AFC energy plc

Powering the Hydrogen Economy

Report & Accounts

for the year ended 31 October 2009

Alkaline fuel cell systems for clean electricity

Report & Accounts for the year ended 31 October 2009

AFC Energy develops low-cost alkaline fuel cell systems that use hydrogen to produce clean electricity.

AFC Energy's fuel cell systems are developed with commercial viability as the key driver and in this regard we have re-engineered proven alkaline fuel cell technology:

- **High efficiency levels.** Using readily available hydrogen and air as the source of oxygen, electrical efficiency is up to 60% which compares to around 30% for conventional electricity generating technology.
- **Low cost materials.** Electrodes are made from proprietary materials that cost less than 5% of platinum electrodes.
- **Low temperature and pressure.** Operating at less than 100 degrees centigrade enables us to use plastic mouldings for many parts.
- **Hydrogen sealing.** By using low pressures, hydrogen is easily sealed within the system.
- **Thermal management.** By using a circulating liquid electrolyte, we prevent excessive heat build up at the electrodes.
- **Balance of plant.** The majority of components are off-the shelf and mass manufactured for other uses enabling us to benefit from these economies of scale.
- **Value engineered for assembly.** The component count has significantly reduced and commercial units are designed for easy assembly.

AFC Energy has significantly reduced the cost of its technology to make its fuel cell systems a commercially compelling product.

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About AFC Energy plc

Operational and financial highlights

- Successful trial of initial Alpha fuel cell system at AkzoNobel in April 2009
- Second chlor-alkali partnership signed with Ineos ChlorVinyls
- Significant progress in both electrode specification and system design
- 5 further patents applied for
- Technical and management team strengthened to support anticipated growth
- Operating costs further reduced

Since the period end

- £2.2 million raised through share placing and option/warrant conversions
- Cash balance, at end February 2010 of £3.19 million
- Heads of Agreement signed with Linc Energy to exploit underground coal gasification
- SuperGreen Power Station project initiated with WSP Group plc, CEL International and Air Products as confirmed partners
- Agreement with Centrica plc for reservation of future capacity

Ian Balchin, CEO commented,

Our objective is to develop and commercialise an alkaline fuel cell system for the 21st century at a significantly lower cost than any other fuel cell system. We have made considerable technical progress this year and have deepened and widened our commercial relationships with key partners. Our Alpha system fuel cell will be further tested by both AkzoNobel and Linc Energy during 2010 and we remain on track to deliver our first 50kW unit in 2011.

Tim Yeo, Chairman added,

I am delighted that the new management team has accelerated the technical and commercial development of the Company beyond R&D and towards revenue. I firmly believe that AFC Energy is now fully equipped to prioritise and develop its many commercial partnerships during its next phase.

Chairman's Statement

The Company remains focused on its goal of developing fuel cells for industrial companies to generate electricity from the hydrogen that they produce as a by-product.

Introduction

It is a pleasure to report the Company's substantial progress during the year to 31 October 2009. We have delivered a fuel cell system to our first commercial customer, AkzoNobel, and have built on that strong foundation with a range of additional, world class partnerships. These include, INEOS ChlorVinyls and, Waste2Tricity Ltd (which has entered into a relationship with Alter NRG Westinghouse). Since the end of the financial year, progress has accelerated further and commercial relationships have been formed with Centrica, WSP Environment and Energy, CEL International, Air Products, Linc Energy and B9 Coal.

During the year the Company's technical progress accelerated significantly and was validated by the second independent review of AFC's technology by the Centre for Process Innovation (CPI) which we reported in November 2009. We delivered an Alpha fuel cell system to AkzoNobel's Bitterfeld site (chlor-alkali) in Germany in April 2009. Following installation, integration and load cycling tests, the first electricity was exported from this system to AkzoNobel's local grid during tests in June.

Strategy

The Company remains committed to developing and commercialising low cost alkaline fuel cell systems that generate clean electricity from hydrogen feedstocks that are widely available directly or indirectly, from many different sources.

The Company is addressing the chlor-alkali industry directly and will work with partner organisations to access additional markets. The Letter of Intent signed by the Company in August with INEOS ChlorVinyls achieves the goal set out in last year's report to seek additional customers from within the chlorine and chlorate industries.

The Company expects that, following an initial period of direct sales, it will move to a business model where it supplies fuel cell systems under an ESCO (Energy Supply Contract), a well established model which enables us to participate in a share of the revenue generated by our fuel cell systems rather than from the sale of capital equipment. This mechanism has the potential to enable a faster, more profitable roll out of the technology.

Partnerships

In February 2009 the Company formalised its agreement with Waste2Tricity Ltd for municipal energy from waste applications. Waste2Tricty is currently working with waste gasification operator, Alter NRG Westinghouse.

Since the year end the Company has become more closely involved in the Underground Coal Gasification ('UCG') sector, recognising it as the largest potential market that we have yet reported on for our low cost fuel cell technology. On 8th December 2009, AFC signed a binding Heads of Agreement with B9 Coal Limited and Linc Energy Limited (ASX: LNC), Australia's leader in clean coal technology. Since then we have configured and assembled an Alpha fuel cell system which is now ready for shipping to an operational UCG plant in Chinchilla, Australia, and for which our first payment has been received.

B9 Coal Limited also has an agreement with UCG developer, Thornton New Energy, who have rights to a major coal field under the Firth of Forth in Scotland.

The Company has also initiated its SuperGreen Power Station demonstrator project. This initiative will commence with the demonstration of a 50kW fuel cell system and, subject to commercial support, it will lead to a 1MW power station demonstrator.

Finance

During the year the Company has continued to implement a tight control on its operating expenditure whilst making modest investments in capital equipment and processes to reduce the overall development cost and timescale. Operating costs during the six months to 31 October 2009 were £160k on average, compared with £250k on average for the same period of the previous year.

A successful share placing was completed in December 2009, raising £2 million after expenses. We received strong support from our existing institutional shareholder base and welcomed new institutional and private investors. We remain grateful for the continued support of all our shareholders.

Operating Framework

Concerns about the high level of greenhouse gas emissions from traditional methods of electricity generation are increasing world wide. In the United States the Obama administration is addressing this issue far more urgently than its predecessor. In Europe efforts to develop low carbon methods of producing electricity are intensifying. In Asia similar work is under way.

This is an extremely favourable background for the Company's operations. Financial incentives for the use of our technology are likely to increase. Customers, actual and potential, are becoming more concerned about their carbon footprints as these come under closer scrutiny from governments, regulators, other businesses and the general public.

The Company is therefore well placed to contribute to the global shift to lower carbon technology.

Management and Board

During the year, we have reshaped the team working within the Company to match its objectives. In particular, we have made senior appointments in materials, modelling and production management. It is the intention of the Board to ensure that all staff receive share options in the Company to help ensure that the objectives of individuals are aligned with those of the Company and also to reward the value that is created.

Ian Balchin joined the Company during October 2008 as part time Managing Director. I am pleased that following his considerable efforts and positive contribution to the Company's progress he was appointed to the Board as Chief Executive Officer during November 2009.

Dr Gene Lewis, who was originally recruited to the Company at the end of 2008 as Chief Technical Officer, was appointed to the Board as Technical Director in July 2009. He has demonstrated significant technical achievements and under his leadership the Company's technical programme is now back on track.

David Marson was appointed to the Board as Finance Director in July 2009 having commenced work with the Company in November 2008. He has used his considerable experience to implement best practice and quality procedures which have significantly improved the Company's financial performance.

During the year Harry Epstein stepped down as a Non-Executive Director although he continues to be available to provide advice to the Company on supply chain matters and commercial opportunities. Mike Mangan, who has served as a Non-Executive Director since before the Company's admission to AIM will be retiring from the Board in May 2010 although his technical skills will still be available to the Company as required.

Additionally Terry Walsh who has served as the Company's Commercial Director will leave the board with effect from today to focus on the chlor-alkali sector.

I would like to thank all three of these for their hard work and help in bringing the Company closer to achieving its operating goals.

Since the recruitment of Ian Balchin, Gene Lewis and David Marson I am delighted that their commercial, operational and technical skills have been fully unleashed to accelerate the technical and commercial development of the Company beyond R&D and towards revenue. I firmly believe that AFC is now fully equipped to prioritise and develop its many commercial partnerships during its next phase. I look forward to reporting on this next year.

On behalf of our newly-strengthened Board, I wish to thank all the Company's employees for their continued efforts on behalf of shareholders, customers and, ultimately, the environment.

