

Enabling heavy duty trucks to run on natural gas



Clean Air Power is leading the move towards using natural gas as a fuel for heavy goods vehicles.

The solutions maintain diesel performance and efficiency while delivering significant fuel cost savings and reductions in carbon emissions.

Front cover images

Left: Navistar Dual-Fuel™ installation, San Diego USA

Right: Volvo Dual-Fuel™ installations, Leyland UK

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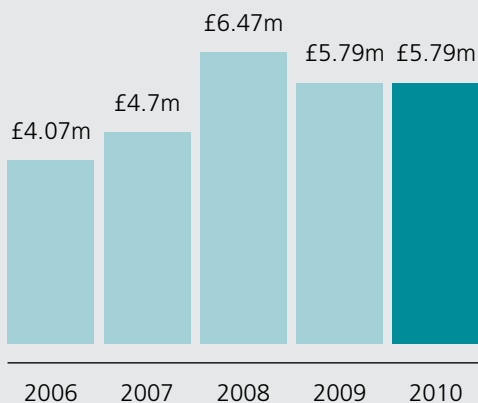


Highlights

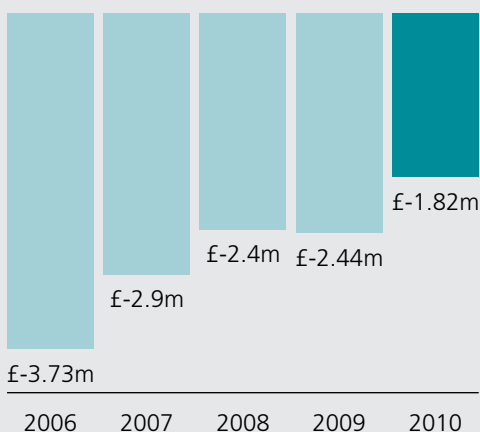
Financial Highlights

- Revenue remained stable at £5.79m, (2009: £5.79m)
- Net loss substantially reduced to £1.82m, (2009: £2.44m)
- Gross profit margin improved to 52%, (2009: 51%), driven by Dual-Fuel™ systems and development revenue
- Gross profit improved to £3.03m, (2009: £2.97m)
- £2.41m in cash at 31 December 2010, (£2.94m as at 31 December 2009)
- Successful £2.25m equity raise in September 2010

Revenue



Net loss



Operational Highlights

- Supply and Development Agreements signed with Volvo Powertrain, a key milestone for the Company
- Fleet trials of Volvo product began in Autumn 2010 in UK and Sweden
- Concept Development Agreement signed with Navistar Inc. in February 2010
- Development agreement signed with Volvo Bus Corporation in July 2010
- Development agreement signed with Volvo Construction and Schmidt to develop a Dual-Fuel™ Snowblower signed in May 2010
- Euro 5 Volvo Genesis EDGE product launched June 2010
- Order received to deliver ten Genesis EDGE units ordered by HAM Group ('HAM') to be fitted on Volvo FM13 trucks
- New on-vehicle catalyst product developed by Emissions Divisions received orders in 2010 for £0.37m

Post Period End

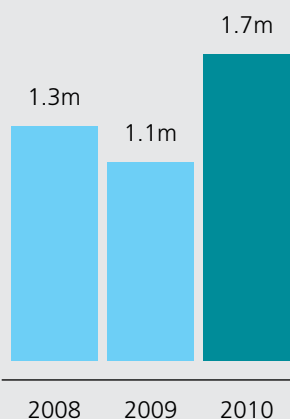
- Order received to deliver eleven Dual-Fuel™ systems to Volvo Bus Corporation
- Deliverables under Navistar Concept Development Agreement successfully achieved

Market Overview

Clean Air Power's Dual-Fuel™ technology enables heavy duty trucks to operate on a combination of diesel and natural gas with minimal change to the base engine.

DRIVING DEMAND

ANNUAL SALES OF VEHICLES OVER 16T



Alternatives to Oil

- Power generation has reduced dependency on oil thanks to developments in nuclear, hydro and wind
- In contrast oil usage for transport has increased

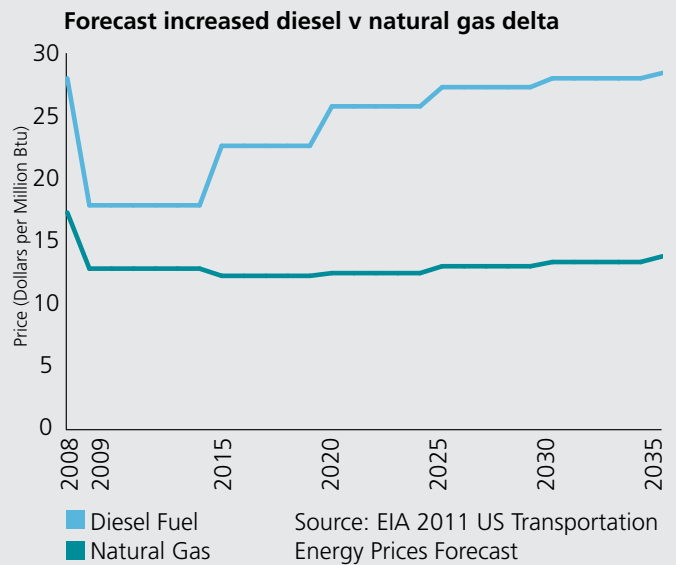
Alternatives in Road Transport

- Electric power and hybrids offer solutions for passenger cars and light/medium duty vehicles
- These are not suitable for the heavy duty sector ('HGV')
- HGVs typically consume over 11,000 gallons of diesel every year, an expense greater than the capital cost of the truck

Drivers for Adoption

- Reduces fuel cost, the highest single expense for transport operators
- Reduces carbon emissions
- Reduces dependency on imported oil in target markets
- Genuine renewable fuel (Bio-Methane)

WORLD TRANSPORT ENERGY USE



DUAL-FUEL™ FUNDAMENTALS

- A Dual-Fuel™ engine is a diesel engine – no basic change
- Four main components are added to the vehicle:
 - > Tank to store gas on the vehicle
 - > Injection system to deliver gas to the engine
 - > Engine control unit containing Clean Air Power's patented software to control injection of the gas
 - > Catalyst solution to control emissions (not required in some markets)
- Retains diesel-cycle performance & efficiency with up to 90% gas substitution
- Delivers lower regulated & carbon emissions than diesel
- Dual-Fuel™ uses a diesel pilot injection to ignite a lean, homogeneous mixture of natural gas (methane) and air
- Can operate on Bio-Diesel, Bio-Methane, LNG (Liquefied Natural Gas) or CNG (Compressed Natural Gas)
- Returns to 100% diesel operation automatically when gas supply is terminated which can be compelling for immature gas markets

At a Glance

Clean Air Power is the developer and supplier of Dual-Fuel™ combustion technology for heavy duty diesel engines.

COMPANY BACKGROUND

Dual-Fuel™ engines substantially cut fuel costs, due to the lower cost of natural gas, and carbon emissions by substituting diesel with clean natural gas without sacrificing the original diesel engine's characteristic efficiency or reliability. The recent upward trend in oil pricing has increased the extent to which Clean Air Power is well positioned to assist corporations and governments to deliver on their environmental commitments, while at the same time reducing transport operators overheads.

Around £47m has been invested in developing the technology since 1991 with the result that 66 patents are currently held or pending. The holding Company of the Group is based in Bermuda with operational subsidiaries in the UK, USA and Australia. The Group was admitted to the AIM market of the London Stock Exchange in February 2006.

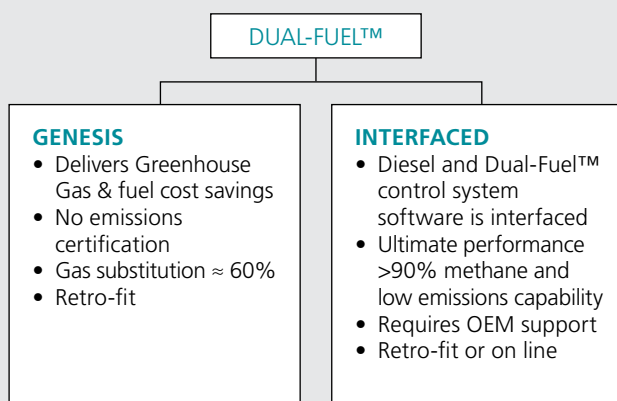
STRATEGY

Clean Air Power is established as a leader in the development of Dual-Fuel™ technology based on the patents, experience and knowledge held within the Company. The main objective of the Company is to enter into agreements with manufacturers whereby our technology is installed on their vehicles as an OEM (Interfaced) option and is distributed through their normal sales channels. In 2010 the signature of a supply agreement with Volvo demonstrated a major success and validated the Company's strategy.

