss for liabilities held at the end of the reporting period	53	53
Opening balance at 1 January 2010	(477)	(477)
Issues	(7,651)	(7,651)
Total gains or losses		
– in profit or loss	1,818	1,818
– in other comprehensive income	–	–
Settlements	641	641
Closing balance at 31 December 2010	(5,669)	(5,669)
Total gains or losses for the period included in profit or loss for liabilities held at the end of the reporting period	1,818	1,818

Gains or losses included in profit or loss for the periods (above) are presented in fair value gains on embedded derivatives within the income statement.

29. Market risk

The Group is exposed to market risk in assessing the fair value of the embedded derivatives. The sensitivity of the embedded derivative to changes in the market price of the Company's share price over the year would lead to a range of values between £5,639,000 and £9,280,000. This sensitivity assumes a +/- 36.9% change in the Company's quoted share price for the year ended at 31 December 2010.

The directors of the Company consider that all the proposals to be considered at the annual general meeting details of which appear below are in the best interests of the Company and its members as a whole. The directors unanimously recommend that you vote in favour of all the proposed resolutions as they intend to do in respect of their own beneficial holdings.

Notice is hereby given that the annual general meeting of Proton Power Systems plc (the "Company") will be held at the offices of Arbuthnot Securities, Arbuthnot House, 20 Ropemaker Street, London, EC27 9AR at 12:00 noon on 28 June 2011 to consider and, if thought fit, pass the following resolutions as ordinary resolutions other than resolution 9 which will be proposed as a special resolution:-

ORDINARY RESOLUTIONS

1. To receive the accounts for the financial year ended 31 December 2010 together with the directors' report, and the auditors' report.
2. To re-elect John Wall as a director of the Company.
3. To re-elect Tomas Melczer as a director of the Company.
4. To re-elect Achim Loecher as a director of the Company.
5. To re-elect Helmut Gierse as a director of the Company.
6. To re-appoint Grant Thornton UK LLP as the auditors of the Company.
7. To authorise the directors to agree the remuneration of the auditors of the Company.
8. That the directors be generally and unconditionally authorised for the purpose of section 551 of the Companies Act 2006 to exercise all the powers of the Company to allot or grant rights to subscribe for or to convert any security into shares in the Company up to an aggregate nominal amount of £4,750,000, provided that:-

   8.1 (except as provided in paragraph 8.2 below) this authority shall expire on the date of the next annual general meeting of the Company; and

   8.2 the Company may before such expiry make an offer or agreement which would or might require shares or equity securities, as the case may be, to be allotted or such rights granted after such expiry and the directors may allot shares or equity securities or grant such rights, as the case may be, in pursuance of such offer or agreement notwithstanding that the authority conferred by this resolution has expired.

   All unexercised authorities previously granted to the directors to allot shares or to grant rights to subscribe for or to convert any security into shares be and are hereby revoked but such revocation shall not have retrospective effect.

SPECIAL RESOLUTION

9. That, subject to the passing of resolution 8 above, the directors, pursuant to the general authority conferred on them be empowered pursuant to section 570 of the Companies Act 2006 (the "Act") to allot for cash, either pursuant to the authority so conferred or where the equity securities are held by the Company as treasury shares (within the meaning of section 724(5) of the Act), to allot equity securities (within the meaning of section 560 of the Act) as if section 561 of the Act did not apply to any such allotment provided that this power shall be limited to the allotment of equity securities:-

9.1 made in connection with an offer of securities, open for acceptance for a fixed period, by the directors to ordinary shareholders of the Company on the register on a fixed record date in proportion (as nearly as may be) to their then holdings of such shares (but subject to such exclusions or other arrangements as the directors may deem necessary or expedient to deal with treasury shares or any legal or practical problems under the laws or requirements of any recognised regulatory body or any stock exchange in any overseas territory or in connection with fractional entitlements) or by virtue of shares being represented by depositary receipts or any other matter whatsoever; and/or

9.2 wholly for cash (otherwise than pursuant to paragraph 9.1 above) up to an aggregate nominal value of £4,750,000 (being 97.5% of the issued share capital of the Company on 2 June 2011);

9.3 and shall expire on the conclusion of the next annual general meeting of the Company or, if earlier, fifteen months after the passing of this resolution but the Company may before such expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities pursuant to such an offer or agreement notwithstanding that the power conferred by this resolution has expired.

2 June 2011
By order of the board

John Wall
Chairman

Registered office:-
St Ann's Wharf
112 Quayside
Newcastle Upon Tyne
NE1 3DX
Registered in England and Wales No. 5700614

Notes

The following notes explain your general rights as a shareholder of the Company and your right to attend and vote at this meeting or to appoint someone else to vote on your behalf.

1. Only those members registered in the Register of Members of the Company as at 6.00pm on 26 June 2011 shall be entitled to attend and vote at the meeting convened above in respect of the number of shares registered in their names at that time. This time will still apply for the purpose of determining who is entitled to attend and vote if the annual general meeting is adjourned from its scheduled time by 48 hours or less. If the annual general meeting is adjourned for longer, members who wish to attend and vote must be on the Company's register of members by 48 hours before the time fixed for the adjourned meeting. Changes to entries on the register of members after that time will be disregarded in determining the rights of any person to attend or vote at the meeting.