Tim Yeo

Chairman
10 March 2010

Operating and Financial Review

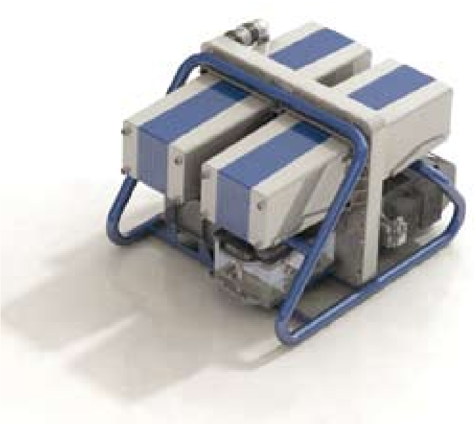
We believe that the successful commercialisation of AFC Energy's fuel cell system technology will be as important to a hydrogen economy in the 21st century as the internal combustion engine was to the petrochemical industry in the 20th century.

Introduction

Alkaline fuel cells are a proven technology that has been around for decades. AFC Energy is now developing 21st century alkaline fuel cell systems for generating clean electricity from hydrogen.

Our principal objective is to re-engineer alkaline fuel cells systems so that they are significantly more economic than any other fuel cell system. This will enable widespread adoption in a number of large industries. We have applied modern low-cost materials and processes, as well as computer aided design and value engineering methodologies, to radically reduce the cost of manufacture, operation and maintenance of this technology. Our projected manufacturing costs per kilowatt hour of installed capacity are on a par with conventional electricity generating technology.

Our initial target market is the surplus hydrogen generated by the chlor-alkali industry. This is hydrogen that currently has little or no economic value and is ideal for high-efficiency conversion into electricity and water in our alkaline fuel cell systems. During the year we successfully installed and tested our first fuel cell system at AkzoNobel's plant in Bitterfeld, Germany.



Alpha fuel cell system

Technical Progress

AFC Energy has made significant and rapid technical progress under the leadership of its Technical Director, Dr Gene Lewis.

We have made some important changes to our technical team to further strengthen key areas such as materials, fluid modelling, value engineering and manufacturing.

Our development facility has been significantly upgraded during the year to improve the quality, quantity and throughput of development work. Iterative work on catalyst materials can now proceed around thirty times faster than it was at the start of the reporting period. We now have the capability to produce up to 1000 electrodes per day, depending upon the exact processing conditions. Our work focuses on non-precious metal catalysts using materials which can be less than 5% of the cost of platinum.

At the core of our system is the electrode cartridge, comprised of a stack of individual electrochemical cells. During the period we made significant progress with electrode materials and the technology for collecting the electrical current from the cells. The technical programme is continuous. However, we periodically consolidate our developments into a new generation of electrodes for use in the fuel cell system tests.

Since our fuel cell system is designed to be operated at less than 100 degrees centigrade we are able to choose from many low cost materials for its construction. This relatively low temperature of operation means that we generate water rather than steam as a by-product of the system and so no pressure vessels are required. This also enables us to keep construction costs low.

We have also developed a low cost method for ensuring that hydrogen (the smallest molecule) is sealed within the fuel cell system.

Alpha Fuel Cell System

The electrical power output of our small (less than a cubic metre) fuel cell system depends upon the number and composition of the electrodes used.

Alpha fuel cell systems are capable of automatic operation and remote monitoring. The performance of each individual cell can monitored remotely and maintenance can be scheduled to be carried out only when required.

We have demonstrated that an electrode cartridge can be replaced in 90 minutes. This is the elapsed time from stopping a working Alpha fuel cell system, replacing the cartridge and returning it to operating power again.

Large Scale Fuel Cell Systems

Feeding on the results from the Alpha fuel cell system, work on the large-scale fuel cell system was started during the year in parallel with work on the Alpha fuel cell system. It is this larger system that will become the building block for multi-megawatt installations.

We are on track to deliver our first 50kW system to AkzoNobel during 2011. We will use sufficient electrodes to ensure that it meets the power specification.

The emerging design of the large scale fuel cell system lends itself to low cost mass assembly. Other than the possibility that we will manufacture electrodes, the assembly of fuel cell systems will be carried out by third parties. This should enable faster roll out and lower capital expenditure costs for the Company.

The design has also taken into account the need to minimise the time taken to carry out maintenance and the desire to minimise the carbon footprint in manufacturing the fuel cell systems. A large proportion of this system will be reusable and/or recyclable.

SuperGreen Power Station

This initiative will showcase our fuel cell systems, enable relationships to be built with partner organisations and raise the profile of the participating companies ahead of commercial roll out.

Initially, the SuperGreen Power Station will demonstrate a 50kW large scale fuel cell system in operation close to our development facility in Surrey, UK. To date confirmed partners in the project include WSP Energy and Environment, CEL International and Air Products. These organisations are respectively involved in planning and regulations, engineering and gas handling and supply.

Multi-megawatt SuperGreen power station (concept)

Operating and Financial Review continued

Financial Highlights

During the early part of the year all aspects of the Company's operations were reviewed. We were able to improve operational efficiency and reduce costs whilst still accelerating the technical development programme. As a result of the review, our operating cash costs (excluding changes in working capital) in the year to 31 October 2009 were reduced to £1.9 million, compared with £2.6 million in the previous year.

A successful placing of 21,500,000 shares was completed in December 2009, raising £2 million after expenses and through which we have welcomed a number of new institutional and private investors. The Company received a further £167,000 in February 2010 as a result of the exercise of options and warrants issued in February 2007 as part of a pre-IPO fund raising.

Intellectual Property

We regularly review the intellectual property generated by our technical programme and apply for patent protection for significant inventions.

Since reporting last year, the Company has submitted 5 new patent applications covering inventions relating to low cost alkaline fuel cells.

Health and Safety

The health and safety of our employees and those we work with is regularly reviewed by and on behalf of the Board.

Commercial Outlook

Within our chlor-alkali target market we have made significant progress over the year. In addition to our contract with AkzoNobel we have entered into a letter of intent with INEOS ChlorVinyls to develop a hydrogen fuel cell project at its manufacturing complex in Runcorn, Cheshire, UK.

Whilst we anticipate selling the first few megawatts of power generating capacity, our intention is to move to an Energy Supply Company (ESCo) business model as soon as possible. Under the ESCo model, AFC Energy would obtain financing to build and supply fuel cell systems to a customer and then share the revenue generated by the installed equipment. Our financial modelling shows that there is a distinct benefit to the Company from doing this, especially as we expect, over time, that new generations of electrode cartridges will be increasingly lower cost per kilowatt hour of electricity generated and that we will be able to retrofit them to installed fuel cell systems.

The models show that our electrode cartridges only need an operational life of a few months for our fuel cells systems to become economic and that payback can be achieved in around 2 years from sales of electricity generated. In some applications the demineralised water and heat produced by the fuel cell system will also have a considerable value.

In summary, we believe that AFC Energy has the makings of a highly attractive commercial product.

To access other markets the Company will continue working with and though third parties. In this way we intend to harness the expertise and resources available from partner companies to accelerate the timescales for reaching new markets whilst improving the likelihood of success and minimising the distraction this causes the Company.

The second market opportunity that we have developed is with Waste2Tricity Limited, a company focused on the efficient conversion of municipal solid waste into electricity. During the year it has formed strategic relationships with AlterNRG Westinghouse and others. It is currently in the process of raising funds for the next phase of its commercial development. If successful, Waste2Tricity will purchase an exclusive UK licence for the Company's fuel cell technology for use in the conversion of waste into electricity. Whilst, this has taken slightly longer than originally envisaged, it is currently in discussions regarding some major commercial opportunities which have potential to generate revenue for the Company.

The third market opportunity is Underground Coal Gasification (UCG). We have also entered into contract a with B9 Coal Limited and Linc Energy (ASX:LNC). Linc Energy is a leader in the development of converting underground coal into synthetic gas for processing into diesel and/or electrical power. Linc Energy plans to install hundreds of megawatts of generating capacity over the next few years.

The carbon dioxide produced from power generation is relatively easy to capture and has the prospect of being pumped back underground to be stored in the caverns created when the coal is burnt out – offering the tantalising prospect of clean power from coal. Under the £200,000 contract, we are supplying Linc Energy with an Alpha fuel cell system for testing with hydrogen produced from the underground coal gasification process. Under the agreement, Linc Energy also has the option to buy up to £2.3 million of new shares in the Company before the end of 2011.

Elsewhere, as commercial momentum builds we have begun to take orders reserving future production capacity. The first order in this regard is from Centrica plc for 250kW of capacity for use with a flagship project. We are also in discussions with many other global organisations about developing future markets.