Once we have established our technology within the core heavy duty truck sector, we will look to expand into medium, light duty vehicles, industrial engines, locomotives and mining in the longer term.

Additionally, we aim to expand the sales of its 'Genesis' brand retro-fit version of the Dual-Fuel™ technology, which can be adapted for use on any diesel engine.

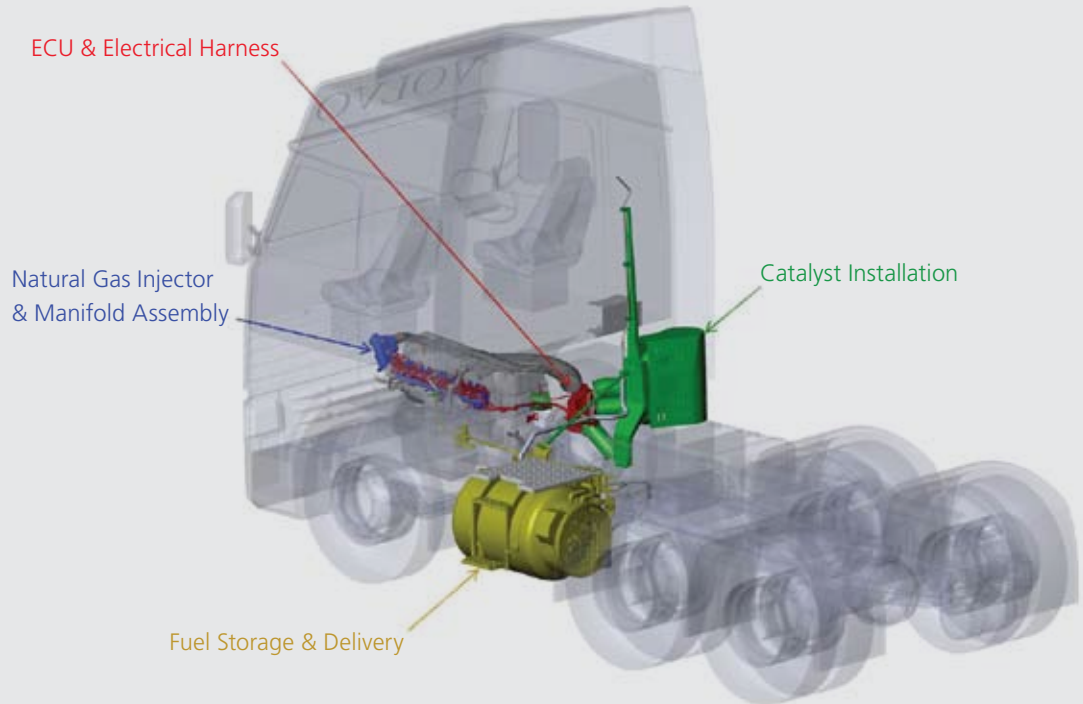
We will also seek to continue to support sales from the Components and Emissions Reduction Divisions by developing our marketing and product development activity.



Clean Air Power has three commercial divisions:

DUAL-FUEL™

Clean Air Power's flagship technology is its patented Dual-Fuel™ system which enables heavy duty diesel engines to operate primarily on natural gas, providing customers with diesel engine performance, operating fuel cost savings and low carbon emissions.



COMPONENTS

Clean Air Power manufactures and delivers innovative hydraulic valves, natural gas injectors and filters for natural gas engines that enable automotive and engine manufacturers to build low-emission natural gas vehicles that meet worldwide emissions regulations.



EMISSIONS REDUCTION

Clean Air Power provides emission reduction solutions to very large stationary diesel, automotive diesel engines and natural gas engines by integrating its technology into the exhaust system of the engine.



Chairman's Statement

Clean Air Power is a supplier of market leading technology that delivers proven reductions in carbon emissions, along with significant fuel cost savings to operators of trucks and other vehicles.



A Supply and Development Agreement was signed with Volvo Powertrain in July 2010, a subsidiary of AB Volvo (Volvo). Under this agreement we were very pleased to see the commencement of fleet trials in the UK and Sweden late in 2010. These trials are taking place using Volvo trucks fully integrated with Clean Air Power's technology in commercial operations. Significant progress was also made with Navistar Inc. with the signing of a Concept Development Agreement early in 2010. In early 2011 Navistar confirmed that Clean Air Power has successfully completed the required deliverables under this agreement.

We also completed the development of the Euro 5 Genesis EDGE Dual-Fuel™ aftermarket product which was introduced in Europe during 2010.

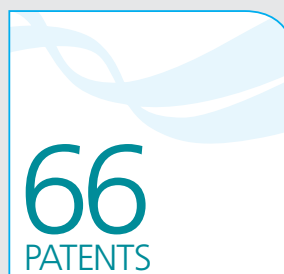
Despite challenging economic conditions, I am pleased to report that good progress was made by our Dual-Fuel™ Division, where the improved revenues offset planned shortfalls in the Components and Emissions Reduction Divisions. The focus on cost management continued during 2010 to help improve operating and net loss levels from a position where sales were flat versus last year. In addition, the equity raises in September 2010 and May 2011 demonstrate continuing investor confidence in our technology and commercial progress.

2011 sales have started slower than expected, but the outlook for the future looks promising, now that we have secured a Supply and Development Agreement with Volvo with limited Volvo factory production expected to start in the second half of 2011. The objective for the Company is to continue to pursue manufacturer cooperation and the Board will be aiming to convert the Navistar Concept Development Agreement into a Product Development contract following the successful initial stage. We will continue to seek new partnerships with other manufacturers and also plan to introduce 'Genesis EDGE' into new markets.

While many opportunities exist for our technology the core strategy of the Company is to continue to focus on progressing its manufacturer cooperation relationships.

Finally I would like to thank John Pettitt and the team for making 2010 such a successful year by improving the financial performance of the Company and by making significant progress with two major global truck manufacturers.

Rodney Westhead
Chairman



GEOGRAPHIC LOCATIONS



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Australia

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Clean Air Power Pty Ltd
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Tullamarine VIC 3043

YEAR IN REVIEW

Feb 2010 – Navistar Agreement

Concept Development Agreement signed with Navistar Inc. ('Navistar') to develop Prototype International Pro Star + Liquefied Natural Gas Truck

May 2010 – Order to develop a Dual-Fuel™ Snow Blower Demonstrator

Purchase order received from Volvo Construction Equipment to develop a Dual-Fuel™ Snowblower. Demonstrator delivered to Stockholm airport, Sweden.

June 2010 – Genesis EDGE Dual-Fuel™ launch with order

Order received from HAM Group ('HAM') for 10 Genesis EDGE Dual-Fuel™ installations to be fitted on Volvo FM13 tractor units to reduce emission and fuel costs by using CAP's Dual-Fuel™ technology.

July 2010 – Signing of Volvo Supply and Development Agreements

Development Agreement and Supply Agreement, initially for five years signed with Volvo Powertrain.

July 2010 – Volvo Bus Agreement

Clean Air Power signed a Development Agreement with Volvo Bus Corporation.

Chief Executive's Review

The Supply and Development Agreements signed with Volvo and the Concept Development Agreement with Navistar represent major milestones for the Company during 2010.

These achievements demonstrate the success of the strategy to target a global truck manufacturer that was set out by Clean Air Power at its admission to AIM in 2006.

Limited production with Volvo is expected to commence in the second half of 2011, which will see Clean Air Power become a tier-one system supplier to Volvo. We also aim to develop the Navistar Concept Development Agreement towards a Product Development Agreement following the successful cooperation during 2010. On the assumption that both of these manufacturer relationships progress to full commercial product launch, the Company will have access to the US and European markets and potentially most other major markets.

