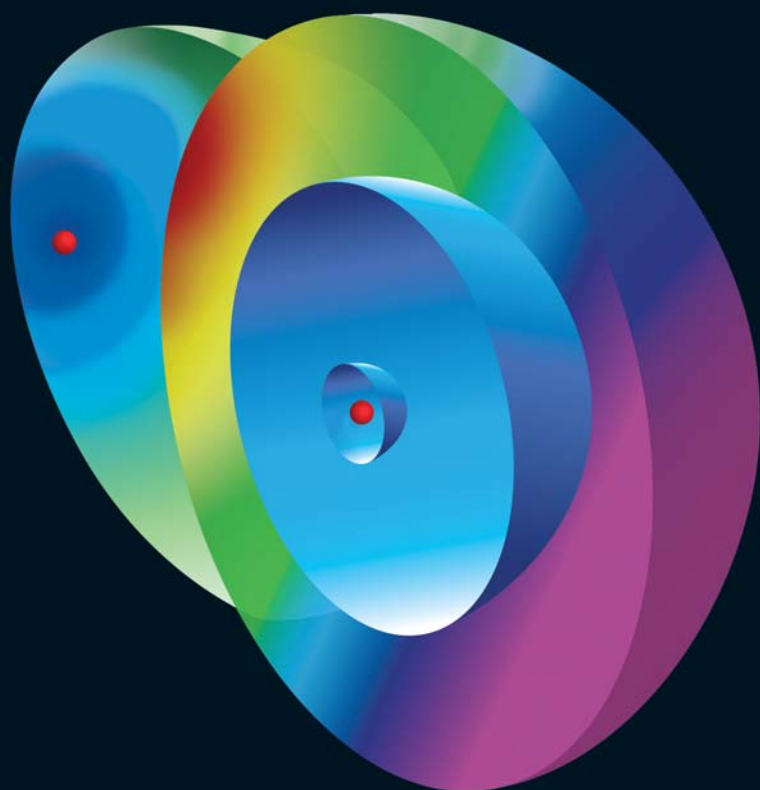


# Mid-States PLC

Annual report and accounts 2006



The front cover illustration is a graphic representation of a hydroxyl radical (a single hydrogen atom bound to a single oxygen atom, with an unpaired electron in the outer shell) important in certain of the Group's technologies.

# Mid-States PLC

Report and accounts 18 months to 30 June 2006

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## Chairman's statement

I am pleased to report to you on both the Company's acquisition of Inov8 Technologies Ltd and Moving Sun Ltd, (together "Inov8") and the financial results of the Company prior to the acquisitions, for the eighteen month period to 30 June 2006.

### Acquisition of Inov8

At the Extraordinary General Meeting held on 5 September 2006 shareholders approved the acquisition of Inov8 as detailed in the circular to shareholders dated 14 August 2006. The acquisition which completed on 5 October 2006 brought together Mid-States' corporate infrastructure and balance sheet, Moving Sun's ground breaking air disinfection technology and Inov8 Technologies' management, engineering and systems testing business.

### Inov8 business

The acquisition created a leading environmental technology group founded on proven expertise in atmospheric chemistry. Its technologies target global concerns and interest in clean air and an improved environment. Inov8 has a suite of sophisticated current, soon to be launched, and in-development products. It has established revenues and is well placed to take advantage of significant growth opportunities in its international commercial and retail markets.

Inov8 is a global leader in fuel system testing technology and the provision of equipment directed toward meeting emission requirements and increasing fuel efficiency. Its customers include manufacturers such as Ford, Renault and Volkswagen as well as tier one suppliers including Siemens, Delphi, Denso and Keihin. The Group is well positioned to take advantage of the demand in these markets that will be generated by the increasingly stringent EU and US emission regulations.

As well as new fuel system testing equipment, the Group is planning to launch a ground breaking air disinfection technology. This has been developed over the past several years by David Macdonald, the Group's new Chief Scientific Officer, based on research conducted by both David and Professor Derek Elwood, a consultant to the Group. It replicates, indoors, the natural pathogen control which exists in the atmosphere.

In open air, the harmful effects of pathogens are proven to be eliminated by naturally occurring hydroxyl radicals (a graphic representation of a hydroxyl radical is shown on the front cover of this annual report). The Group's technology, in the form of an air disinfection device, generates a continuous cascade of hydroxyl radicals indoors, reproducing the same effect as occurs naturally outdoors. The device has been tested at Porton Down and is scientifically proven to be effective in killing pathogens, including MRSA, E. coli and C. diff in an enclosed environment. It is suitable for both commercial and domestic use and target markets include hospitals, care homes, hotels, offices, as well as retail customers.

The enlarged Group provides the necessary infrastructure to support the volume production of the air disinfection products as well as development of the existing Inov8 business.

### Structure of acquisitions and move to AIM

Inov8 Technologies Limited and Moving Sun Limited were acquired by the Group in exchange for issuing shares in Mid-States. The sellers now own 29.99% of the enlarged share capital of the Group. The two individual sellers have joined the Company, Michael Heath as Managing Director and David Macdonald as Chief Scientific Officer. The cash held at completion by Mid-States, approximately £6.5 million after transaction expenses, provides working capital for the Group.