I look forward to reporting our continued progress towards commercialisation and thank all those working for and with the Company for their support.

Ian Balchin

Chief Executive Officer
10 March 2010

Directors' Report

The Directors present their report together with the audited financial statements for the year ended 31 October 2009. The comparative period was from 1 November 2007 to 31 October 2008.

Principal activity and review of business developments

The principal activity of AFC Energy plc (or 'the Company') was the development of fuel cells.

Reviews of operations, business developments and current projects are included in the Chairman's Statement and the Operating and Financial Review.

Results and dividend

The results for the year are set out in the income statement on page 15

No dividends were paid in the year. The Directors do not intend to declare a dividend in respect of the year.

Principal risks and uncertainties

The major risk faced by the business relates to the technical progress in development of the fuel cell system and the fulfilment of contractual obligations with AkzoNobel. Financial risks include the risk of additional development expenditure being required to produce a commercial product. The Company's approach to the management of these risks is described in the Operating and Financial Review.

Key performance indicators

Given the nature of the business and that the Company is in the development phase of its products, the Directors are of the opinion that analysis using financial KPIs is not appropriate for an understanding of the development, performance or position of the business at this time. However, the Directors constantly review overall expenditure compared to budget and the Company's cash position.

	2009 £	2008 £
Cash and cash equivalents at the year end	1,868,601	3,610,204

Directors and their interests

The Directors who served during the year were:

Tim Yeo	Chairman
Simon Walters	Finance Director (resigned 2 July 2009)
David Marson	Finance Director (appointed 2 July 2009)
Otto Carlisle	Technical Director (resigned 29 January 2009)
Gene Lewis	Technical Director (appointed 2 July 2009)
Terry Walsh	Commercial Director (appointed 30 January 2009)
Dr Michael Mangan	Non-Executive
Harry Epstein	Non-Executive (resigned 2 July 2009)
Mitchell Field	Non-Executive
Gerard Sauer	Chief Executive Officer (resigned 19 December 2008)

On 31 October 2009 the Directors' interests in the equity share capital of the Company were:

	Number of Ordinary shares of 0.1p 2009	Number of Ordinary shares of 0.1p 2008	Number of options and warrants over Ordinary shares of 0.1p 2009	Number of options and warrants over Ordinary shares of 0.1p 2008
Tim Yeo MP	227,272	227,272	2,617,490	1,117,490
David Marson	–	–	500,000	–
Gene Lewis	–	–	1,000,000	–
Terry Walsh	–	–	1,000,000	–
Dr Michael Mangan	–	–	700,000	350,000
Mitchell Field	2,097,845	2,097,845	350,000	–

A Director appointed during or after the year must stand for re-appointment at the first Annual General Meeting after such appointment. Accordingly, Ian Balchin, David Marson and Gene Lewis offer themselves for re-appointment.

Directors' remuneration

Name	Salary £	Share-based payment expense £	Other compensation £	Total 2009 £	Total 2008 £
Tim Yeo MP	45,000	4,147	–	49,147	55,998
Simon Walters (see note 24)	–	–	23,800	23,800	63,863
David Marson (see note 24)		857	15,976	16,833	–
Otto Carlisle	21,250	2,064	42,648[1]	65,962	90,200
Gene Lewis	25,000	1,773	129	26,902	–
Terry Walsh	78,000	2,666	–	80,666	–
Dr Michael Mangan	20,000	968	–	20,968	30,724
Harry Epstein	–	–	–	–	20,000
Mitchell Field	–	968	–	968	–
Gerard Sauer	–	14,942	–	14,942	306,577

[1] Includes compensation for loss of office. See Note 22

Directors' Report continued

Directors' service contracts

Tim Yeo was appointed as Chairman and Non-Executive Director under the terms of a Non-Executive letter dated 20 February 2007 for an indefinite term, subject to a minimum of six months' notice.

David Marson entered into a consultancy agreement with the Company on 1 November 2008, subject to one months' notice by either party (see also note 24).

Gene Lewis' service contract with the Company commenced on 1 November 2008 for an indefinite term, subject to six months' notice by either party.

Terry Walsh service contract with the Company commenced on 23 July 2008 for an indefinite term, subject to three months' notice by either party.

Dr Michael Mangan's services as a Non-Executive Director are provided under the terms of a Non-Executive letter of appointment dated 14 December 2006 for an indefinite term, subject to a minimum of six months' notice.

Mitchell Field was elected as a Non-Executive Director at the Company's AGM on 10 April 2008.

Board changes

Details of changes to the membership of the Board are disclosed in note 22 to the financial statements.

Capital structure

Details of the Company's share capital are disclosed in notes 16 and 17 of the financial statements.

Shareholder funds have been used to develop the alpha fuel cell system, to undertake testing of the system and to design the 50kW system that will become the Company's initial commercial product.

On 10 March 2010, the Company was aware of the following holdings of three per cent or more in the Company's issued share capital:

	Number of shares	Approximate percentage of the Company's issued share capital
Age of Reason Foundation	22,602,420	14.98
Chase Nominees Ltd	10,248,000	6.79
Eturab Trade Corporation	8,000,000	5.30
Harry Epstein	7,000,000	4.64
Giltspur Nominees Ltd	5,395,260	3.58

Political and charitable donations

Charitable donations in the year amounted to £ nil (2008: £300).

Corporate governance

The Directors seek, as far as is considered appropriate having regard to the size and nature of activities of the Company, to comply with the Combined Code on Corporate Governance applicable to listed companies. The Board is assisted in this regard by a number of committees with delegated authority.

The Company's organisational structure has clearly documented and communicated levels of responsibility, delegated authority and reporting procedures. The professionalism and competence of employees is maintained through recruitment, performance appraisal, written job descriptions and personal training and development plans. The Board supports the highest levels of commitment and integrity from employees. Expected standards of behaviour are set out in the Staff Handbook, a copy of which is given to all employees.

Audit Committee

The Company's Audit Committee comprises Tim Yeo, Michael Mangan and Mitchell Field. The Committee meets at least twice a year and at any other time when it is appropriate to discuss audit, accounting or control issues. The Committee will meet the external Auditors, without executive Board members being present, to review accounting and internal control matters.

The Committee's principal objectives are to review annual and interim financial statements; to review accounting policies; to review with management and the Company's external Auditors the effectiveness of internal controls; to oversee the publication of reserve and resource statements to ensure compliance with best practice under the new AIM rules; and to review with the Company's external Auditors the scope and results of their audit. Tim Yeo chairs the Audit Committee.

Remuneration Committee

The Remuneration Committee's members are Tim Yeo, Michael Mangan and Mitchell Field who review the performance of the Executive Directors and set the scale and structure of their remuneration and the basis of their service agreements. In determining remuneration, the Committee seeks to enable the Company to attract and retain executives of the highest calibre. The Committee also makes recommendations to the Board concerning allocation of share options to employees. No Directors participate in discussions or decisions concerning their own remuneration. This Committee is also responsible for nominating candidates, for the approval of the Board, to fill either executive or Non-Executive vacancies or additional appointments to the Board.

Details of the Directors' remuneration, service agreements and their interests in the share capital of the Company are disclosed in the Directors' Report.

AIM Rules Compliance Committee

The AIM Rules Compliance Committee comprises Tim Yeo, Michael Mangan and Mitchell Field and meets as appropriate. The Committee monitors internal procedures, resources and controls to enable the Company to comply with AIM rules.

Payments to creditors

The Company's policy is to settle the terms of payment with its suppliers when agreeing the terms of each transaction, either by accepting the suppliers' terms or by making the suppliers aware of alternative terms, and to abide by the agreed terms. Trade creditors of the Company at 31 October 2009 represented 57 days (2008: 50 days) of annual purchases.

Liability insurance for company officers

The Company has in place a Directors' and Officers' insurance policy.

Financial risk management objectives

These are detailed in note 20 to the financial statements.

Research and development

The company invests substantially in research and development and makes claims under the Government's R&D tax credit scheme. In the year to 31 October 2009, relevant expenditure totalled £932,085 (2008: £1,288,107).

Directors' Report continued

Going concern

The Company raised £2,000,000, after expenses in December 2009. The Directors are satisfied that for the foreseeable future, the monthly cash requirement to meet the development programme agreed with major customers, including AkzoNobel, will not be significantly greater than that incurred in the year to October 2009. They expect the Company to receive modest cash receipts from exercise of maturing options and warrants and from small numbers of sales of development systems. Therefore, the Directors are satisfied that the Company has sufficient resources to continue its operations and to meet its commitments for the foreseeable future.