The Dual-Fuel™ division's sales increased by 52% during 2010, this was helped partly by revenue from Volvo development activity and OEM trial fleet sales. Operating losses were improved as a result of continued cost management and the maintenance of strong margins in difficult conditions.

We are seeing increased interest in our products since the signature of the agreement with Volvo and the Group is well placed to take advantage of two significant and high profile global issues – rising oil prices and growing concern over harmful emissions including CO₂. The Clean Air Power technology delivers a marked improvement in both of these areas and has already been proven on more than 1,750 vehicles worldwide.

Manufacturer Progress

The Development Agreement signed with Volvo in July 2010 sets out the terms under which Clean Air Power will develop and apply its Dual-Fuel™ technology to Volvo 13-litre products for the European and Thai markets. The Supply Agreement, also signed in July with Volvo, sets out the arrangements under which Clean Air Power will supply the Dual-Fuel™ software and system parts to the Volvo factories as a tier-one supplier for an initial five year term with the Euro 5 product to be marketed in Europe until 2014 and has the potential in developing markets beyond that point.

Fleet trials with commercial operators are under way in the UK and Sweden. Assuming that the products meet their pre-agreed targets including gas substitution, emissions compliance, reliability and fuel economy the intention is that Volvo will offer Dual-Fuel™ product variants. Volvo will market their trucks incorporating the system as the Volvo MethaneDiesel and provide full aftersales support for the vehicles. The products will have the Clean Air Power technology fully interfaced with the OEM engine management system and applied to Volvo's D13 engine.



Production volumes are expected to build from an initial limited production in late 2011 over time. However, the agreement with Volvo allows Clean Air Power to market its own 'Genesis EDGE' product on Volvo FM13 13-litre Euro 5 trucks in order to complement the incremental revenues expected under the Supply Agreement from the Volvo interfaced products.

While the clear contracted intention is for Clean Air Power to supply its systems as a tier-one supplier for online production in the Volvo factories, the Company may carry out some conversions at its UK premises according to demand and to support the Volvo activity.

The Company signed a Concept Development Agreement with Navistar in February 2010 which aims to deliver a Dual-Fuel™ version of the Maxxforce 13 engine that achieves the US Environmental Protection Agency ('EPA') 2010 emissions standard. This stage has now been completed and discussions are under way with a view to progressing the relationship towards a Product Development Contract in 2011. The route to market for the Navistar product is still under discussion but in any event, under such an agreement, the intention is that the technology would be offered to the market as a Navistar product option. Should agreement be reached on the next stage of development Navistar and Clean Air Power will together seek US grant funding or alternative sources of funding to support a project to deliver a certified US 2010 emissions compliant Dual Fuel truck.

North America has an increasing awareness and uptake of natural gas as a road fuel for heavy goods vehicles. This is driven by a considerable increase in US natural gas reserves, energy security concerns, costs benefits and environmental requirements.

Our progress with manufacturers has been driven by the commercial success of our Dual-Fuel™ vehicle technology, by the credibility of our engineering team and by the proven effectiveness of our product offering. We have a strong senior management team with over 150 man years of experience in the development of Dual Fuel Technology. In recent years our recruitment policy has focused on attracting engineers with experience of working for or with major global manufacturers, this ensures that the Company is well placed to capitalise on the exciting opportunities with Volvo, Navistar and others.

The considerable success of 2010 could not have been achieved without the dedication and commitment of all my colleagues at Clean Air Power. We have made significant strides during 2010 with Volvo and Navistar while continuing to manage carefully the finances of the Company. The Company will now focus on delivering its commitments to bring the Volvo products to market and to progress development activity with Navistar. On behalf of myself and the whole Board I would like to thank them for those efforts and look forward to continued success in 2011 and beyond.

John Pettitt
Chief Executive

Volvo

- Volvo Supply Contract signed in July 2010
- Volvo presented FM MethaneDiesel at IAA Truck Show, Hannover, September 2010
- Initial 5 year agreement to supply complete Dual-Fuel™ kits
- Fleet trials began in late 2010
- Series production in Volvo factory expected in second half of 2011
- Initial markets expected to be Netherlands, Great Britain and Sweden
- Volvo is one of Europe's and the world's largest manufacturers of heavy-duty trucks
- Other Volvo brands include Renault Trucks, Mack Trucks, UD Trucks (formerly Nissan Diesel) and Eicher



Navistar

- Concept Development Agreement signed in February 2010 to develop Prototype International Pro Star + Liquefied Natural Gas Truck, now successfully completed
- Prototype vehicle presented at the Mid-America trucking Show in March 2011
- Navistar has a 24% market share of the Class 8 vehicle sector in North America, a 9 point gain over the last three years. Class 8 is the largest sector in the North American commercial truck industry
- Discussions with Navistar are ongoing with a view to the development of a commercial Dual-Fuel™ product



Business Review

Clean Air Power has three commercial divisions – Dual-Fuel™ vehicle systems, Components and Emissions Reduction systems and operates from locations in the UK, the USA and in Australia.

Dual-Fuel™ Vehicles Systems

Clean Air Power's flagship technology is its patented Dual-Fuel™ system, which enables heavy duty diesel engines to operate primarily on natural gas, with diesel fuel acting as a 'liquid spark plug'. The diesel engine is basically unchanged and retains its high performance and high efficiency 4-stroke diesel cycle. By efficiently burning up to 90% natural gas, in certain applications, customers benefit from lower fuel costs and a lower carbon footprint. Dual-Fuel™ can operate normally on bio-methane and bio-diesel, giving it the potential to be carbon-neutral. If the natural gas supply runs out, the Dual-Fuel™ system changes seamlessly to operate on 100% diesel, giving complete diesel operational back-up, a crucial feature in attracting risk averse operators to a new technology.

The primary target market for this technology lies within the estimated 1.7m heavy duty (above 16 tonnes) vehicles sold annually. It is, however, technically feasible to apply Clean Air Power's technology to any diesel engine and in the longer term it is expected that the much larger, medium and light duty vehicle sectors will also become potential targets. During 2010, we developed a Dual-Fuel™ Snowblower for Volvo Construction and Schmidt on a Volvo 9-litre engine. We also developed our system on a bus, for the Volvo Bus Corporation. The success of this cooperation has led to initial orders for 11 units from Volvo bus, which will be delivered during 2011.

2010 was a successful year for this division as revenues increased to £2.76m compared with £1.81m in 2009. This 52% increase is due mainly to revenue from development activity and increased Dual-Fuel™ vehicle systems sales.

2011 sales are currently slower than expected but expected to gain momentum later in the year with positive indications for both UK and Australia.

The Dual-Fuel™ technology is currently available in two main variants; the Interfaced product and the 'Genesis EDGE' retro-fit product currently marketed in Europe.

Interfaced Vehicle System:

In this solution our technology is interfaced with the manufacturer's electronic engine management system. This requires the cooperation of the vehicle manufacturer to integrate the Clean Air Power software with the vehicles' existing Electronic Control Unit. This integration increases the flexibility with which the engine fuelling can be managed and, as a result, maximises the product benefits in terms of carbon emissions and fuel cost savings. Between approximately 70% to 90% of the diesel normally used by the vehicle is substituted for gas in our interfaced products.

In order to sell interfaced Dual-Fuel™ vehicles, compliance with the relevant emissions regulations is required in most markets. Clean Air Power's preferred strategy is to demonstrate such compliance in partnership with a manufacturer and then allow the manufacturer, with the Company's support, to gain the necessary compliance requirements and then market the product. This arrangement is in place with Volvo.



Clean Air Power's only current interfaced product in full production is installed on Caterpillar engines. However, this product is at the end of its life cycle with only certain niche markets in Australia being current realistic targets. During 2010, sales were affected by this reduced opportunity and by the delay in commissioning the LNG plant in Tasmania and the subsequent delayed supply of fuel used in the target market.