In conjunction with the acquisition, the Company moved from being listed on the Official List of the London Stock Exchange to being quoted on the Alternative Investment Market of the London Stock Exchange (AIM). The board believes that this is appropriate in order to take advantage of the simplified ongoing administration and lower costs of trading which are more appropriate for a company of Mid-States' size at its stage of development. In the longer term, it will also provide greater flexibility to pursue growth objectives with regard to any corporate transactions. Shareholders can continue to trade shares on the market as before.

## Chairman's statement

continued

### Board and management changes

As noted previously, Michael Heath has been appointed Managing Director of the enlarged Group. Mike, who has over 25 years of business experience, has been a director of Inov8 since 2004. As well as his experience in the UK, Mike has significant experience in China, which is expected to be an important trading location for the Group.

David Macdonald has been appointed Chief Scientific Officer of the enlarged Group. David has a broad career in senior business management positions in the technology and biotechnology sectors, and as a scientist. As well as in the UK, he has extensive experience of working in the US, which is also expected to be a significant market for the Group's products.

I would like to welcome Mike, David and all the management and staff of Inov8 to the Group.

As indicated in the circular to shareholders dated 14 August, Roger McCabe stepped down from the Board as a non-executive director on completion of the acquisition. Roger had been a director of the Company since 1998 and served as its Chief Executive from then until the disposal of the Group's former operations in October 2001. Roger leaves the Board with our gratitude for his services to the Company and best wishes for the future.

### Results for the period to 30 June 2006

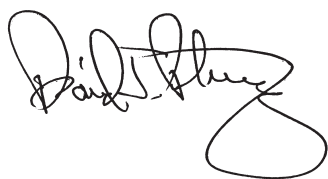
Following the change in the Company's year end, the period being reported upon commenced on 1 January 2005 and ended on 30 June 2006.

The Group did not trade during the period. Net interest on the Group's cash balances during this period totalled £512,000 and expenses incurred totalled £417,000, which included certain expenses associated with the acquisition of Inov8. The Group made a profit after tax of £95,000 in the period.

### The future

The next twelve months will be a key period in the Company's development. It will bring challenges as well as exciting opportunities. We are optimistic about the results that the Company will achieve and believe these should become evident during the course of 2007.

Finally, I would like to thank shareholders for their support during the search for an appropriate transaction for the Company and in the acquisition of Inov8.



David J. Plucinsky  
*Chairman*

## Directors' report

The directors have pleasure in submitting their annual report together with the audited accounts for the 18 months ended 30 June 2006.

### Activities

The Company did not actively trade during the period being reported upon. A review of operations during the period and the prospects of the Company are contained in the Chairman's statement on pages 2 and 3.

### Change of year end

Following the change in the Company's year end, the period being reported upon commenced on 1 January 2005 and ended on 30 June 2006.

### Results and transfer to reserves

The results for the period are set out in the profit and loss account. The profit on ordinary activities after taxation was £95,000 (2004: £89,000).

### Dividends

The directors are not recommending payment of a dividend (2004: £nil).

### Post balance sheet event

On 5 October 2006, Mid-States completed the acquisition of Inov8 Technologies Limited and Moving Sun Limited, (together "Inov8"), following approval by shareholders at the Extraordinary General Meeting on 6 September 2006. In conjunction with the above acquisition the Company moved from being listed on the Official List of the London Stock Exchange to being quoted on the Alternative Investment Market (AIM) and is now subject to the reporting requirements of AIM.

Further details of this acquisition appear in the Chairman's statement on pages 2 and 3 and in note 16 on page 21 of the accounts.

### Substantial interests

At the date of this report the Company has been notified of the following substantial interests in the shares of the Company:

	No. of shares	%
David Macdonald	17,928,288	23.99
North Atlantic Smaller Companies Investment Trust PLC <sup>(1)</sup>	12,000,000	16.06
Bottin (International) Investments Ltd	9,915,000	13.27
Fidelity Special Situations & Values Trust	4,985,782	9.53
Michael Heath	4,482,072	6.00
Starlight Investments Ltd	4,388,463	5.87
Sun Life Assurance Company of Canada (UK) Ltd <sup>(2)</sup>	2,742,536	3.67
North Atlantic Value LLP <sup>(1)</sup>	2,500,000	3.35

<sup>(1)</sup> These shareholders have notified the Company that along with one other party, they are parties to an agreement for the purposes of section 204 of Companies Act 1985 and are therefore to be treated as interested in the shares held by all other parties to that agreement. The combined holdings of the parties to that agreement are 14,800,000 ordinary shares, or 19.81% of the issued enlarged share capital following the acquisition of Inov8.

<sup>(2)</sup> Credit Suisse Asset Management Ltd have an interest in 4,534,336 shares in the Company, in their capacity as discretionary investment manager, and the 2,742,536 shares of Sun Life Assurance Company of Canada (UK) Ltd form part of that holding.