Post-balance sheet events

Details of post-balance sheet events are provided in note 22 to the financial statements.

Relations with shareholders

The Board attaches great importance to maintaining good relationships with shareholders. The Board regards the Annual General Meeting as an opportunity to communicate directly with investors, who are encouraged to attend and participate.

AGM notice

Notice of the Annual General Meeting of the Company for 2009 is on page 34.

Auditors

A resolution to re-appoint the Auditors of the Company, Jeffreys Henry LLP, will be proposed at the forthcoming Annual General Meeting. Jeffreys Henry LLP have expressed their willingness to continue as Auditors of the Company.

This report was approved by the Board of Directors on 10 March 2010.

David Marson

Company Secretary

Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual Report and financial statements in accordance with applicable law and International Financial Reporting Standards.

Company law requires the Directors to prepare financial statements for each financial period. Under that law the Directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards as adopted for use in the European Union. The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing those financial statements, 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 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 proper accounting records which 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.

The directors are responsible for the maintenance and integrity of the company's website (www.afcenergy.com) and legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Statement of disclosure to auditor

So far as the Directors are aware, there is no relevant audit information of which the Company's Auditors are unaware, and each Director has taken all the steps that he ought to have taken as Director in order to make himself aware of any relevant audit information and to establish that the Company's Auditors are aware of that information.

Independent Auditors' Report to the shareholders of AFC Energy plc

We have audited the financial statements of AFC Energy plc for the year ended 31October 2009 which comprise the Income Statement, the Balance Sheet, the Statement of Cash Flow, the Statement of Changes in Equity 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.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 13, 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 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.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Sections 495 to 497 of the Companies Act 2006 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 October 2009;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters 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.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept, or
- the 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.

Mark Tenzer

(Senior statutory auditor) Date 10 March 2010

for and on behalf of Jeffreys Henry LLP, Statutory Auditor
Chartered Accountants & Registered Auditors
Finsgate, 5-7 Cranwood Street, London, EC1V 9EE

Income Statement

	Note	Year ended 31 October 2009 £	Year ended 31 October 2008 £
Revenue		–	–
Direct expenses		–	–
Gross profit/(loss)		–	–
Other income		4,664	–
Administrative expenses		(2,345,651)	(3,110,515)
Analysed as:			
Administrative expenses		(2,280,731)	(2,863,177)
Equity-settled share-based payments	17c	(64,920)	(247,338)
Operating loss	5	(2,340,987)	(3,110,515)
Financial income	8	67,890	150,320
Share of loss of Associate	9a	(26,651)	–
Loss before tax		(2,299,748)	(2,960,195)
Taxation	10	219,220	308,427
Loss for the year attributable to equity holders		(2,080,528)	(2,651,768)
Basic loss per share	11	(1.63)p	(2.51)p
Diluted loss per share	11	(1.63)p	(2.51)p

All amounts relate to continuing operations.

The notes on pages 19 to 33 form part of these financial statements.

Balance Sheet

	Note	31 October 2009 £	31 October 2008 £
Assets			
Non-current assets			
Intangible assets	12	308,525	307,852
Property and equipment	13	270,069	504,458
Trade and other receivables	9b	124,849	–
		703,443	812,310
Current assets			
Work in progress		123,740	123,740
Trade and other receivables	14	307,644	592,055
Cash and cash equivalents	15	1,868,601	3,610,204
		2,299,985	4,325,999
Total assets		3,003,428	5,138,309
Equity and liabilities			
Equity attributable to ordinary shareholders			
Share capital	16b	127,683	127,683
Share premium		8,940,379	8,940,379
Other reserve		602,308	537,388
Retained loss		(6,986,367)	(4,905,839)
Total equity		2,684,003	4,699,611
Current liabilities			
Trade and other payables	18	319,425	438,698
		319,425	438,698
Total equity and liabilities		3,003,428	5,138,309

The notes on pages 19 to 33 form part of these financial statements.

These financial statements were approved and authorised for issue by the Board on 10 March 2010.

Tim Yeo
Chairman

David Marson
Finance Director

Cash Flow Statement

	Note	31 October 2009 £	31 October 2008 £
Cash flows from operating activities			
Loss before tax for the year		(2,299,748)	(2,960,195)
Adjustments for:			
Depreciation and amortisation		345,005	293,473
Equity-settled share-based payment expenses	17c	64,920	247,338
Finance income		(67,890)	(150,320)
Share of loss of associate		26,651	–
Cash flows from operating activities before changes in working capital and provisions		(1,931,062)	(2,569,704)
Corporation tax received		463,721	–
Decrease/(increase) in trade and other receivables		38,411	54,198
Decrease/(increase) in trade and other payables		(119,273)	26,157
Cash absorbed by operating activities		(1,548,203)	(2,489,349)
Cash flows from investing activities			
Purchase of plant and equipment	13	(105,192)	(308,829)
Acquisitions of patents	12	(18,820)	(25,478)
Disposal of plant and equipment		12,722	–
Loans to Associates	9a	(150,000)	
Interest received	8	67,890	150,320
Net cash absorbed by investing activities		(193,400)	(183,987)
Cash flows from financing activities			
Proceeds from the issue of share capital		–	4,400,000
Costs of issue of share capital		–	(244,810)
Net cash from financing activities		–	4155,190
Net increase/(decrease) in cash and cash equivalents		(1,741,603)	1,481,854
Cash and cash equivalents at start of year		3,610,204	2,128,350
Cash and cash equivalents at 31 October	15	1,868,601	3,610,204

Statement of Changes in Equity

For the year ended 31 October 2009

	Share Capital £	Share Premium £	Other Reserve £	Retained Loss £	Total Equity £
Balance at 1 November 2007	87,683	4,825,189	290,050	(2,254,071)	**2,948,851**
Loss after tax for the year	–	–	–	(2,651,768)	**(2,651,768)**
Total recognised in income and expense for the year	–	–	–	(2,651,768)	**(2,651,768)**
Issue of equity shares	40,000	4,360,000	–	–	**4,400,000**
Share issue expenses	–	(244,810)	–	–	**(244,810)**
Equity-settled share-based payments	–	–	247,338	–	**247,338**
Balance at 31 October 2008	127,683	8,940,379	537,388	(4,905,839)	**4,699,611**
Balance at 1 November 2008	127,683	8,940,379	537,388	(4,905,839)	**4,699,611**
Loss after tax for the year	–	–	–	(2,080,528)	**(2,080,528)**
Total recognised in income and expense for the year	–	–	–	(2,080,528)	**(2,080,528)**
Equity-settled share-based payments	–	–	64,920	–	**64,920**
Balance at 31 October 2009	127,683	8,940,379	602,308	(6,986,367)	**2,684,003**

Share capital is the amount subscribed for shares at nominal value.

Share premium represents the excess of the amount subscribed for share capital over the nominal value of these shares net of share issue expenses.

Other reserve represents the credit to equity in respect of equity-settled share-based payments.

Retained earnings represent the cumulative loss of the Company attributable to equity shareholders.

Notes forming part of the Financial Statements

1. Corporate information

AFC Energy plc ('the Company') is a public limited company incorporated in England & Wales and quoted on the Alternative Investment Market of the London Stock Exchange.

The address of its registered office is Finsgate, 5-7 Cranwood Street, London, EC1V 9EE.

2. Basis of preparation and accounting policies

These consolidated financial statements of AFC Energy plc have been prepared in accordance with International Financial Reporting Standards (IFRSs), International Accounting Standards (IASs) and International Financial Reporting Interpretations Committee (IFRIC) interpretations (collectively 'IFRSs') as adopted for use in the European Union and as issued by the International Accounting Standards Board and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

The accounting policies set out below have, unless otherwise stated, been applied consistently in these financial statements.

Judgements made by the Directors in the application of these accounting policies that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 3.

a. Standards, amendments and interpretations to published standards not yet effective.