2. A member entitled to attend and vote at the meeting convened by the above notice is entitled to appoint another person as his proxy to exercise all or any of his rights to attend and to speak and vote at a meeting of the Company. On a poll demanded, all of a member's voting rights may be exercised by one or more duly appointed proxies. Any such member may appoint more than one proxy provided that each proxy is appointed to exercise the rights attached to a different share or shares held by such member. You may not appoint more than one proxy to exercise

rights attached to any one share. To appoint more than one proxy, please contact the Company's Registrars: Neville Registrars Limited, Neville House, 18 Laurel Lane, Halesowen, West Midlands, B63 3DA. A proxy need not be a member of the Company. Appointing a proxy will not prevent a member from attending in person and voting at the meeting. If you wish your proxy to speak on your behalf at the meeting you will need to appoint your own choice of proxy (not the Chairman of the meeting) and give your instructions directly to them. A proxy must vote in accordance with any instructions given by the appointing member.

3. A form of appointment of proxy is enclosed. To appoint a proxy using this form in hard copy form, this form must be completed and signed, sent or delivered to Neville Registrars Limited at Neville House, 18 Laurel Lane, Halesowen, West Midlands, B63 3DA. In the case of a member which is a company, the proxy form must be executed under its common seal or signed on its behalf by an officer of the company or an attorney of the company. If you return more than one proxy appointment, either by hard copy form or by electronic form, that received last by the registrar before the latest time for the receipt of proxies will take precedence.

4. The form of proxy includes a vote withheld option. Please note that a vote withheld is not a vote in law and will not be counted in the calculation of the proportion of the votes for and against any particular resolution.

5. The appointment of a proxy and the original or duly certified copy of the power of attorney or other authority (if any) under which it is signed or authenticated should be deposited with Neville Registrars Limited at the address shown on the proxy form not later than 12:00 noon on 26 June 2011 or 48 hours before the time for holding any adjourned meeting or in the case of a poll not taken on the same day as the meeting or adjourned meeting for the taking of the poll at which it is to be used.

6. CREST members who wish to appoint a proxy or proxies by utilising the CREST electronic proxy appointment service may do so for the annual general meeting to be held on 28 June 2011 and any adjournment(s) of that meeting by utilising the procedures described in the CREST Manual. CREST personal members or other CREST sponsored members and those CREST members who have appointed a voting 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.

7. In order for a proxy appointment made by means of CREST to be valid, the appropriate CREST message (a "CREST Proxy Instruction") must be properly authenticated in accordance with Euroclear UK & Ireland Limited's (EUI) specifications and must contain the information required for such instructions, as described in the CREST Manual. The message, regardless of whether it constitutes the appointment of a proxy or 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 7RA11) by the latest time(s) for receipt of proxy appointments specified in this notice. 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 Applications 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.

8. CREST members and, where applicable, their CREST sponsors or voting service providers should note that EUI does not make available special procedures in CREST for any particular messages. 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(s), 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 service providers are referred, in particular, to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.

9. 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.

10. In the case of joint holders of shares, where more than one of the joint holders purports to appoint a proxy, only the appointment submitted by the most senior holder will be accepted. Seniority is determined by the order in which the names of the joint holders appear in the Company's register of members in respect of the joint holding (the first named being the most senior).

Explanatory Notes on the Resolutions

Resolution 1 : Report and Accounts

The Directors must present their report and the annual accounts to the meeting. This gives shareholders the opportunity to ask questions on the content before voting on the resolution.

Resolution 2-5: Directors

The Company's Articles of Association require re-election of Directors (other than those appointed as permanent board members in accordance with Article 22.9) to retire and submit themselves for election at each AGM following their appointment. John Wall, Thomas Melczer, Achim Loecher, and Helmut Gierse must, therefore, all retire and submit themselves to re-election at this AGM.

Resolution 6: Appointment of Auditors

An ordinary resolution will be proposed to re-appoint Grant Thornton UK LLP as the Company's auditors to hold office from the conclusion of the annual general meeting until the conclusion of the next general meeting at which accounts are laid before the Company.

Resolution 7: Remuneration of the Auditors

An ordinary resolution will be proposed to authorise the Directors to determine the remuneration payable to the auditors.

Resolution 8: Directors' Authority to Allot Shares

This Resolution seeks shareholder approval for the directors to be authorised to allot shares. Under the provisions of section 551 of the Companies Act 2006, the directors are not permitted to allot shares unless authorised to do so by the shareholders. This Act provides for such authority to be granted either by the Company in general meeting or by the Articles of Association and in both cases such authority must be renewed every five years. At the previous annual general meeting of the Company held on 22 June 2010, the directors were given authority to allot ordinary shares in the capital of the Company up to a maximum nominal amount of £4,750,000, representing approximately 97.95% of the Company's then issued ordinary share capital. This authority expires at the end of this year's annual general meeting.

This power will last until the conclusion of the next annual general meeting of the Company in 2012. The directors have no present intention of exercising this authority.