## Directors' report

continued

### Directors and their interests

The directors who held office during the period were: David J. Plucinsky (Chairman), John G. Bateson, Paul G. Dumond, The Hon. William D. Eberle, Roger J. McCabe and Christopher H. B. Mills. Roger J. McCabe resigned as a director on 5 October 2006.

In accordance with the Articles of Association, Paul G. Dumond and The Hon. William D. Eberle retire by rotation and being eligible offer themselves for re-appointment at the forthcoming Annual General Meeting. Michael Heath was appointed a director on 5 October 2006 and, having been appointed a director since the last Annual General Meeting, retires and is being proposed for re-appointment at the forthcoming Annual General Meeting. Biographical notes about the directors are set out on page 22.

The directors' interests in shares of the Company are shown below.

The directors who held office at the period end had beneficial interests in the Company's share capital as set out below.

	<b>Ordinary Shares of 1p each At 30 June 2006</b>	Ordinary Shares of 1p each At 31 December 2004
D. J. Plucinsky	–	–
R. J. McCabe (resigned 5 October 2006)	<b>180,000</b>	180,000
J. G. Bateson	–	–
P. G. Dumond	<b>60,529</b>	60,529
W. D. Eberle	<b>74,000</b>	74,000
C. H. B. Mills	<b>470,430</b>	470,430

At the date of this report there have been no changes in the holdings shown above. Michael Heath, who was appointed to the board on 5 October 2006, has a beneficial interest in 4,482,072 shares.

Aggregate emoluments disclosed in Note 4 do not include any amounts for the value of options to subscribe for ordinary shares in the Company granted to the directors. Details of the options are as follows:

	1 January 2005	30 June 2006	Date of grant	Date of expiry	Pre variation Exercise price	Post variation Exercise price <sup>(1)</sup>
D. J. Plucinsky	200,000	200,000	27 Aug, 1998	27 Aug, 2008	21.5p	11.2p
	150,000	150,000	8 Dec, 1998	8 Dec, 2008	23.5p	13.2p
	150,000	150,000	8 Dec, 1998	8 Dec, 2008	23.5p	13.2p
	200,000	200,000	1 Oct, 2001	1 Oct, 2011	19p	8.7p
R. J. McCabe	375,000	375,000	1 Dec, 1998	1 Dec, 2008	23p	12.7p
	375,000	375,000	1 Dec, 1998	1 Dec, 2008	23p	12.7p
W. D. Eberle	100,000	100,000	1 Oct, 2001	1 Oct, 2011	19p	8.7p

<sup>(1)</sup> The exercise prices were reduced by approximately 10.3p from the original price when issued, in accordance with the resolutions approved by the shareholders at the Extraordinary General Meeting on 1 April 2003. These provided that the option exercise prices to be reduced by the capital amount per share returned to shareholders under the capital reduction effected on 15 May 2003. See Note 12, Called Up Share Capital, for further details.

All options before 2000 were granted under the Company's US Stock Option Plan and all in 2001 under the Company's 1999 Stock Option Plan. All options are currently exercisable. Performance criteria on the above options are all historic and no longer apply since the disposal of former US operations.

## Directors' report

continued

### Supplier payment policy

It is Mid-States PLC's policy to endeavour to pay its suppliers on the terms agreed with them.

As the Company is a holding company it has no significant trade creditors and accordingly no disclosure is made of the period end creditor days.

### Derivatives, other financial instruments and financial risks

The Group's financial instruments comprise cash and items such as sundry debtors and creditors. The Group does not enter into or trade in financial instruments. The financial risks faced by the Group during the period primarily relate to the cash balances which are held on short-term deposit at interest rates available at the time of placing on the money market. The money market rates are ultimately dependent upon the Bank of England's base rate. Fluctuations in interest rates are limited largely to the movement and expected movement in the Bank of England's base rate as reflected in the money market.

### Auditors

A resolution to re-appoint RSM Robson Rhodes LLP as auditors will be proposed at the forthcoming Annual General Meeting.

Masters House  
107 Hammersmith Road  
London W14 0QH  
7 November 2006

By Order of the Board

Anthony G. Hunter  
*Secretary*

## Corporate governance

### DIRECTORS' STATEMENT ON CORPORATE GOVERNANCE MATTERS

As an AIM listed company Mid-States PLC is not required to comply with the corporate governance principles contained in the Combined Code, however the Company has regard to those principles and its activities in the area of corporate governance are discussed below.

#### Statement of compliance with the Code of Best Practice

The Company has complied throughout the period being reported upon with the Provisions of the Code of Best Practice set out in section 1 of the Combined Code except as noted or explained below. The level of compliance considered appropriate by the board has taken account of the Company during the period being a cash shell without any business operations, and the requirement to keep expenses to a minimum. As a result of having no executive directors throughout the period, Combined Code Provisions B1.1, B1.2, B1.5 and B1.6, which relate to executive director remuneration and service contracts, have not been applicable to the Company. In addition, as explained further below under 'Directors', the Company has not recognised a senior independent non-executive director as required by Provision A3.3 of the Combined Code, and has decided to defer consideration of putting in place formal terms of reference for its nominations committee until such time as an acquisition of a new business has taken place. The Combined Code requires directors, at least annually, to conduct a review of the effectiveness of the Group's system of internal control. The board has conducted such a review. Further details of the Group's system of internal control during the period are given below.