At the date of authorisation of these consolidated financial statements, the IASB and IFRIC have issued the following standards and interpretations which are effective for annual accounting periods beginning on or after the stated effective date. These standards and interpretations are not effective for and have not been applied in the preparation of these consolidated financial statements:

- IAS 1: Presentation of Financial Statements (Revised 2008) (effective as of 1 January 2009).
- IAS 23: Borrowing Costs (Revised 2008) (effective as of 1 January 2009).
- IAS 27: Consolidated and Separate Financial Statements (Amended) (effective as of 1 July 2009).
- IFRS 2: Share-Based Payments: Vesting conditions and Cancellations (Amended) (effective as of 1 January 2009).
- IFRS 3: Business Combinations (Revised) (effective as of 1 July 2009) includes an amendment to the treatment of minority interests (renamed non-controlling interests), amendments to the calculation of goodwill, a change to the method of accounting for acquisitions in stages, amendment to the accounting for contingent consideration and changes to the recognition and measurement of certain assets and liabilities.
- IFRS 8: Operating Segments (effective as of 1 January 2009).
- IFRIC Interpretation 15: Agreements for the Construction of Real Estate (effective as of 1 January 2009 – not yet endorsed by the EU).
- IFRIC Interpretation 17: Distributions of non-cash assets to owners (effective 1 July 2009, not yet endorsed by the EU).
- IFRIC Interpretation 18: Transfers of assets from customers (effective 1 July 2009, not yet endorsed by the EU).
- Amendments to IAS32 Financial Instruments: Presentation and IAS1 Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation (effective for beginning on or after 1 January 2009).

Notes forming part of the Financial Statements continued

2. Basis of preparation and accounting policies continued

- Amendments to IFRS1 and IAS27 Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate (effective for accounting periods beginning on or after 1 January 2009).

- Eligible Hedged Items (Amendment to IAS 39 Financial Instruments: Recognition and Measurement). Entities shall apply the amendment retrospectively for annual periods beginning on or after 1 July 2009. This amendment is still to be endorsed by the EU.

The Directors anticipate that the adoption of these standards and interpretations will not have a material impact on the Company's financial statements in the period of initial adoption with the exception of IAS23: Borrowing Costs (Revised) which will require interest incurred in respect of long term development projects to be capitalised within the relevant project and of IFRS 3: Business Combinations (Revised), which will require transaction costs arising on business combinations to be expensed to the income statement as opposed to the existing treatment of capitalisation, in the event that acquisitions are undertaken.

b. Capital Policy

The Company manages its equity as capital. Equity comprises the items detailed within the principal accounting policy for equity and financial details can be found in the balance sheet. The Company adheres to the capital maintenance requirements as set out in the Companies Act.

c. Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received, excluding discounts, rebates, and other sales taxes or duty. Revenue arising from the provision of services is recognised when and to the extent that the Company obtains the right to consideration in exchange for the performance of its contractual obligations.

d. Development costs

Development expenditure does not meet the strict criteria for capitalisation under IAS 38 and has been recognised as an expense.

Prior year laboratory costs have been re-classified from direct expense to administrative expenses as they do not relate to revenue generating contracts.

e. Foreign currency

The financial statements of the Company are presented in the currency of the primary economic environment in which it operates (the functional currency) which is pounds sterling. In accordance with IAS21, transactions entered into by the Company in a currency other than the functional currency are recorded at the rates ruling when the transactions occur. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing at the balance sheet date.

f. Work in Progress

Work in progress is valued at cost, less the cost of work invoiced on incomplete contracts and less foreseeable losses. Cost comprises purchase cost plus production overheads.

g. Trade and other receivables

Trade and other receivables arise principally through the provision by the Company of goods and services to customers (trade debtors). They also include other types of contractual monetary assets. These assets are initially recognised at fair value and are subsequently measured at amortised cost less any provision for impairment.

h. Loans and other receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, loans and receivables are carried at amortised cost using the effective interest method less any allowance for impairment. Gains and losses are recognised in profit or loss when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

The Company's loans and receivables include cash and cash equivalents. These include cash in hand, and deposits held at call with banks.

i. Property and equipment

Property and equipment are stated at cost less any subsequent accumulated depreciation and impairment losses.

Where parts of an item of property and equipment have different useful lives, they are accounted for as separate items of property and equipment.

Leases in which the Company assumes substantially all the risks and rewards of ownership of the leased asset are classified as finance leases. Leased assets acquired by way of finance lease are stated at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and impairment losses.

Depreciation is charged to the income statement within cost of sales and administrative expenses on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. The estimated useful lives are as follows:

- Leasehold improvements 1 to 3 years
- Fixtures, fittings and equipment 1 to 3 years
- Vehicles 3 to 4 years

Expenses incurred in respect of the maintenance and repair of property and equipment are charged against income when incurred. Refurbishment and improvement expenditure, where the benefit is expected to be long lasting, is capitalised as part of the appropriate asset.

The useful economic lives of property, plant and equipment and the carrying value of tangible fixed assets are assessed annually and any impairment is charged to the income statement.

j. Intangible assets

Expenditure on research activities is recognised in the income statement as an expense as incurred.

Other intangible assets that are acquired by the Company are stated at cost less accumulated amortisation and impairment losses.

Amortisation of intangible assets is charged using the straight-line method to administrative expenses over the following period:

Patents 20 years

k. Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits with major banking institutions realisable within 180 days.

Notes forming part of the Financial Statements continued

2. Basis of preparation and accounting policies continued

l. Other financial liabilities

The Company classifies its financial liabilities as:

Trade and other payables

These are initially recognised at invoiced value. These arise principally from the receipt of goods and services. There is no material difference between the invoiced value and the value calculated on an amortised cost basis or fair value.

Deferred income

This is the carrying value of income received from a customer in respect of the order for five 3.5kW systems which has not been recognised in the Income Statement pending delivery to the customer. The carrying value is fair value.

m. Leases

Finance leases, which transfer to the Company substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are reflected in profit or loss. Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term, if there is no reasonable certainty that the Company will obtain ownership by the end of the lease term. Operating lease rentals are charged to income in equal annual amounts over the lease term.

n. Financial assets

All of the Company's financial assets are loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets at fair value and comprise trade and other receivables and cash and cash equivalents.

o. Share-based payment transactions

The Company awards share options and warrants to certain Directors and employees to acquire shares of the Company. The fair value of options and warrants granted is recognised as an employee expense with a corresponding increase in equity. The fair value is measured at grant date and spread over the period during which the Directors and employees become unconditionally entitled to the options or warrants. The fair value of the options and warrants granted is measured using a binomial option valuation model, taking into account the terms and conditions upon which the options and warrants were granted. The amount recognised as an expense is adjusted to reflect the actual number of share options and warrants that vest only where vesting is dependent upon the satisfaction of service and non-market vesting conditions or where the vesting periods themselves are amended by the introduction of new schemes and the absorption of earlier schemes by agreement between the Company and the relevant Directors and employees. Where options or warrants granted are cancelled, all future charges arising in respect of the grant are charged to the income statement on the date of cancellation.

p. Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event and it is probable that the Group will be required to settle the obligation. Provisions are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the balance sheet date and are discounted to present value where the effect is material.

q. Taxation

Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable or recoverable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date together with any adjustment to tax payable in respect of previous years.

Deferred tax assets are not recognised due to the uncertainty of the period over which they will be recovered.

3. Significant accounting estimates and judgements

Carrying values of property and equipment.

The Company monitors internal and external indicators of impairment relating to its property and equipment. Management has considered whether any indicators of impairment have arisen over certain assets relating to these assets. After assessing these, management has concluded that no impairment has arisen in respect of these assets during the year and subsequent to 31 October 2009.

Useful lives of intangible assets, and property and equipment

Intangible assets, and property and equipment are amortised or depreciated over their useful lives. Useful lives are based on the management's estimates of the period that the assets will generate revenue, which are periodically reviewed for continued appropriateness.

Income taxes and withholding taxes

The Company believes that its receivables for tax recoverable are adequate for all open audit years based on its assessment of many factors including past experience and interpretations of tax law. This assessment relies on estimates and assumptions and may involve a series of complex judgements about future events. To the extent that the final tax outcome of these matters is different from the amounts recorded, such differences will impact income tax expense in the period in which such determination is made.

Capitalisation of development expenditure

The Company uses the criteria of IAS38 to determine whether development expenditure should be capitalised. After assessing these, management has concluded it would not be appropriate to capitalise development expenditure incurred during the year ended 31 October 2009.

Share-based payments

Certain employees (including Directors and senior executives) of the Company receive remuneration in the form of share-based payment transactions, whereby employees render services as consideration for equity instruments ('equity-settled transactions').

The fair value is determined by an external valuer using an appropriate pricing model.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ('the vesting date'). The cumulative expense recognised for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Company's best estimate of the number of equity instruments that will ultimately vest. The profit or loss charge or credit for a period represents the movement in cumulative expense recognised as at the beginning and end of that period.