'Genesis EDGE' Retro-Fit Vehicle System:

The 'Genesis EDGE' system was developed specifically to be a retro-fitted product which can be installed without the need for formal cooperation of the engine manufacturer. This new product launched in the summer of 2010 incorporates improved software which has increased the expected diesel substitution performance. The solution does not interface directly with the vehicle's own engine management system and up to 60% of the diesel normally used by the vehicle is substituted for gas. The emissions and fuel savings are therefore lower than would be expected on a fully interfaced system, but are still commercially attractive in the target markets, particularly with recent oil price increases.

Components Division

Clean Air Power designs and manufactures a number of components that are used in the Group's Dual-Fuel™ technology. These components are also commercially available to enable automotive and truck manufacturers to build low-emission natural gas vehicles that meet worldwide emissions regulations. Volvo and Mercedes-Benz currently manufacture engines with Clean Air Power's components, including gas injectors and coalescing filters. Clean Air Power components are certified by the EU standard ECE R 110. Revenue and cash generated by this division are an important supplement to Clean Air Power's overall business, particularly while we develop core Dual-Fuel™ products.

In 2010 sales reduced by 27% to £2.11m from £2.90m in 2009, as a result of a planned decrease in activity from a US based defence contractor. This business tends to operate with long initial order lead times but thereafter receives regular ongoing revenues, once customers have specified one of our products into their engines. Repeat orders can typically then be expected, often for the life of the vehicle to provide for maintenance and servicing needs. We expect that 2011 revenues in this division will be lower than 2010 due to the loss of a large customer.

Emissions Reduction Division

This division provides systems incorporating catalysed substrates supplied by specialist manufacturers and can be integrated during the initial installation or retro-fitted to older existing engines and plants. New and more stringent legislation is driving the development and application of exhaust after-treatment in all areas where internal combustion engines operate. It is extremely unlikely that developments in base-engine technology will meet these regulations, thus guaranteeing a need for companies to use emissions reduction technology far into the future.

A major success in 2010 has been the development of a new product offering. Historically this division has only provided emissions solutions to very large stationary diesel and natural gas engines such as those used in pumping stations. However, during

2010 the division secured orders with Emissions Solutions Inc. (ESI) for catalytic converters to be used on a 7.6-litre Natural Gas Engine for trucks and buses in the USA. These trucks are compliant with the US EPA 2010 emissions levels which require near-zero emissions of particulates and NOx.

In 2010 revenues decreased by 15% with sales of £0.92m compared with £1.08m in the previous year, partly due to budget cut backs within our customer base for large scale projects. The increased revenue from the new products helped to offset the deficit from the large scale projects during the year. Revenue from both areas is targeted for the future although trading levels are below expectations for early 2011.

Outlook

Our key objective in 2010 was to deliver a contract with an OEM partner. This was achieved in July 2010 with the signing of the Supply and Development Agreements with Volvo. The top priority in 2011 is to support Volvo to bring this product to market, thereby providing the Company with its first interfaced product launch since its admission to AIM. Development of the product is being finalised and the commencement of limited production is expected in the second half of 2011.

Discussions with Navistar are ongoing and we aim to progress from Concept Development towards a Full Development Contract.

The Company expects to deliver Dual-Fuel™ systems for 11 buses under its agreement with Volvo Bus and may progress certain other opportunities depending on resource requirements for the key manufacturer projects, which remain the main focus.

We have a strong team with excellent experience that ensures that the Company is well placed to deliver on these projects and capitalise on other opportunities for the year ahead.

While we are delighted to have made such good progress with Volvo and Navistar, we continue to discuss cooperation opportunities with other potential partners and engine developers.

In addition to the activity with manufacturers, Clean Air Power plans to expand its 'Genesis EDGE' Dual-Fuel™ system offering into new markets to supplement revenues during the incremental roll out of the Volvo products.

The Company continues to explore avenues in which to maximise shareholder value and during 2011 intends to evaluate the feasibility and potential benefits of a listing on a North American market.

Clean Air Power continues to receive a significant and increasing level of interest from a variety of organisations with regard to the use of its Dual-Fuel™ technology. While some of these may be of interest in the long term, our clear focus remains firmly fixed on the delivery of agreements with manufacturers to incorporate our Dual-Fuel™ technology on their vehicles.

Financial Review

Our Dual-Fuel™ Systems revenue increased by 52% in 2010 while the progress made with manufacturers lays the foundation for future revenue growth opportunities.

The Company benefited from a stronger performance from our Dual-Fuel™ vehicle systems, following increased sales of vehicle systems and revenue from product development activity during the year. During the year, Group revenue remained at £5.79m (2009: £5.79m). However, the 2010 revenues were adversely affected by the delayed commissioning of an LNG plant in Australia and lower orders from a US based defence contractor for our Components division.

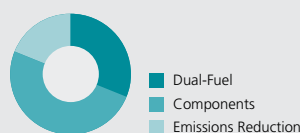
The Group's financial and non-financial highlights of the year were as follows:

	2010 £'000	2009 £'000	Change
Group Revenue	5,788	5,793	–
Total Operating Loss before Non-Cash Items and Exceptional Costs*	(1,256)	(1,407)	11%
Loss for period	(1,820)	(2,436)	25%
Shareholders' Funds	5,352	4,779	12%
Cash and Cash Equivalents	2,410	2,938	–18%
Net Current Assets	2,842	3,303	–14%
Loss per Share	3.00p	4.75p	37%
Average no of employees	57	54	6%
Staff Turnover %	12.0	7.1	
No of Installations	28	21	33%

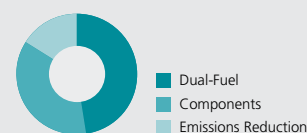
* Non-cash items including depreciation £0.14m (2009: £0.15m), amortisation £0.33m (2009: £0.60m), impairment £nil (2009: £0.06m) and share-based payments £0.11m (2009: £0.11m).

Revenue for the Group across our three divisions was mixed. Dual-Fuel™ Vehicle Systems division's revenue increased by 52% to £2.76m in 2010, mainly as a result of development revenue, compared with £1.81m in 2009, a significant improvement. The Components division revenue decreased by 27% to £2.11m, compared with £2.90m in 2009, mainly due to the loss of revenue from a US defence contractor. The Emissions Reduction division revenue fell by 15% to £0.92m from £1.08 in 2009.

Revenue by Segment 2009



Revenue by Segment 2010



Total operating loss before non-cash items and exceptional costs improved by 10% to £1.26m from £1.41m.

Total net loss reduced by 25% to £1.82m from £2.44m.

Shareholders' funds increased in 2010 due to the Company issuing new share capital during the period.



Net current assets for the year ended 31 December 2010 were £2.84m (2009: Net current assets £3.30m).

Loss per share improved by 37%.

The average number of employees increased as the business accelerated the development programme with Volvo and Navistar.

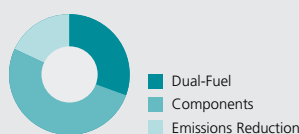
Staff turnover in 2010 was 12% (2009: 7.1%).

Number of Dual-Fuel™ Vehicle Systems installations increased to 28 (2009: 21) units in the year. This increase was mainly due to fleet trial pre-production units built for Volvo and sales in the Australian market.

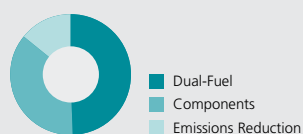
Gross Profit and Cost of Sales

The gross profit margin for the Group for the year improved to 52% (2009: 51%) and gross profit improved to £3.03m (2009: £2.97m).

Gross Profit by Segment 2009



Gross Profit by Segment 2010



Administration Costs

Administration costs were £4.76m (2009: £5.13m). This reduction was mainly due to cost savings maintained since the 2009 re-organisation and capitalisation of internal labour.

Share-based Payments

The share-based payments charges for the Group were £0.11m (2009: £0.11m).

Operating Loss Before Exceptional Costs

Operating losses before exceptional costs for the year reduced significantly to £1.84m (2009: £2.32m).

Taxation

Due to continued losses the Group reports no tax charge for 2010 (2009: nil).

Dividend

The Directors do not recommend a dividend in respect of the current financial year (2009: nil) and no interim dividend was paid (2008: nil).

Statement of Financial Position and Liquidity

Explanations of the most significant items in the Statement of Financial Position during the year are as follows:

Intangible Assets

Intangible assets are carried at £2.24m (2009: £1.14m). This reflects product development costs capitalised in accordance with IAS 38 'Intangible Assets'. Intangible assets are tested annually for impairment and at 31 December 2010, no impairments were required in 2010 (2009: £0.06m).