#### Statement about applying the Principles of Good Governance

The Company applied the Principles of Good Governance set out in section 1 of the Combined Code by complying with the Code of Best Practice as reported above to the extent considered appropriate for a Company of this size and nature. Further explanation of how the Principles were applied is set out below.

#### Directors

The board of directors meets at regular intervals when matters which have been specifically reserved to the board are considered. Matters reserved to the board include the approval of interim and final financial statements, significant financial commitments including substantial external costs associated with evaluating identified investment opportunities, appointments to the board and its committees, the Company's future strategy and the Company's internal controls. During the period being reported upon, the day to day running of the Company and the initial assessment of potential investment opportunities were carried out by the chairman, together with the company secretary, and one or more of the other directors where considered appropriate.

During the period, six meetings of the board and two meetings of the audit committee were held. All directors attended each meeting except those of a procedural nature or where certain directors were unable to attend. No formal meetings of the remuneration and nominations committees were held during the period. However, members of the remuneration committee did meet informally during this period.

As the Company was a cash shell during the period being reported upon the performance of the board, committees and directors were evaluated informally amongst the directors, rather than through a formal evaluation process.

Directors have direct access to the Company's advisers and also the company secretary who is responsible to the board for ensuring that board procedures are followed and that applicable rules and regulations are complied with. The removal of a company secretary is a matter to be decided upon by the board as a whole in terms of the Company's Articles of Association. Although there is no formal training procedure for newly-appointed directors as envisaged by the code, they have direct access to qualified advisers who are able to advise on the necessary requirements for a member of the board of a listed company.

During the period being reported upon, the board comprised the chairman and five non-executive directors. All of the non-executive directors are considered to have been independent and free from material conflicts of judgement. Three directors held options in the Company and the board is satisfied that these did not form material conflicts of judgement to those directors in the current context of the Company. The board does not recognise a senior independent director and believes this to be appropriate in view of the already strong independent representation on the board.

## Corporate governance

continued

Non-executive directors are not appointed for specific terms and instead retire by rotation under the Company's Articles of Association and in accordance with the Combined Code and their appointments are otherwise terminable, by all the other directors, at will. The board believes this provides sufficient flexibility at present.

Information, including that shown in the following section on internal control, is supplied to the board in a timely and appropriate fashion.

The board has a remuneration committee and its members during the period were C.H.B. Mills (Chairman), J.G. Bateson, P.G. Dumond and W.D. Eberle. None of the Committee has any personal financial interest (other than as shareholders), conflicts of interest arising from cross-directorships or day-to-day involvement in running the business. The Committee makes recommendations to the board. No director plays a part in any discussion about his or her own remuneration.

The board has an audit committee which is responsible for making recommendations to the board on the annual financial statements, the appointment of auditors and the review of the Company's internal controls.

The board has a nominations committee which has historically been responsible for recommendations for the appointment of new directors to the board.

Members of each of these committees are shown on page 22.

### **Dialogue with institutional shareholders**

The directors seek to build a mutual understanding of objectives between the Company and its institutional shareholders by discussing long-term issues with, and obtaining feedback from, such shareholders, communicating regularly during the period and issuing regular trading updates.

### **Internal control**

The board of directors has overall responsibility for ensuring that the Group maintains a system of internal control to provide them with reasonable assurance regarding the reliability of financial information used within the business and for publication and that assets are safeguarded. The board is also responsible for reviewing the effectiveness of the Group's system of internal control. The directors review the effectiveness of the system of internal control at least annually.

There are inherent limitations in any system of internal control and the Group's system, which is designed to manage rather than eliminate the risk of failure to achieve business objectives, can provide only reasonable, and not absolute, assurance against material misstatement or loss. The Group's system of internal control during the period being reported upon includes an ongoing process for identifying, evaluating and managing the significant risks faced by the Group and was in place for the period under review. The directors are responsible for identifying, evaluating and managing business risks. Significant identified risks are reviewed and considered by the board or a committee of the board. This process accords with the Internal Control Guidance for Directors on the Combined Code having regard to the nature of the Group and has been in place throughout the period under review and up to the date of approval of the annual report.

The board has considered it inappropriate to establish an internal audit function given the nature of its activities in the period.

### **Auditors**

The audit committee reviews the scope and results of the external audit and its cost-effectiveness and the objectivity of the auditors. The analysis between audit and non-audit fees in the period under review is shown in note 2 to the financial statements. Non-audit fees, which include due diligence and corporate finance, tax compliance and tax advisory work, are considered not to affect the independence or objectivity of the auditors.