Notes forming part of the Financial Statements continued

3. Significant accounting estimates and judgements continued

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance and/or service conditions are satisfied. Where the terms of an equity-settled award are modified, the minimum expense recognised is the expense as if the terms had not been modified. An additional expense is recognised for any modification, which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification. Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

4. Segmental analysis

A segment is a distinguishable component of the Company that is engaged in providing products or services in a particular business sector (business segment) or in providing products or services in a particular economic environment (geographic segment), which is subject to risks and rewards that are different in those other segments. The Company operated in the year in one segment, the development of fuel cells, and in one principal geographic area, the United Kingdom, but conducted some system tests at AkzoNobel's site in Bitterfeld, Germany.

5. Operating loss (2008: loss)

This has been stated after charging:	Year ended 31 October 2009 £	Year ended 31 October 2008 £
Depreciation of property and equipment	**326,858**	276,972
Research and Development expenditure	**932,085**	1,288,107
Amortisation of intangible assets	**18,147**	16,500
Equity-settled share-based payment expense	**64,920**	247,338
Auditors' remuneration – audit	**17,500**	18,000
Auditors' remuneration – other services	**7,330**	3,965

6. Staff numbers and costs, including Directors

The average number of employees in the year were:	Year ended 31 October 2009 Number	Year ended 31 October 2008 Number
Support, operations and technical	**20**	22
Administration	**4**	4
	24	26

The aggregate payroll costs for these persons were:	£	£
Wages and salaries (including Directors' emoluments)	**1,013,576**	1,137,699
Social security	**112,532**	103,703
Equity – settled share-based payment expense	**57,843**	198,397
	1,183,951	1,439,799

7. Directors' remuneration

	Year ended 31 October 2009 £	Year ended 31 October 2008 £
Wages and salaries	189,250	296,250
Social security	15,904	28,067
Equity-settled share-based payment expense	28,385	135,321
Other compensation (see note 21 & 22)	82,553	166,516
	316,092	626,154
The emoluments of the Chairman were:	49,147	55,998
The emoluments of the highest-paid Director were:	80,666	306,577

The remuneration, details of share options and interests in the Company's shares of each Director is shown in the Directors' Report on pages 8 to 12.

8. Financial income

	Year ended 31 October 2009 £	Year ended 31 October 2008 £
Bank interest receivable	66,390	150,320
Loan interest receivable	1,500	–
Total interest receivable	67,890	150,320

9a. Investment in Associate

The Company acquired 25% of the share capital of Waste2Tricity Ltd (W2T) on 17 June 2009 for £2,500 by converting £2,500 of the £150,000 loan provided to W2T under an agreement of February 2009. The balance of the loan is repayable in full by 31 December 2010 and accrues interest at 0.5% above base rate. The loan is shown in Trade and Other Receivable due after more than 1 year.

The Company's share of the results of its associate was as follows:

	Year ended 31 October 2009
Revenue	–
Profit/(loss)	(26,651)
Assets	7,236
Liabilities	18,685

The Company share of W2T losses if the shareholding had been acquired at 1 November 2008 would have been £51,449.

9b. Loan to Associate

	Year ended 31 October 2009 £	Year ended 31 October 2008 £
Loan to W2T, including accrued interest	149,000	–
Share of W2T losses after write off of investment	(24,151)	–
Loan at 31 October 2009	124,849	–

Notes forming part of the Financial Statements continued

10. Taxation

Recognised in the income statement	Year ended 31 October 2009 £	Year ended 31 October 2008 £
Research and development tax credit – current year	228,361	301,942
Research and development tax credit – prior year adjustment	(9,141)	6,485
Total tax credit	219,220	308,427
Reconciliation of effective tax rates		
Loss before tax	(2,299,748)	(2,960,195)
Tax using the domestic rate of corporation tax of 28% (2008: 30%)	643,929	888,058
Effect of:		
Expenses not deductible for tax purposes	26,037	76,295
Research and development allowance	(195,318)	(217,214)
Research and development tax credit	228,361	301,942
Depreciation in excess of capital allowances	58,536	23,174
Losses surrendered for research and development	399,631	592,164
Other adjustments	–	4,060
Unutilised losses carried forward	355,043	409,579
Total tax credit for the year	228,361	301,942

11. Loss per share

The calculation of the basic loss per share is based upon the net loss after tax attributable to ordinary shareholders of £2,651,768 (2008: loss of £2,651,768) and a weighted average number of shares in issue for the year.

	Year ended 31 October 2009	Year ended 31 October 2008
Basic loss per share (pence)	(1.63)p	(2.51)p
Diluted loss per share (pence)	(1.63)p	(2.51)p
Loss attributable to equity shareholders	(2,080,528)	(2,651,768)

	Number	Number
Weighted average number of shares in issue	127,682,854	105,545,868

Diluted earnings per share

The diluted loss per share is the same as the basic loss per share, as the loss for the year has an anti-dilutive effect.

12. Intangible assets

	2009 Patents £	2008 Patents £
Cost		
Balance at 1 November	**349,583**	324,105
Additions	**18,820**	25,478
Balance at 31 October	**368,403**	349,583
Amortisation		
Balance at 1 November	**41,731**	25,231
Charge for the year	**18,147**	16,500
Balance at 31 October	**59,878**	41,731
Net book value	**308,525**	307,852

13. Property and equipment

	Leasehold improvements £	Fixtures, fittings and equipment £	Total £
Cost			
At 1 November 2007	126,592	510,207	**636,799**
Additions	20,400	288,429	**308,829**
Disposals	–	(61,000)	**(61,000)**
At 31 October 2008	146,992	737,636	**884,628**
Additions	3,160	102,032	**105,192**
Disposals	–	(133,289)	**(133,289)**
At 31 October 2009	150,152	706,379	**856,531**
Depreciation			
At 1 November 2007	50,175	114,023	**164,198**
Charge for the year	43,970	233,002	**276,972**
Disposals	–	(61,000)	**(61,000)**
At 31 October 2008	94,145	286,025	**380,170**
Charge for the year	49,113	277,745	**326,858**
Disposals	–	(120,566)	**(120,566)**
At 31 October 2009	143,258	443,204	**586,462**
Net book value			
At 31 October 2009	6,894	263,175	**270,069**
At 31 October 2008	52,847	451,611	**504,458**

There are no assets held under finance leases. No assets have been revalued.

Notes forming part of the Financial Statements continued

14. Trade and other receivables

	2009 £	2008 £
Trade receivables	4,579	–
Other receivables	254,195	524,917
Prepayments	48,870	67,138
	307,644	592,055

There were no trade and other receivables that were past due or considered to be impaired. The trade and other receivables balances are categorised as loans and other receivables. There is no significant difference between the fair-value of the trade and other receivables and the values stated above.

15. Cash and cash equivalents

	2009 £	2008 £
Cash at bank	–	–
Bank deposits	1,868,601	3,610,204
	1,868,601	3,610,204

Cash at bank and bank deposits consist of cash. There is no material foreign exchange movement in respect of cash and cash equivalents.

16a. Authorised share capital

	2009 Number	2008 Number	2009 £	2008 £
Ordinary Shares of 0.1p	700,000,000	700,000,000	700,000	700,000

16b. Issued share capital

	Number	£
At 1 November 2007	87,682,854	87,683
Issue of shares on 21 May 2008[1]	40,000,000	40,000
At 31 October 2008 and 31 October 2009	127,682,854	127,683

[1] 140,000,000 ordinary shares with a par value of 0.1p per share were issued at 11p per ordinary share by way of a placing to UK investors. Gross proceeds from the issue amounted to £4,400,000.

The Company considers its capital and reserves attributable to equity shareholders to be the Company's capital. In managing its capital, the Company's primary long-term objective is to provide a return for its equity shareholders through capital growth. Going forward the Company will seek to maintain a gearing ratio that balances risks and returns at an acceptable level and also to maintain a sufficient funding base to enable the Company to meet its working capital needs. The Company's product development activities are at an early stage and management considers that no useful target debt to equity gearing ratio can be identified at this time.

Details of the Company's capital are disclosed in the Company statement of changes in equity.

There have been no other significant changes to the Company's management objectives, policies and processes in the year nor has there been any change in what the Company considers to be capital.