Trade and Other Receivables

The value of trade and other receivables decreased by £0.20m to £1.34m (2009: £1.54m), principally due to a change in the timing of revenues.

Cash Flows

Cash and cash equivalents decreased by £0.53m to £2.41m (2009: £2.94m). Further analysis of this movement is included in the consolidated cash flow statement on page 31.

Trade and Other Payables

The value of trade and other payables was £1.13m (2009: £1.18m).

Treasury Policy and Financial Risk

The Group's treasury operation is managed within formally defined policies which are reviewed by the Board. The Group finances its activities with cash and overnight deposits. Other financial assets and liabilities, such as trade receivables and trade payables, arise directly from the Group's operating activities. Surplus funds of the Group are invested through the use of short-term deposits with the objective of maximising fixed interest rate returns whilst still providing the flexibility to fund on-going operations when required. It is not the Group's policy to engage in speculative activity or to use complex financial instruments. Further analysis can be found on pages 48 to 50.

Financing

On 29 September 2010, the Company successfully raised £2.25m before expenses; this increased the ordinary share capital to £44,298 by the creation of an additional 18,000,000 Ordinary Shares with a nominal value of \$US0.001 each and a market price of 12.5 pence per share.

In May 2011, the Company successfully raised approximately £1.50m from a combination of new and existing investors. Further analysis can be found on page 54.

Financial Review continued

Key Performance Indicators Financial

The Group uses the following primary measures to assess its performance and propositions.

Revenue

- Revenue and revenue growth are used for internal performance analysis and by investors to assess progress against projections in the market.

Operating Result Before Exceptional Items

- Operating result and profitability trends are used for internal performance analysis and by investors to assess progress against projections in the market. The measure used excludes non-cash items including depreciation £0.14m, amortisation £0.33m and share-based payments £0.11m.

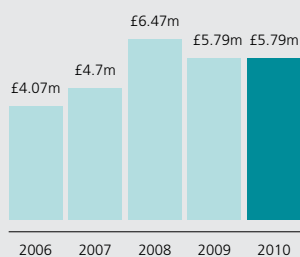
Earnings Per Share

- Earnings per share is calculated as basic earnings per share from continuing operations.

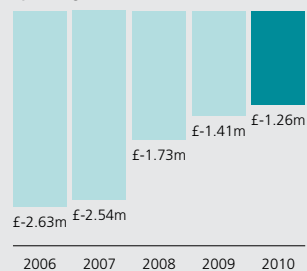
Cash

- Cash and cash equivalent balances are used for internal performance analysis and by investors to assess progress against projections in the market.

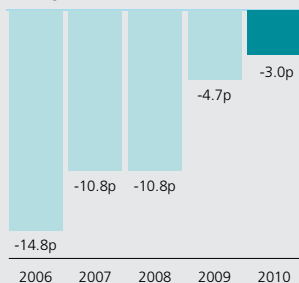
Revenue



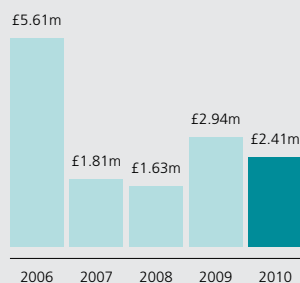
Operating Result



Earnings Per Share



Cash



Non-Financial

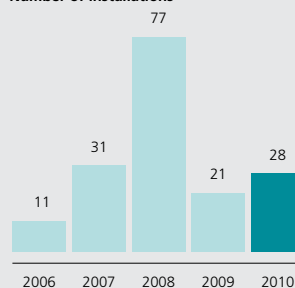
Number of Vehicle Installations

- The Group's development of its customer base with a view to installing its equipment on customer vehicles is a key objective. The number of vehicle installations, and associated trends, is therefore a very important measure of progress.

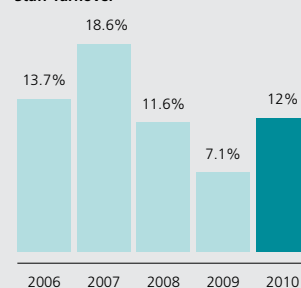
Staff Turnover

- Clean Air Power values its staff very highly and recognises that the success of the Group is largely due to the dedication and knowledge of its employees. Staff turnover is therefore regularly monitored. Although 2010 saw a slight increase, this did not include any core management or engineering teams.

Number of installations



Staff Turnover



Risks and Uncertainties

The following factors may affect the Group's operating results, financial condition and/or the trading price of the Company's shares. The risk factors below are those the Directors believe are potentially significant, but this should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties related to an investment in the Group.

Additional Capital Requirements

The Directors believe that, based on the current level of cash, additional funding may not be required. The current aspiration is that the significant investment that will be required to commercialise the technology with Navistar will be covered by grant funding or third parties without the need to raise equity. However, if such funding is not forthcoming and/or working capital needs exceed expectations, then the Group will need to raise additional capital from equity or debt sources.

Manufacturer Cooperation

The Group anticipates that the Supply Agreement with Volvo Powertrain will lead to products being sold in 2011. Any delays, adverse feedback during the fleet trials or other issues that lead to the Volvo product not being produced will seriously affect the Company's ability to generate revenues. The discussions with Navistar are aimed to lead to formal contracts being agreed for the commercialisation of its technology and expectations are that revenue from a Navistar product will commence in 2012. There are certain technical and commercial milestones to be achieved in the process of moving from the current position to a full commercial relationship, product not being produced will seriously affect the Company's ability to generate revenues.

Fuel Pricing

The degree of financial saving that is generated by the product depends on the difference between price of diesel and the price of natural gas or biogas used to fuel the vehicle. The absolute values are less important. Long-term indications are that natural gas prices generally follow oil prices, and that the difference is expected to widen, but if the relative difference between the two fuels remains too close then the financial case for investment in the Dual-Fuel™ products will be less attractive. Also, should the levels of taxation of diesel be reduced or the level of taxation on natural gas be increased in target markets, then the financial benefits available to the Group's customers could be diminished. This could have the effect of significantly reducing demand to those operators who are prepared to invest only for environmental reasons.

In-House Product Development

The Company has developed a new in-house 'Genesis EDGE' product which can be retro-fitted to Euro 5 vehicles. The Company is currently working towards meeting emissions regulations and other product compliance regulations to ensure the product can be sold in other markets as well as in the UK. However, if this is delayed or is not possible, then the ability to earn revenue from this variant of its Dual-Fuel™ Technology may be seriously impaired. A further risk remains that even assuming the Euro 5 version is successfully developed; some interested operators may prefer to wait until a manufacturer backed version is available with better economics, emissions levels, funding and repair and maintenance packages.

Adaptation of the Core Technology

While the core technology has now been fitted on more than 1,750 vehicles across the world, a number of new product variants are in the process of development. Each new variant requires the adaptation of the core technology to each specific engine platform and emissions compliance dictates that engine platforms are constantly developing. If such adaptations are not able to be completed in line with the timing anticipated in Group plans then the ability to meet sales expectations will be adversely affected.

Gas Supply

The natural gas infrastructure across the world is much less developed than for existing road fuels. The Company is aware of a number of potential suppliers prepared to enter the market. The Company also anticipates, from discussions with such suppliers, that the suppliers will be prepared to provide capital to install gas refuellers and recover the cost over time via a levy in the fuel price. The Company may consider undertaking partnering arrangements with such suppliers. Should either the gas, or the capital, not be available the ability to grow sales will be affected.

Regulatory Framework

The Group's products fall within a number of heavily regulated areas. In order to prosper, the Group's technological solutions must keep pace with the increasingly stringent emissions legislation in order to be allowed onto the market. Depending on the route to market, in some cases the product may require homologation or approval. Failure to meet such regulations could lead to an adverse effect on demand for the product.

Competition/Intellectual Property

In the majority of markets the Group has historically experienced relatively low levels of competition mainly due to the degree of technological development and patents that apply to the Group's technology. The demand to reduce fuel costs and carbon emissions has attracted new competitors to the market. Competition has been increasing with some competitors making progress. Should they succeed in entering these markets and gaining commercial traction, with or without infringing the Company's patents, then such competitive pressure could significantly affect the ability of the Group to achieve sales and satisfactory margins.