### **Going concern**

After making enquiries, the directors have a reasonable expectation that the Company and Group have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

## Statement of directors' responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Generally Accepted Accounting Practice.

Company law requires the directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the Company and Group and of the profit or loss of the Group for that period. In preparing those accounts, the directors are required to:

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

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and Group and enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

## Independent auditors' report

### To the shareholders of Mid-States PLC

We have audited the financial statements on pages 11 to 21. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's shareholders, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's shareholders those matters we are required to state to them in an auditors' 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 shareholders as a body, for our audit work, for this report, or for the opinions we have formed.

### Respective responsibilities of directors and auditors

As described in the Statement of Directors' Responsibilities the company's directors are responsible for the preparation of the financial statements in accordance with applicable law and United Kingdom Accounting Standards.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the Company and other members of the Group is not disclosed.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Chairman's Statement, Directors' Report, the Corporate Governance Statement and the Statement of Directors' Responsibilities. We consider the implication for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

### Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

### Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 30 June 2006 and of the Group's profit for the 18 months then ended; and
- the financial statements have been properly prepared in accordance with the Companies Act 1985.

RSM Robson Rhodes LLP  
Chartered Accountants and Registered Auditors  
London, England  
7 November 2006

## Group profit and loss account

For the 18 months ended 30 June 2006

	Notes	18 months to 30 June 2006 £000	12 months to 31 December 2004 £000
<b>Administrative expense</b>		<b>(417)</b>	(235)
<b>Operating (loss) from continuing operations</b>	2	<b>(417)</b>	(235)
Net interest receivable	5	<b>512</b>	324
Profit on ordinary activities before taxation		<b>95</b>	89
Taxation	6	–	–
<b>Profit on ordinary activities after taxation</b>		<b>95</b>	89
<b>Profit for the period</b>		<b>95</b>	89
<b>Earnings per share:</b>			
<b>Basic earnings per share</b>	7	<b>0.18p</b>	0.17p
Diluted earnings per share	7	<b>0.17p</b>	0.16p

There are no recognised gains or losses for the period other than the profit and loss shown above.

Movements on reserves are set out in note 13.

The accompanying notes are an integral part of these accounts.

## Group balance sheet

As at 30 June 2006

	Notes	30 June 2006 £000	31 December 2004 £000
<b>Current assets</b>			
Debtors	9	466	61
Cash at bank and in hand		7,669	7,579
		<b>8,135</b>	7,640
<b>Creditors:</b> amounts falling due within one year	10	<b>(476)</b>	(76)
<b>Net assets</b>		<b>7,659</b>	7,564
<b>Capital and reserves</b>			
Called up share capital	12	523	523
Capital redemption reserve	13	253	253
Profit and loss account	13	6,883	6,788
	14	<b>7,659</b>	7,564

As approved by the board of directors on 7 November 2006 and signed on its behalf by:

D. J. Plucinsky  
*Director*

The accompanying notes are an integral part of these accounts.

## Company balance sheet

As at 30 June 2006

	Notes	30 June 2006 £000	31 December 2004 £000
<b>Fixed asset investments</b>	8	<b>3,776</b>	3,776
<b>Current assets</b>			
Debtors	9	<b>466</b>	61
Cash at bank and in hand		<b>7,669</b>	7,579
		<b>8,135</b>	7,640
<b>Creditors:</b> amounts falling due within one year	10	<b>(4,303)</b>	(3,903)
<b>Net current assets</b>		<b>3,832</b>	3,737
<b>Net assets</b>		<b>7,608</b>	7,513
<b>Capital and reserves</b>			
Called up share capital	12	<b>523</b>	523
Capital redemption reserve	13	<b>253</b>	253
Profit and loss account	13	<b>6,832</b>	6,737
		<b>7,608</b>	7,513

As approved by the board of directors on 7 November 2006 and signed on its behalf by:

D. J. Plucinsky  
*Director*

The accompanying notes are an integral part of these accounts.

## Group cash flow statement

For the 18 months ended 30 June 2006

	Notes	18 months to 30 June 2006 £000	12 months to 31 December 2004 £000
<b>Net cash (outflow) from operating activities</b>	15	<b>(465)</b>	(214)
Returns on investments and servicing of finance	15	<b>555</b>	311
Taxation	15	–	(32)
<b>Cash inflow before liquid resources and financing</b>		<b>90</b>	65
Management of liquid resources	15	<b>(119)</b>	(47)
(Decrease)/increase in cash in the period	15	<b>(29)</b>	18

The accompanying notes are an integral part of these accounts.

## Notes to the accounts

### 1. ACCOUNTING POLICIES

The accounts have been prepared under the historical cost convention and in accordance with applicable UK Accounting Standards. The following paragraphs describe the principal policies, all of which have been applied consistently throughout the current and preceding periods.

#### Basis of consolidation

The Group accounts include the accounts of the Company and all of its subsidiary undertakings at any time during the financial period. All Group undertakings changed their year end to 30 June and now make up their accounts to 30 June annually. The results of subsidiary undertakings and businesses acquired during the period are included from the date of acquisition. The results of subsidiary undertakings and businesses disposed of during the period are included to the date of their disposal.