Resolution 9: Directors' Power to Disapply Pre-emption Rights

This resolution, which will be proposed as a special resolution, supplements the directors' authority to allot shares in the Company proposed by resolution 8.

Section 561 of the Companies Act 2006 requires a company proposing to allot equity securities (which includes selling shares held in treasury) to offer them first to existing shareholders in proportion to their existing shareholdings. Equity securities includes ordinary shares but does not include shares issued under employee share schemes. If resolution 9 is passed, the requirement imposed by section 561 will not apply to allotments by the directors in two cases:-

1. in connection with a rights (or similar) issue, where strict application of the principle in section 561 could (for example) either result in fractional entitlements to shares arising

or require the issue of shares where this would be impractical because of local, legal or regulatory requirements in any given overseas jurisdiction; and

2. allotments of shares for cash up to a total nominal value of £4,750,00. This gives the directors flexibility to take advantage of business opportunities as they arise.

To comply with recent guidelines, this authority will expire at the conclusion of the next annual general meeting or, if earlier, on 27 September 2012.

FORM OF PROXY

PROTON POWER SYSTEMS PLC – ANNUAL GENERAL MEETING

To be held at: 12.00 noon Tuesday 28 June 2011 at Arbuthnot Securities Limited, Arbuthnot House, 20 Ropemaker Street, London EC2Y 9AR

I/We, the undersigned

of

being a holder(s) of ordinary shares of 1p each in Proton Power Systems plc (the "Company") hereby appoint the Chairman of the meeting or (see note 1)

as my/our proxy to vote for me/us on my/our behalf at the Annual General Meeting of the Company to be held at 12.00 noon Tuesday 28 June 2011 at Arbuthnot Securities Limited, Arbuthnot House, 20 Ropemaker Street, London EC2Y 9AR and at any adjournment thereof.

I/We instruct my/our said proxy to vote as follows:

Please indicate with an 'X' in the appropriate box how you wish your vote to be cast. If no indication is given, your proxy will be deemed to have the authority to vote or to abstain at his/her discretion on the resolutions below and on any other business transacted at the meeting.

Signature(s) Date 2011

Ordinary Resolutions	**For**	**Against**	**Vote withheld**
1. To receive and adopt the accounts for the financial year ended 31 December 2010 together with the directors' report, and the auditor's report on those accounts.			
2. To re-elect John Wall who retires in accordance with the Company's articles of association as a director of the Company.			
3. To re-elect Tomas Melczer who who retires in accordance with the Company's articles of association as a director of the Company			
4. To re-elect Achim Loecher who retires in accordance with the Company's articles of association as a director of the Company			
5. To re-elect Helmut Grierse who retires in accordance with the Company's articles of association as a director of the Company			
6. To re-appoint Grant Thornton UK LLP as the auditors of the Company.			
7. To authorise the directors to agree the remuneration of the auditors of the Company.			
8. To authorise the directors in accordance with section 551 of the Companies Act 2006 to allot relevant securities.			
Special Resolutions			
9. To disapply the statutory pre-emption rights contained in section 561 of the Companies Act 2006 in respect of the equity securities to be allotted persuant to this authority given to the directors in accordance with section 570 of the Companies Act 2006.			

Notes:

1. A member may appoint one or more proxies of his/her own choice. Delete the words "the Chairman of the meeting or", insert your own choice in the space provided and initial the amendment.
2. When two or more valid but differing forms of proxy are delivered for the same share, the one which is last validly delivered (regardless of its date) shall be treated as replacing and revoking the other or others as regards that share. Deposit of a form of proxy does not prevent a member attending and voting in person at the meeting or an adjournment of the meeting or on a poll. A proxy need not be a member of the Company.
3. In the case of joint holders, the signature of any one of them will suffice, but the names of all joint holders should be shown and the vote of the person whose name stands first in the register who tenders a vote whether in person or by proxy shall be accepted to the exclusion of all votes of the other joint holders.
4. In the case of a corporation, this form of proxy shall be executed under its seal or under the hand of its duly authorised attorney or officer or other person authorised to sign.
5. To be effective this form of proxy, and unless previously registered with the Company, the authority or power of attorney (if any) under which it is signed or a notarially certified copy thereof must be lodged with the Company's registrar at Neville Registrars Limited, Neville House, 18 Laurel Lane, Halesowen, West Midlands, B63 3DA, not later than 48 hours before the time appointed for the holding of the meeting or (as the case may be) the adjourned meeting.
6. The Company, pursuant to regulation 41 of the Uncertificated Securities Regulations 2001, specifies that only those members entered on the register of members at 6.00 p.m. on 26 June 2011 shall be entitled to attend or vote at the meeting or, if the meeting is adjourned, close of business on such date being not more than two days prior to the date fixed for the adjourned meeting. Changes to entries on the register after such time shall be disregarded in determining the rights of any person to attend or vote at the meeting.

Second Fold

Business Reply
Licence Number
BM3865

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Neville Registrars Limited
Neville House,
18 Laurel Lane
Halesowen
West Midlands
B63 3BR

First Fold

Third Fold (Tuck in)









THE ZERO EMISSION SOLUTION



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