Employees

The relatively small size of the Group, an average of 57 employees during 2010 creates the risk that key knowledge of certain aspects of the business is concentrated in a relatively small number of employees. Recruitment and training plans are in place to mitigate this risk.

Trading Risks

The trading performance of the Group could be affected by a number of factors outside its control, including currency risk. A significant proportion of the Group's activities will take place in the USA or Australia and there is the potential for exchange rates variances to impact on the profitability of the Group. The current economic turmoil also has the potential to affect the Company's activities and results in a number of areas.

Corporate Social Responsibility

Socially Responsible Goals

Clean Air Power aims to make a major contribution towards the challenge of addressing climate change by enabling the use of more efficient utilisation of natural resources and to contribute to the creation of a low-carbon economy by providing cleaner, more efficient solutions for the transport industry.

Employees

We continue to create high-skill employment, aiming to recruit the best talent and acting as an equal opportunities employer at all times, by valuing the diversity of our workforce and ensuring that people remain safe from discrimination and harassment in the workplace. We conduct regular surveys of our employees to monitor satisfaction and to encourage feedback. We have in-house personnel resource in both the UK and USA to ensure high standards of employment practice while developing and retaining our most critical asset – our people.

Safety First

Clean Air Power remains committed to achieving high standards in health and safety practice. We invest in health and safety training and work positively to ensure that an open culture towards safety is maintained. We commission regular reviews of our health and safety arrangements by external experts to ensure that we benefit from external developments in this specialism and secure continuous improvement in this vital area.

Environmental Awareness

We aim to operate while minimising our use of resources and environmental impact in terms of waste. We seek to recycle in all areas – from office supplies to production waste.

In 2010 the UK facility achieved ISO 14001: 2004 status, with the US facility currently working towards the same award.

Ethical Standards

Clean Air Power actively strives to achieve high ethical standards in all activities. We seek to ensure that all our business partners apply similarly high standards, including our supply chain partners and customers.

Board of Directors

Rodney Westhead, Chairman

Rodney, who joined as a Director of Clean Air Power in January 2006, is the Chairman of the AEA Technology Audit Committee and Senior Independent Director and a Non-Executive Director of Transens Technology plc. During his career in the British automotive industry, Rodney served as the Group Chief Executive of Ricardo plc, where he was responsible for managing a global range of companies engaged in automotive strategic and technology consulting. Rodney led the Group in strategic acquisitions of companies in the UK and Europe and established offices throughout the world. Ricardo is the largest automotive consultancy company in Europe with approximately £150m in annual turnover. Prior to serving as Chief Executive, Rodney served as the Group Finance Director. Rodney Westhead was a partner in Grant Thornton and had served as Managing Partner of the London office.

John Pettitt, President and Chief Executive

John joined Clean Air Power in August 2005 as part of the Group's focus on the world truck market. John has over 25 years' senior level experience in General Management, Sales & Marketing within the business-to-business services sector. A successful track record of business development has been built on recruiting and developing strong management teams at all levels and providing clear direction and leadership. His career started with Thomson Yellow Pages and Thomson Directories reaching the position of Sales Controller with a staff of 350. Leaving Thomson after 13 years, he joined Lex Service plc as Sales Director of Lex Vehicle Leasing and helped that company grow from 15,000 to 50,000 vehicles in five years becoming the UK's leading vehicle leasing company. He left to become Managing Director of Fraikin Limited, the UK division of Europe's largest independent truck leasing business. After roles with TLS Truck Rental and Iveco-Ford Truck Limited, he rejoined Lex Service and remained there for five years before joining Clean Air Power. His last role was managing Lex Transfleet Airside Solutions, a company employing over 400 staff and maintaining 6,500 pieces of equipment and vehicles for British Airways at four UK airports.

Peter Rowse, Group Financial Director

Peter joined Clean Air Power in January 2006. Previously he served as Chief Financial Officer of DeLonghi America, Inc., the USA subsidiary of the Italian appliance company, where he was responsible for finance, IT management and development, human resource functions, and logistics. Peter was integrally involved in all commercial areas and strategic planning and was instrumental in the company's turnaround. Peter led several initiatives at DeLonghi to improve internal controls and played an active role in managing Canadian and Mexican operations. Peter also served as Contoller, and later, Finance Director of DeLonghi Limited in the UK. During his tenure, the company grew revenue from £5m to £50m GBP. Prior to DeLonghi, he held financial and management accounting roles at Alexon Group plc and TNT Express Europe (UK) Limited. Peter is FCMA qualified.

Bernard Lord, Non-Executive Deputy Chairman

Bernard Lord is a solicitor and lives in Moncton, New Brunswick, Canada. Since completing his second term as Premier of the Province of New Brunswick in October 2006, he is currently President and CEO of the Canadian Wireless Telecommunication Association. Prior to that, he was with the leading Canadian law firm McCarthy Tétrault LLP as Senior Counsel. His interest in transportation was evident during his tenure as Premier, during which time major investment in infrastructure of the road network of New Brunswick was made. His commitment to the environment was demonstrated by the creation of Efficiency New Brunswick, an agency dedicated to the reduction of energy consumption and costs, and improving the environment.

He holds a bachelor's degree in social science with a major in Economics, a bachelor's degree in common law from the Université de Moncton, an honorary doctorate of laws from the University of New Brunswick and honorary doctorate degree from the Université de Moncton and St. Thomas University. He was elected four times as the MLA for Moncton East.

Dr. Ulrich Wöhr, Non-Executive Director, Chairman of the Audit Committee

Ulrich joined as a Director in September 2006 and is currently Chairman of the Supervisory Board of BorgWarner BERU Systems GmbH in Ludwigsburg, Germany, Deputy Chairman of the Supervisory Board of EAN European Avionics Navigationssysteme GmbH & Co. KG, Weilderstadt, Germany and advisor to several large and medium sized non-listed and privately held companies, as well as shareholder and partner in the family owned Otto Wöhr GmbH, Frielzheim, a leading and worldwide supplier of mechanical and automatic car parking devices. During his career in the German industry, he served inter alia for almost 20 years as CEO/CFO of VDO Adolf Schindling AG, an important worldwide operating partner of the automotive industry.

Thereafter he was CFO of the then troubled Metallgesellschaft AG, Frankfurt am Main, followed by the CEO function in GEA AG Bochum, a company acquired by Metallgesellschaft AG in 1999. He retired in the year 2000 and from 2002 to 2004 he was responsible for the restructuring of Bundesdruckerei GmbH, Berlin, a former privatised German government printing body.

Prof. Dr. Karl Viktor Schaller, Non-Executive Director

Between 1990 and 2009 Viktor worked at MAN Commercial Vehicles AG, one of Europe's leading industrial players in transport related engineering, heading various departments including those responsible for development of alternative drive systems (batteries, various hybrids, natural gas, hydrogen in combustion engines and fuel cells) and heavy trucks, and in 2006 became a full board member of MAN Commercial Vehicles AG at that time responsible for product development, purchasing and planning. (MAN was the fastest growing truck maker and exceeded 10bn Euro turnover and 100,000 trucks at that time.)

He holds a diploma and a doctorate in mechanical engineering from the Technical University of Munich. In 2006 he was awarded honorary professor at this university for his lecture 'Commercial Vehicles'.

Directors' Report

Financial Statements

The Directors present their annual report and Group financial statements for the year ended 31 December 2010.

Principal Activities and Review of the Business

Clean Air Power continues to develop and market Dual-Fuel™ solutions to power heavy goods vehicles. In addition, the Group sells specialised components used in the automotive industry and emissions reduction solutions for both mobile and large stationary diesel engine applications.

The Group results are set out in the Consolidated Income Statement on page 27 and are explained in the Financial Review on pages 12 to 14. A review of the Group's business and future development is contained in the Chairman's Statement on page 6 and the Chief Executive's Review on pages 8 to 9.

Results and Dividends

The results of the Group are set out on page 27. The retained loss for the year is £1.82m (2009: £2.44m).