#### Goodwill

Goodwill arising on acquisitions in the year ended 31 December 1997 and earlier periods was written off to reserves in accordance with the accounting standard then in force. As permitted by the current accounting standard the goodwill previously written off to reserves has not been reinstated in the balance sheet.

#### Investments

Fixed asset investments are shown at cost less provision for impairment. Income is included in the accounts in the year in which it is receivable.

#### Deferred taxation

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or a right to pay less or to receive more, tax, with the following exceptions:

Deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which future reversal of the underlying timing differences can be deducted.

Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which the timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

#### Foreign currencies

Foreign currency transactions are converted at the rate of exchange ruling at the date of the transaction or translated at the period end rate in the case of transactions not then finalised. Monetary assets and liabilities denominated in foreign currencies at the year end are expressed in sterling at the rate of exchange ruling at that date. Currency adjustments are included in the profit and loss account.

### 2. OPERATING LOSS

	<b>18 months to 30 June 2006 £000</b>	12 months to 31 December 2004 £000
This is stated after charging/(crediting):		
Auditors' remuneration		
– audit services	<b>8</b>	5
– non-audit services	<b>77</b>	2
Currency translation gains	–	(1)

### 3. EMPLOYEES

The Company and Group did not have any employees at the balance sheet date (2004: nil).

## Notes to the accounts

continued

### 4. DIRECTORS

The emoluments of the directors of the Company comprise the following:

	<b>18 months to 30 June 2006 fees total £000</b>	12 months to 31 December 2004 fees total £000
Name of director		
Non-executive:		
D. J. Plucinsky	<b>85</b>	44
J. G. Bateson	<b>15</b>	10
P. G. Dumond	<b>15</b>	10
W. D. Eberle	<b>15</b>	10
C. H. B. Mills	<b>15</b>	10
R. J. McCabe	<b>15</b>	10
Aggregate emoluments	<b>160</b>	94

The directors of the Company during the period being reported upon were non-executive. The Company does not contribute to any pension schemes or funds on behalf of the directors.

### 5. NET INTEREST RECEIVABLE

	<b>18 months to 30 June 2006 £000</b>	12 months to 31 December 2004 £000
Bank interest receivable	<b>512</b>	325
Interest payable and similar charges	–	(1)
Net interest receivable	<b>512</b>	324

### 6. TAXATION ON PROFIT ON ORDINARY ACTIVITIES

	<b>18 months to 30 June 2006 £000</b>	12 months to 31 December 2004 £000
Profit on ordinary activities before tax	<b>95</b>	89
Profit on ordinary activities before tax multiplied by the standard rate of UK corporation tax 30% (2004: 30%)	<b>29</b>	27
Effects of:		
Utilisation of losses in the period	<b>(29)</b>	(27)
Tax charge in the period	–	–

The Group has tax losses arising in the UK of £3,289,000 (2004: £3,385,000) that are available indefinitely for offset against future taxable profits in those companies in which the losses arose.

## Notes to the accounts

continued

### 6. TAXATION ON PROFIT ON ORDINARY ACTIVITIES

There are unprovided deferred tax assets as follows:

	Group		Company	
	30 June 2006 £000	31 December 2004 £000	30 June 2006 £000	31 December 2004 £000
Unutilised tax losses	986	1,015	812	841
Capital losses	1,630	1,630	–	–
	<b>2,616</b>	2,645	<b>812</b>	841

### 7. EARNINGS PER SHARE

The calculation of the basic earnings per share is based on the profit for the period after tax of £95,000 (2004: £89,000) and on the weighted average number of ordinary shares in issue during the period of 52,315,751 (2004: 52,315,751).

The diluted earnings per share has been calculated using the profit for the period after tax of £95,000 (2004: £89,000) and on, the weighted average number of ordinary shares in issue during the period of 52,315,751 (2004: 52,315,751) plus the number of share options in existence at the balance sheet date which may vest and convert into ordinary shares at some future date of 2,000,000 (2004: 2,000,000), totalling 54,315,751 ordinary shares (2004: 54,315,751).

### 8. FIXED ASSET INVESTMENTS

	The Company
	Investments in shares in subsidiaries Restated £000
Cost	
At 1 January 2005 and 30 June 2006	29,915
Provisions	
At 1 January 2005 and 30 June 2006	26,139
Net book value	
At 30 June 2006	3,776
At 31 December 2004	3,776

The Company has no trading subsidiaries. The subsidiary undertakings of the Company at the balance sheet date were:

	Nature of business	Country of registration	Class of shares held	Proportion held
DSC (Consumer Products) Ltd	Dormant	England and Wales	Ordinary	100%
Juneau Ltd	Dormant	England and Wales	Ordinary	100%
Ketchican Ltd	Dormant	England and Wales	Ordinary	100%
Mid-States Investments Ltd	Dormant	England and Wales	Ordinary	100%
Old Stylus Ltd	Dormant	England and Wales	Ordinary	100%
Scagway Ltd	Dormant	England and Wales	Ordinary	100%

## Notes to the accounts

continued

### 9. DEBTORS

	Group		Company	
	30 June 2006 £000	31 December 2004 £000	30 June 2006 £000	31 December 2004 £000
Amounts falling due within one year:				
Value added tax recoverable	16	5	16	5
Other debtors	–	43	–	43
Prepayments and accrued income	450	13	450	13
	<b>466</b>	61	<b>466</b>	61

Prepayments and accrued income includes acquisition costs of £439,000. See Note 16 for further details.