17a. Share options

	Number of options	Exercise price (p)	Weighted Average remaining contractual life
At 1 November 2007	7,379,660	10-23	
Options granted in the year	144,000	23	
At 31 October 2008	7,523,660		
Options granted in the year	6,600,000	3.13	
Options lapsed in the year	3,978,670	10-23	
At 31 October 2009	10,144,990	3.13-22	7.4 yrs

17b. Warrants

	Number of warrants	Exercise price (p)	Weighted Average remaining contractual life
At 1 November 2007 and 31 October 2008	4,039,980	10-22	
Warrants granted in the year	4,750,000	3.13	
At 31 October 2009	8,789,980	3.13-22	6.4 yrs

17c. Equity-settled share-based payments charge

Share options

Option price (p)	Average grant date share price (p)	Average expected volatility (pa)	Average risk-free interest rate (pa)	Average dividend yield (pa)	Average implied option life (years)	Average fair value per option (p)	Amount expensed in the 2009 accounts £
10	9	46%	4.4%	0.0%	3.5	2.5	15,478
22	20	46%	4.4%	0.0%	3.5	6	15,536
23	21	46%	4.4%	0.0%	3.5	6	1,849
23	14	46%	4.4%	0.0%	3.5	2	323
3.13	3.13	113.8%	4.4%	0.0%	3	2	18,246

Adjustment for changes in assumptions in respect of vesting conditions	–
Total charge for the year (2008: £156,319)	51,432

Notes forming part of the Financial Statements continued

17c. Equity-settled share-based payments charge continued

Warrants

Warrant price (p)	Average grant date share price (p)	Average expected volatility (pa)	Average risk-free interest rate (pa)	Average dividend yield (pa)	Average implied warrant life (years)	Average fair value per warrant (p)	Amount expensed in the 2009 accounts £
10	20	46%	4.4%	0.0%	3.5	10	3,440
22	20	46%	4.4%	0.0%	3.5	6	(3,084)
3.13	3.13	113.8%	4.4%	0.0%	3	2	13,132
Adjustment for changes in assumptions in respect of vesting conditions							–
Total charge for the year (2008 £91,019)							13,488
Total equity-settled share-based payment charge (2008: £247,338)							64,920

Expected volatility has been based on the historical volatility of share price returns over one year to the date of grant of the options and warrants. Vesting requirements are one year and three years for the exercise of warrants and options respectively.

The fair value of services received in return for share options and other share-based incentives granted is measured by reference to the fair value of share options and incentives granted. This estimate is based on a Black-Scholes model which is considered most appropriate considering the effects of the vesting conditions, expected exercise period and the dividend policy of the Company.

18. Trade and other payables

	2009 £	2008 £
Trade payables	133,875	151,511
Deferred income	123,740	123,740
Other payables	31,723	38,461
Accruals	30,087	124,986
	319,425	438,698

19. Operating lease commitments

	2009 £	2008 £
Non-cancellable operating leases are as follows:		
Within one year	7,200	42,846
Between one and two years	3,600	–
	10,800	42,846

The lease commitments relate to one vehicle.

20. Financial instruments

In common with other businesses, the Company is exposed to risks that arise from its use of financial instruments. This note describes the Company's objectives, policies and processes for managing those risks and the methods used to measure them. Further quantitative information in respect of these risks is presented throughout these financial statements. The significant accounting policies regarding financial instruments are disclosed in note 2 and the significant accounting estimates and judgements are set out in note 3.

Principal financial instruments

The principal financial instruments used by the Company, from which financial instrument risk arises, are as follows:

	2009 £	2008 £
Trade and other receivables	**307,644**	592,055
Cash and cash equivalents	**1,868,601**	3,610,204
Trade and other receivables > 1 yr	**124,849**	–
Trade and other payables	**319,425**	438,698

General objectives, policies and processes

The Board has overall responsibility for the determination of the Company's risk management objectives and policies and, while retaining ultimate responsibility for them, it has delegated part of the authority for designing and operating processes that ensure the effective implementation of the objectives and policies to the Company's finance team. The Board receives reports from financial team through which it reviews the effectiveness of the processes put in place and the appropriateness of the objectives and policies it sets.

The overall objective of the Board is to set policies that seek to reduce ongoing risk as far as possible without unduly affecting the Company's competitiveness and flexibility. Further details regarding these policies are set out below:

Credit risk

Credit risk arises principally from the Company's trade and other receivables and cash and cash equivalents. It is the risk that the counterparty fails to discharge its obligation in respect of the instrument. The maximum exposure to credit risk equals the carrying value of these items in the financial statements as shown below.

	2009 £	2008 £
Trade and other receivables	**307,644**	592,055
Cash and cash equivalents	**1,868,601**	3,610,204
Trade and other receivables > 1 yr	**124,849**	–

The Company's principal trade and other receivables arose from work in progress on the contract with AkzoNobel for which the company has already received payment (held as a payment in advance pending completion of the work). The Company's principal trade and other receivables due in more than 1yr arose from a loan to W2T repayable in December 2010. The recoverability of all amounts shown is expected without material adjustment based on W2T projections of revenue arising from contracts under negotiation. Credit risk with cash and cash equivalents is reduced by placing funds with banks with acceptable credit ratings and government support where applicable.

Liquidity risk

Liquidity risk arises from the Company's management of working capital and the amount of funding required for the development programme. It is the risk that the Company will encounter difficulty in meeting its financial obligations as they fall due. The Company's policy is to ensure that it will always have sufficient cash to allow it to meet its liabilities when they become due. The Company raised £2 million net of costs after 31 October 2009 to provide additional financial resources.

The principal liabilities of the Company are trade and other payables in respect of the ongoing product development programme, Trade and other payables are all payable within 2 months with the exception of the payment in advance noted above. The Board receives cash flow projections on a regular basis as well as information on cash balances.

Notes forming part of the Financial Statements continued

20. Financial instruments continued

Interest rate risk

The Company is exposed to interest rate risk in respect of surplus funds held on deposit.

Fair-value of financial liabilities

	2009 £	2008 £
Trade and other receivables	319,425	438,698

There is no difference between the fair-value and book-value of trade and other payables.

Currency risk

The Company does not currently enter into forward exchange contracts or otherwise hedge its potential foreign exchange exposure. The Board considers that this exposure is not material pending commercialisation of the Company's products. The Board monitors and reviews its policies in respect of currency risk on a regular basis. At 31 October 2009 the Company held no monetary assets or liabilities in currencies other than the functional currency of the operating units involved (2008: £nil).

21. Capital commitments

The Company had no capital commitments outstanding at 31 October 2009.

22. Board changes and post-balance sheet events

Gerard Sauer resigned as Chief Executive Officer on 13 October 2008, effective from 19 December 2008. On 30 January 2009, Terry Walsh was appointed as Commercial Director. On 29 January 2009, Otto Carlisle left the Company and ceased to be a Director. He was paid £42,500 in full and final settlement of all contractual entitlements. On 2 July 2009, Simon Walters resigned as Finance director. On the same day David Marson was appointed as Finance Director and Gene Lewis was appointed as Technical Director. On 5 November 2009, Ian Balchin was appointed to the Board as Chief Executive Officer. Terry Walsh stepped down as a Director on 10 March 2010 to focus on the chlor-alkali sector.

On 4 December 2009 the Company raised net proceeds of £2,000,000 million by way of a placing of 21,500,000 new ordinary shares to UK investors.

23. Ultimate controlling party

There is no ultimate controlling party.

24. Related-party transactions

During the year ended 31 October 2009, £26,812 (plus VAT) was invoiced by FD Solutions, the trading name of DFM Limited (a company registered in England & Wales) for services including Simon Walters as a Director of AFC Energy plc (2008: £86,160). Mr Walters is also a Director and shareholder of DFM Limited. At 31 October 2009, the sum owing to DFM Limited was £200 plus VAT (2008: £14,432).

During the year ended 31 October 2009, £40,701 (plus VAT) was invoiced by Hudson Raine Ltd (a company registered in England & Wales) for services including David Marson as a financial consultant, and latterly for his services as a Director of AFC Energy plc (2008: £ nil). Mr Marson is also a Director and shareholder of Hudson Raine Ltd. At 31 October 2009, the sum owing to Hudson Raine Ltd was nil (2008: £ nil).

During the year ended 31 October 2009, AFC Energy plc provided Waste2Tricity (a company registered in England and Wales) with an interest bearing loan of £150,000 repayable in full by December 2010, under the terms of an agreement to supply AFC fuel cells to W2T for integration into its system for the conversion of municipal solid waste. The Company subsequently converted £2,500 of the loan to equity for a 25% share of W2T (see note 9). In addition, AFC incurred costs of £1,835 on behalf of W2T for which it was reimbursed. Tim Yeo and Terry Walsh joined the board of W2T in December 2008, when AFC Energy was exploring collaborative opportunities with W2T in the UK waste to energy market. Both directors also serve on the board of AFC Energy. Terry Walsh resigned as a director of W2T on 18 January 2010 to concentrate on the chlor-alkali market for AFC Energy. In addition, shareholders in W2T include Adam White, Eturab Corporation and Ian Balchin. Members of the White family are nominated beneficiaries of the Age of Reason Foundation. Both the Age of Reason Foundation and Eturab Corporation are substantial shareholders in AFC Energy. Ian Balchin was appointed Chief Executive Officer of AFC Energy on 5 November 2009. His shareholding in W2T was granted in lieu of payment for work done for W2T before he was employed by AFC Energy.