The Directors do not recommend the payment of a dividend in respect of the current financial year (2009: nil) and no interim dividend was paid (2009: nil).

Employment

The Group recognises and places considerable value on the contribution made by all employees to the development of the Group and the achievement of its goals. The Group seeks to keep all its employees informed on matters affecting them as employees and affecting the Group as a whole.

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

Substantial Shareholders

On 31 December 2010 the following persons had reported an interest of 3% or more in the issued ordinary share capital of the Group.

	No. of shares	Percentage of issued ordinary share capital
CSFB Strategic Partners Holdings II, L.P.	21,704,058	29.34%
Enertech Capital Partners	7,387,546	9.99%
Henderson Global Investors	6,530,522	8.83%
FIL Ltd	6,062,659	8.20%
Axa Framlington	5,791,991	7.83%
Royal Bank of Canada Capital Partners	5,501,483	7.44%
Emerson Family	5,436,693	7.35%
Ardsley Partners	2,597,403	3.51%

No other person has reported an interest of 3% or more in the issued ordinary share capital.

Directors and Directors' Interests

The names and brief biographical details of Directors at the date of this report are set out on page 17.

Creditor Payment Policy

It is the Group's policy to settle terms of payment with suppliers when agreeing the terms of the transaction, to ensure suppliers are aware of these and abide by them. Normally, suppliers will be advised as soon as practicable of a dispute and payment will be made of that part of the invoice not in dispute unless good reason exists. Total creditor days for the period ending 31 December 2010 were 32 days (2009: 56 days).

Donations

The Group made charitable donations in the year of £100 (2009: £nil).

Going Concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Chief Executive's Review on pages 8 to 9 and the risks and uncertainties which are described above. The financial position of the Group, its cash flows and financing are described on pages 12 to 15. Note 25 to the financial statements includes a description of the Group's policies and objectives for managing capital and financial risk, details of financial instruments and its exposures to credit risk and liquidity risk.

In September 2010, the Company successfully raised a £2.25m, from a combination of new and existing investors.

In May 2011, the Company successfully raised approximately £1.50m from a combination of new and existing investors. Further analysis can be found in note 31.

The Group has adequate financial resources, together with long-term relationships with a number of customers and suppliers in different countries and industries. As a result, the Directors believe the Group is well placed to manage its business risks successfully despite the current economic outlook.

After making enquiries, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements.

Future Developments

The Directors aim to maintain the management policies which have resulted in the Group's growth in 2010. They consider the best possibilities for growth in 2011 to be from sales of the Dual-Fuel™ technology.

Financial Instruments

The Group's objectives and policies in respect of financial instruments are disclosed in note 25 in the financial statements.

Disclosure of Information to the Auditors

So far as each person who was a Director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware. Having made enquiries of fellow Directors and the Group's auditor, each Director has taken all the steps that he is obliged to take as a Director in order to make himself aware of any relevant audit information and to establish that the auditor is aware of that information.

Auditors

A resolution proposing the re-appointment of Ernst & Young LLP as auditors of the Company will be put to the forthcoming Annual General Meeting.

Signed on behalf of the Board of Directors

Peter Rowse

Director

6 May 2011

Report on Directors' Remuneration

Introduction

The members of the Group's remuneration Committee are Bernard Lord, Prof. Dr. Karl Victor Schaller and Dr. Ulrich Wöhr.

The Remuneration Committee is responsible for considering and making recommendations to the Board on:

- The Company's general policy on executive and senior management remuneration;
- The specific remuneration packages for Executive Directors of the Company, including basic salary, performance-based incentives, pensions and other benefits; and
- The design and operation of the Company's share schemes.

The remuneration of each Executive Director is determined on behalf of the Board by the Remuneration Committee. The remuneration of the Non-Executive Directors is determined by the Executive Directors.

Remuneration Policy

Remuneration packages aim to attract, retain and motivate high calibre managers and reward individual performance. On appointment and periodically thereafter, the Committee benchmarks the executive remuneration packages against appropriate comparators. The reward structure comprises the following elements:

Basic Salary and Benefits

In accordance with the remuneration policy outlined above, the salaries of the Executive Directors are reviewed annually. Consideration is also taken of an Executive Director's experience, responsibilities and performance. Performance is assessed both from an individual and business perspective.

Benefits in kind comprise of private medical insurance benefits for John Pettitt and Peter Rowse. Cash in lieu of a benefit in kind is in respect of a car allowance for John Pettitt and a fully expensed motor vehicle for Peter Rowse.

During 2010 John Pettitt received international transfer related benefits in connection with his relocation to the San Diego office in order to increase focus on North American opportunities.

Pensions

The Company does not have a contributory pension scheme. All pension payments are paid directly into the Directors' personal pension plans.

Fees

The fees of the Non-Executive Directors are determined by the Executive Directors.

Performance Related Bonus

This is based on a fixed formula which is determined at the beginning of each financial year by the Remuneration Committee. The formula measures specified personal objectives and measures the Group's performance to specified targets principally relating to earnings before interest and tax. The amount of bonus is dependent on the level of performance achieved.

Share Option Schemes

Clean Air Power Ltd has operated Share Option Schemes since February 2006 under which Executive Directors, managers and staff of the Company are granted options over shares in Clean Air Power Ltd at prevailing market prices at the date of the grant.

Under the Executive Share Option Schemes, options are granted to Executive Directors and employees at the discretion of the Remuneration Committee and on the basis of their performance. Options are granted at the full market value of the Company's shares at the time of the grant and are exercisable between one year and ten years from the date of the grant.

Further information on the options issued to the Executive Directors is detailed below.

At 31 December 2010, the price of the Company's shares quoted on the AIM of the London Stock Exchange was 8.12p and the highest and lowest prices during the year ended 31 December 2010 were 28.00p and 7.50p respectively.

Service Contracts

The service contract and letters of appointment of the Directors include the following terms:

	Date of contract	Unexpired term (months) or rolling contract	Notice period (months)
Executive Directors			
John Pettitt	01.08.05	Rolling	12
Peter Rowse	01.01.06	Rolling	6
Non-Executive Directors*			
Rodney Westhead	11.01.06	*	–
Bernard Lord	04.07.07	*	–
Dr. Ulrich Wöhr	14.09.06		
Prof. Dr. Karl Viktor Schaller (appointed 19 October 2010)	19.10.10	*	–
Hans Folkesson (resigned 3 August 2010)	15.09.06	*	–

* Contracts for service initially for three years with an annual review thereafter.

There are no special provisions for compensation in the event of loss of office.

Directors' Remuneration

	Salary/fees £	Consultancy £	Annual bonus £	Benefits £	Total 2010 £	Total 2009 £	Pension 2010 £	Pension 2009 £
Executive Directors:								
John Pettitt ¹	207,272	–	50,575	37,082	294,929	308,352	9,975	17,100
Peter Rowse ²	110,000	–	14,566	14,434	139,000	155,359	6,600	6,600
Non-Executive Directors:								
Rodney Westhead	37,800	–	–	–	37,800	38,850	–	–
Bernard Lord	19,426	–	–	–	19,426	20,637	–	–
Dr. Ulrich Wöhr	19,426	–	–	–	19,426	20,637	–	–
Prof. Dr. Karl Viktor Schaller (appointed 19 October 2010)	4,415	2,142	–	–	6,557	–	–	–
Hans Folkesson (resigned 3 August 2010)	2,339	10,752	–	–	13,091	25,306	–	–
Larry Wilson (resigned 13 March 2009)	–	–	–	–	–	3,000	–	–
Total	400,678	12,894	65,141	51,516	530,229	572,141	16,575	23,700

1 John Pettitt was awarded £15,827 taken in shares in lieu of cash and was awarded £10,998 in relation to the tax liability incurred on this issue of shares.

2 Peter Rowse was awarded £4,538 taken in shares in lieu of cash and was awarded £3,153 in relation to the tax liability incurred on this issue of shares.

Report on Directors' Remuneration continued

Directors' Interests

Set out below are the beneficial interests of the Directors and their families in the share capital of the Company at the beginning and end of the year.