### 10. CREDITORS: amounts falling due within one year

	Group		Company	
	30 June 2006 £000	31 December 2004 £000	30 June 2006 £000	31 December 2004 £000
Trade creditors	71	21	71	21
Amounts owed to group undertakings	–	–	3,834	3,834
Taxation	–	–	–	–
Other creditors	16	17	10	11
Accruals	389	38	388	37
	<b>476</b>	76	<b>4,303</b>	3,903

### 11. FINANCIAL INSTRUMENTS

All financial assets and liabilities are denominated in sterling, with the exception of creditors totalling £33,000 in the year ended 31 December 2004 which are denominated in Euros and relate to taxation payable.

As permitted by FRS13: “Derivatives and other financial instruments”, short term debtors and creditors have been excluded from the interest rate disclosures.

At 30 June 2006, the Group had sterling cash deposits of £7,669,000 (2004: £7,579,000) which are held on short-term deposit at the money market rate prevailing at the time of placing. The short-term money market rates are ultimately based on the Bank of England base rate and expected future movements thereon.

The fair value of the financial instruments are not significantly different to the book value.

### 12. CALLED UP SHARE CAPITAL

#### (a) Share Capital

For the 18 months ended 30 June 2006 called up share capital comprises ordinary shares of one pence each as follows:

	Authorised		Allotted, called up and fully paid	
	Number of shares	£000	Number of shares	£000
At 1 January 2005 and 30 June 2006	85,000,000	850	52,315,751	523

## Notes to the accounts

continued

### 12. CALLED UP SHARE CAPITAL (continued)

(b) Options

The following options, which include those detailed in the Directors' Report, granted under the US Stock Option Plan and 1999 Stock Option Plan were outstanding at 30 June:

Date of grant	Pre Variation Exercise price	Post Variation Exercise price <sup>(1)</sup>	Expiry date	30 June 2006 Number of Ordinary Shares	31 December 2004 Number of Ordinary Shares
27 August 1998	21.5p	11.2p	27 Aug, 2008	<b>350,000</b>	350,000
1 December 1998	23p	12.7p	1 Dec, 2008	<b>750,000</b>	750,000
8 December 1998	23.5p	13.2p	8 Dec, 2008	<b>300,000</b>	300,000
23 August 2000 (1999 Stock Option Plan)	23.5p	13.2p	23 Aug, 2008	<b>300,000</b>	300,000
1 October 2001 (1999 Stock Option Plan)	19p	8.7p	1 Oct, 2011	<b>300,000</b>	300,000
				<b>2,000,000</b>	2,000,000

<sup>(1)</sup>The exercise price has been reduced by approximately 10.3p in accordance with the resolutions approved at the extraordinary shareholders meeting on 1 April 2003. All the options other than those noted to be under the 1999 Stock Option Plan were granted under the Company's US Stock Option Plan and are currently exercisable. Options granted under the Company's 1999 Stock Option Plan generally become exercisable at the rate of one third on the first to third anniversaries of the date of grant. No options were exercised during the period.

### 13. RESERVES

	Capital Redemption Reserve £000	Profit and Loss Account £000	Total £000
<b>The Group</b>			
At 1 January 2005	253	6,788	7,041
Profit for the period	–	95	95
At 30 June 2006	253	6,883	7,136
<b>The Company</b>			
At 1 January 2005	253	6,737	6,990
Profit for the period	–	95	95
At 30 June 2006	253	6,832	7,085

By virtue of Section 230 of the Companies Act 1985, the Company is exempt from presenting a profit and loss account. Of the Group profit for the period, a profit of £95,000 (2004: £89,000) has been dealt with in the accounts of the Company.

## Notes to the accounts

continued

### 14. RECONCILIATION OF MOVEMENT IN SHAREHOLDERS' FUNDS

	<b>30 June 2006 £000</b>	<b>The Group 31 December 2004 £000</b>
Profit for the period	95	89
Capital reduction	–	–
Net movement in shareholders' funds	95	89
Shareholders' funds at beginning of the period	7,564	7,475
Shareholders' funds at the end of the period	7,659	7,564

### 15. NOTES TO THE GROUP CASH FLOW STATEMENT

#### (a) Reconciliation of operating (loss) to net cash (outflow) from operating activities

	<b>18 months to 30 June 2006 £000</b>	<b>12 months to 31 December 2004 £000</b>
Operating (loss)	(417)	(235)
Currency translation gains	–	(1)
(Increase) in debtors	(448)	–
Increase in creditors	400	22
Net cash (outflow) from operating activities	(465)	(214)

#### (b) Analysis of cash flows

	<b>18 months to 30 June 2006 £000</b>	<b>12 months to 31 December 2004 £000</b>
Returns on investments and servicing of finance		
Interest received	555	312
Interest paid	–	(1)
Net cash inflow	555	311
Taxation		
Tax paid	–	(32)
Net cash (outflow)	–	(32)
Management of liquid resources		
Transfer (to) deposit	(119)	(47)
Net cash (outflow)	(119)	(47)

Liquid resources comprise cash balances held on deposit with a notice period of more than 24 hours. They are included within cash at bank and in hand on the balance sheet.