During the year ended 31 October 2009, £18,889 (plus VAT) was invoiced by Classband Management Ltd (a company registered in England & Wales), a company owned by Howard White, for his services. Members of Mr White's family are nominated beneficiaries of the Age of Reason Foundation, which is a major shareholder in the Company. At 31 October 2009, the sum owing to Classband Ltd was nil (2008: £ nil).

During the year ended 31 October 2009, £608 was invoiced by Ben Sauer, son of Gerard Sauer, for website design and maintenance services (2008: £11,368). The sums were billed at arms-length commercial rates. At 31 October 2009, the sum owing to Mr Sauer was nil (2008: nil).

During the year ended 31 October 2009, £18,000 (plus VAT) was invoiced by Cranwood Management Ltd (a company registered in England & Wales) for consultancy services. The company is owned by Adam White. Members of Mr White's family are nominated beneficiaries of the Age of Reason Foundation, which is a major shareholder in the Company. At 31 October 2009, the sum owing to Cranwood Ltd was nil (2008: £ nil).

AFC ENERGY plc

Notice of Annual General Meeting

Registered in England and Wales No. 05668788

Notice is hereby given to all members that the ANNUAL GENERAL MEETING of the above-named Company will be held at Eversheds LLP, 1 Wood Street, London, EC2V 7WS on Tuesday 13 April 2010 at 2pm for the following reasons:

ORDINARY BUSINESS

To consider and if thought fit, adopt the following resolutions as ordinary resolutions:

1. To receive and approve the financial statements for the year ended 31 October 2009 with the reports of the Directors and Auditors thereon.
2. To re-appoint Jeffreys Henry LLP as Auditors to hold office from the conclusion of the meeting to the conclusion of the next meeting at which Financial Statements are laid before the Company at a remuneration to be determined by the Directors.
3. To re-elect Ian Balchin as a Director.
4. To re-elect David Marson as a Director.
5. To re-elect Gene Lewis as a Director.
6. That, subject to and in accordance with Article 16 of the Company's Articles of Association, in substitution for all existing authorities, to the extent unused, the Directors shall have general and unconditional authority for the purpose of section 551 of the Companies Act 2006 (as amended) (the Act) to exercise all powers of the Company to allot shares in the Company and to grant rights to subscribe for or to convert any security into shares in the Company up to a maximum nominal amount of £30,000 provided that such authorities shall expire on 13 April 2011 unless previously renewed, varied or revoked by the Company in General Meeting and the Directors shall be entitled under the authority hereby conferred or under any renewal thereof to make at any time prior to the expiry of such authority any offer or agreement, which would or might require such shares to be allotted or rights to subscribe for or convert securities into shares to be granted after such expiry, and the board may allot shares and grant rights to subscribe or convert securities into shares in pursuance of such offer or agreement as if the authority conferred by this resolution had not expired.

SPECIAL BUSINESS

To consider and if thought fit, adopt the following resolution as a special resolution:

7. That subject to and conditional upon the passing of resolution 6 and in accordance with Article 17 of the Companies Articles of Association, the Directors shall be and are hereby empowered pursuant to section 570 of the Companies Act 2006 (the Act) to allot equity securities (within the meaning of section 560 of the said Act) for cash pursuant to the general authority conferred by resolution 6 above and be empowered pursuant to section 573 of the said Act to sell ordinary shares (as defined in section 560 of the said Act) held by the Company as treasury shares (as defined in section 724 of the said Act) for cash, as if section 561(1) of the said Act did not apply to such allotment or sale, provided that this power shall be limited to allotments of equity securities and the sale of treasury shares:

i) in connection with or pursuant to an offer by way of rights, open offer or other pre-emptive offer to the holder of shares in the Company and other persons entitled to participate therein in proportion (as nearly as practicable) to their respective holdings, subject to such exclusions or other arrangements as the Directors may consider necessary or expedient to deal with fractional entitlements or legal or practical problems under the laws of any territory or the regulations or requirements of any regulatory authority or any stock exchange in any territory;

ii) otherwise than pursuant to sub-paragraph (i) above, up to an aggregate nominal amount of £30,000, and such powers shall expire on the conclusion of the Annual General Meeting of the Company to be held in 2011 or on 13 April 2011, whichever is earlier, but so that the Company may before such expiry make an offer of agreement which would or might require equity securities to be allotted or treasury shares to be sold after such expiry, and the Directors may allot equity securities or sell treasury shares in pursuance of such offer or agreement as if the power conferred by this resolution had not expired.

By Order of the Board

David Marson

10 March 2010

Notes to the Notice of Annual General Meeting ("AGM"):

Please refer to the notes on the Form of Proxy for guidance on voting.

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AFC ENERGY plc – FORM OF PROXY

Registered in England and Wales No. 05668788

For use at the Annual General Meeting to be held on 13 April 2010

(PLEASE PRINT YOUR NAME AND ADDRESS IN FULL IN BLOCK CAPITALS)

I/We

Of

Hereby appoint the Chairman of the meeting*

*If you wish to appoint someone other than the Chairman as your proxy, please delete these words and insert desired name.

To act as my/our proxy to vote on my/our behalf upon any matter proposed at the Annual General Meeting of the Company to be held on 13 April 2010 and at any adjournment thereof, in such manner as my/our proxy shall think proper, and if expedient to demand a poll. I/We request such proxy to vote on the following resolutions as indicated below:

☐ Please tick here if this proxy appointment is one of multiple proxies being made (and refer to note 6 below)

ANNUAL GENERAL MEETING		Against	For	Vote withheld
Resolution 1	To receive and approve the financial statements			
Resolution 2	To re-appoint the Auditors			
Resolution 3	To re-elect Ian Balchin as a Director			
Resolution 4	To re-elect David Marson as a Director			
Resolution 5	To re-elect Gene Lewis as a Director			
Resolution 6	To authorise the Directors to allot shares and to grant rights to subscribe for or to convert any security in shares pursuant to section 551 of the Companies Act 2006 (as amended)			
Resolution 7	To approve the allotment of equity securities pursuant to section 570 of the Companies Act 2006			

Signature	Date	Number of shares (see notes)

NOTES:

1. Only members whose names appear on the register of members of the company as at 48 hours before the time of the meeting shall be entitled to attend the AGM either in person or by proxy and the number of ordinary shares then registered in their respective names shall determine the number of votes such persons are entitled to cast on a poll at the AGM.
2. To be valid, this form must be signed and received at the offices of the Registrars of the Company not less than 48 hours (excluding any part of the day which is a non-working day) before the time appointed for holding the meeting. In the case of joint holders, any one holder may sign. If both joint holders sign conflicting proxies, the wishes of the holder first named on the register will be accepted.
3. A proxy need not be a member of the Company. Any member entitled to attend and vote at the AGM is entitled to appoint one or more proxies (who need not be a member of the Company) to attend and to vote instead of the member.
4. If the form of proxy is signed on behalf of a shareholder, the copy of the relevant authority of the signatory to act should also be forwarded to the Registrars. In the case of a corporation, the form must be under seal or under hand of a duly authorised officer.
5. Completion and return of this form of proxy does not prevent a shareholder from attending the meeting and voting in person in which case any votes cast by the proxy will be excluded.
6. If any other proxy is preferred, delete the words the Chairman of the Meeting, insert the full name of the proxy or proxies you wish to appoint and initial the alteration. If you are appointing more than one proxy you must indicate the number of shares in respect of which you are making this appointment, you should include the number in the box provided for your first named proxy and either obtain (an) additional proxy form(s) from the registrars (0870 707 1302) or you may photocopy this form. Please return all the forms together and tick the box to indicate each form is one of multiple instructions being given. Please take care when completing the number of shares; if the total number of shares exceeds the total held by the member, all appointments may be invalid.
7. The vote withheld option is provided to enable you to abstain on any particular resolution. However, it should be noted that a vote withheld is not a vote in law and will not be counted in the calculation the proportion of votes For and Against a resolution.
8. Any alteration made in the form of proxy should be initialled.

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Third Fold

Business Reply
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Ian Balchin
David Marson (Company Secretary)
Gene Lewis
Dr Michael Mangan
Mitchell Field

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Registered in England: 05668788

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