## Notes to the accounts

continued

### 15. NOTES TO THE GROUP CASH FLOW STATEMENT (continued)

#### c) Analysis and reconciliation of net funds

	1 January 2005 £000	Cash flow £000	30 June 2006 £000
Cash at bank and in hand	40	(29)	<b>11</b>
Liquid resources on deposit	7,539	119	<b>7,658</b>
Net funds	7,579	90	<b>7,669</b>

	18 months to 30 June 2006 £000	12 months to 31 December 2004 £000
(Decrease)/increase in cash in the period	<b>(29)</b>	18
Cash outflow from increase in liquid resources	<b>119</b>	47
Movement in net funds during the period	<b>90</b>	65
Net funds at beginning of the period	<b>7,579</b>	7,514
Net funds at the end of the period	<b>7,669</b>	7,579

### 16. POST BALANCE SHEET EVENTS

On 5 October 2006 Mid-States PLC completed the acquisition of the whole of the share capital of Inov8 Technologies Limited and Moving Sun Limited. Inov8 Technologies Limited is a global leader in fuel system testing technology. Moving Sun Limited holds the various intellectual property rights associated with Inov8 Technologies operations.

As consideration for the acquisition, Mid-States PLC issued and allotted 22,410,361 ordinary shares to the sellers, representing 29.99% of the issued share capital of the enlarged Group.

Costs incurred with the acquisition of Inov8, as at 30 June 2006, are included within Prepayments and accrued income and amounted to £439,000. These costs will form part of the consideration for the Inov8 acquisition and will be transferred to fixed asset investments.

## Profiles of directors

### **David J. Plucinsky**

*(Chairman)*

David Plucinsky, aged 57, became Chairman in December 1998, having been appointed to the board in March 1998. He was Chief Executive on an interim basis from April to November 1998, previously having acted as a consultant to the Company in 1997. He runs his own consultancy practice and serves on the board of several public and private companies.

### **Michael E. Heath**

Michael Heath, aged 55, was appointed Managing Director in October 2006. He was previously, and continues to be, a director of Inov8 Technologies Limited. Prior to joining Inov8, Mike had 25 years of experience of working in corporate banking and corporate recovery. He has considerable experience of working in China and was formerly the director general of the Southampton Chamber of Commerce and Industry.

### **John G. Bateson \* † #**

John Bateson, aged 42, was appointed a non-executive Director in July 1997. Mr Bateson, a Chartered Accountant, is an executive with the fund management group International Investment & Underwriting Limited. He was formerly with the corporate finance department of NCB, an Irish stockbroker.

### **Paul G. Dumond \* † #**

Paul Dumond, aged 51, was appointed a non-executive Director in May 1996. He served as Company Secretary from October 1989 to June 1998. Mr Dumond, a Chartered Accountant, is Chief Financial Officer Europe and Company Secretary of Danka Business Systems PLC, a world-wide provider of office imaging solutions, and was previously Finance Director of Aberdeen Petroleum PLC.

### **The Hon. William D. Eberle \* † #**

The Hon. William Eberle, aged 83, was appointed a non-executive Director in June 1991. He served as a Special Trade Representative during the Nixon and Ford administrations. A Director of various U.S. corporations, he was a founder of Boise Cascade and served as Chairman and Chief Executive Officer of American Standard. He is currently Vice Chairman of the US Council of the International Chamber of Commerce and Director of several New York Stock Exchange companies.

### **Christopher H. B. Mills \* † #**

Christopher Mills, aged 53, was appointed a non-executive Director in January 1988. He is a Director and Chief Executive of North Atlantic Smaller Companies Investment Trust PLC and American Opportunity Trust PLC, non-executive Chairman of Jarvis Porter Group PLC and a director of several other listed companies. He is a Director and principal shareholder in Growth Financial Services Limited. Mr Mills spent 22 years at Montagu Investment Management Limited and its successor AMVESCAP Plc as an Investment Manager and Director before joining J O Hambro Capital Management Group in 1993. He is currently a member and Chief Investment Officer of North Atlantic Value LLP, a subsidiary of J O Hambro Capital Management Limited and Joint Manager of North Atlantic Companies Investment Trust and Manager of American Opportunity Trust.

\* Member of the audit committee

† Member of the remuneration committee

# Member of the nominations committee

## Corporate information

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Anthony G. Hunter

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