	Number of ordinary shares			
	Shares		Options	
	31.12.2010	01.01.2010 or later appointment	31.12.2010	01.01.2010 or later appointment
John Pettitt	1,004,205	658,653	3,166,791	3,166,791
Peter Rowse	152,946	108,418	591,168	591,168
Rodney Westhead	114,143	74,143	–	–
Bernard Lord	40,000	–	–	–
Dr. Ulrich Wöhr	97,143	57,143	–	–
Prof. Dr. Karl Viktor Schaller (appointed 19 October 2010)	–	–	–	–
Hans Folkesson (resigned 3 August 2010)	25,000	25,000	–	–

Directors' Interests in the Group's Share Option Schemes

	At 1 January 2010	Granted during the year	At 31 December 2010	Date of grant	Exercise price	Date first exercisable	Expiry date
Director							
John Pettitt	1,441,791	–	1,441,791	27 Feb 2006	\$0.98	27 Feb 2007	27 Feb 2017
John Pettitt	1,125,000	–	1,125,000	14 May 2008	19p	14 May 2011	14 May 2018
John Pettitt	600,000	–	600,000	11 Nov 2009	26.3p	11 Nov 2012	11 Nov 2019
Peter Rowse	48,060	–	48,060	28 Feb 2006	100p	28 Feb 2007	28 Feb 2017
Peter Rowse	36,045	–	36,045	28 Feb 2006	100p	1 March 2007	28 Feb 2017
Peter Rowse	36,045	–	36,045	28 Feb 2006	100p	1 June 2007	28 Feb 2017
Peter Rowse	36,045	–	36,045	28 Feb 2006	100p	1 Sept 2007	28 Feb 2017
Peter Rowse	36,044	–	36,044	28 Feb 2006	100p	1 Dec 2007	28 Feb 2017
Peter Rowse	48,929	–	48,929	13 Apr 2007	28.5p	13 March 2010	13 March 2017
Peter Rowse	150,000	–	150,000	14 May 2008	19p	14 May 2011	14 May 2018
Peter Rowse	200,000	–	200,000	11 Nov 2009	26.3p	11 Nov 2012	11 Nov 2019

On behalf of the Board

Peter Rowse

6 May 2011

Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual Report and the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union.

The Directors are required to prepare Group financial statements for each financial year which present fairly the financial position of the Group and the financial performance and cash flows of the Group for that period. In preparing those Group financial statements, the Directors are required to:

- select suitable accounting policies in accordance with IAS 8: 'Accounting Policies, Changes in Accounting Estimates and Errors' and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance; and
- state that the Group has complied with IFRSs, subject to any material departures disclosed and explained in the financial statements.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group. They are also responsible for safeguarding the assets of the Group 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 corporate and financial information included on the Group's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Corporate Governance Statements

Corporate governance, in general terms, is the way in which a Company is controlled and directed and in particular, is concerned with the role of the Board of Directors, how the Board and committees of the Board operate, and accountability within a Company.

The Company's shares are listed on the Alternative Investment Market ('AIM') of the London Stock Exchange. The Company is subject to the AIM Admission Rules of the London Stock Exchange and is consequently not required to comply with best practice corporate governance provisions contained within Section 1 of the revised Combined Code (2008) ('Combined Code') appending to the Listing Rules of the Financial Services Authority. However, the Directors believe good corporate governance is essential. Having considered the provisions of the Combined Code, the Directors set out below the principles of the Combined Code and how the Company has applied those principles. The current size of the Company means that full compliance with the provisions of the Combined Code is not practical or cost effective. However, in areas where the Board of Directors believe that the provisions set out in the Combined Code are paramount to corporate governance, procedures for compliance have been established.

The Board

The Board of Directors is usually structured such that it includes a balance of Executive and Non-Executive Directors. As at 31 December 2010, the Board comprised one Non-Executive Chairman, one Non-Executive Deputy Chairman, two Non-Executive Directors and two Executive Directors including the Chief Executive Officer. The Executive Directors and the Non-Executive Directors bring a wide range of business expertise to the Board's discussions and decision making. The Board of Directors has put in place an organisational structure with clearly defined responsibilities and delegation of authority. Biographical details of all the Directors are set out on page 17.

The Board considers that the Non-Executive Chairman and two of the Non-Executives are independent of management. One of the Non-Executive Directors provides consultancy services relating to corporate development for which he is rewarded on a time spent basis.

The full Board meets formally at least four times each year to consider all matters of significance for the Company as they arise, as well as matters reserved specifically for their consideration. These matters include development of business strategy and policy, the review and approval of operating budgets and monitoring business performance against objectives, the approval of significant financing and capital expenditure programmes, the approval of interim and annual financial statements and consideration of matters relating to internal control. The Board is supplied in a timely manner with all relevant information to assist in the discharge of its duties.

All the Directors have access to the advice and services of 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.

Senior management meet on a regular basis and discuss all major issues affecting the Company which do not require Board discussion or approval by other Board Committees. It is the Company's policy to appoint Non-Executive Directors for specified terms, subject to re-election. All Directors are subject to re-election by shareholders at the first opportunity after their initial appointment, and to re-election thereafter in accordance with the Company's Bye-laws.

Remuneration Committee

The Remuneration Committee seeks to ensure that its policies on remuneration are such that the Company is able to attract and retain high calibre executives, and those executives are rewarded in a way consistent with the interest of shareholders. Remuneration and incentive packages are awarded according to the individual's performance, experience and responsibility.

The Remuneration Committee comprises three Non-Executive Directors and is chaired by Mr Bernard Lord. The Executive Directors attend meetings of the Committee by invitation. The Committee meets at least annually and is responsible for making recommendations to the Board on the remuneration policy of the Executive Directors and senior staff, and for determining salaries, incentive payments and longer term incentives in the form of share options. Shareholders would be invited to approve any new long-term incentive schemes which might give rise to a significant dilution in their equity. The Remuneration of the Non-Executive Directors is set by the Executive Directors ensuring that no Director is responsible for the determination of his own remuneration.

In determining the level of remuneration, individual performance and competitiveness within the sector is considered when setting or reviewing the remuneration package of Executive Directors. Details of the Directors' emoluments are disclosed at note 10 to the financial statements and in the Report on Directors' Remuneration.

Nomination Committee

The Nomination Committee comprises three Non-Executive Directors and is chaired by Mr Rodney Westhead. Its role is to ensure that appropriate procedures are in place for the nomination and selection of candidates for appointment to the Board, having regard for the balance and the structure of the Board. In appropriate cases, recruitment consultants are used to assist the process. The Committee also makes recommendations to the Board regarding the re-election of Directors, succession planning and Board composition.

Accountability and Audit

All the Directors are equally accountable under the law for the proper stewardship of the Company's affairs. The Board acts in a way which allows all Directors to bring their independent judgement to bear on issues of strategy, performance, resources, including key appointments and standard of conduct.

Audit Committee

The Audit Committee comprises three Non-Executive Directors and is chaired by Dr. Ulrich Wöhr. The Committee will review the Company's interim and annual financial statements before submission to the Board for approval. The Committee will also review regular reports from management and the external auditors on accounting and internal control matters. Where appropriate, the Committee will monitor the progress of action taken in relation to such matters. The Audit Committee will also recommend the appointment of and review the fees of the external auditors.

Internal Control

The Board of Directors is responsible for ensuring that the Company maintains an adequate system of risk management and internal control. Due to the relatively small size of the Company, the processes it has employed to identify, evaluate and manage significant business risks have been informal, and have depended upon close business involvement of senior management, including the Executive Directors in all aspects of the Company's operations.

The Company maintains an adequate system of risk management and internal control, and an internal control environment which, in the opinion of the Directors, is appropriate for the Company's size and complexity. These controls include a budgeting process with an annual operating budget approved by the Board of Directors, a comprehensive financial reporting system, comparing actual results to budget (with variations to budget being thoroughly investigated with corrective action taken by the Directors as appropriate), the provision of monthly management accounts, annual budgets and forecasts, and operational limits on the delegation of financial authority.

Full management accounts are normally issued within 12 working days following the month end. Full financial forecast updates are produced bi-annually and the Company reports to shareholders bi-annually.

The Company does not currently have an internal audit function. The Board believes that this is appropriate given the current size of the Company.

Relations with Shareholders

The Company seeks to maintain and enhance its good relationship with its shareholders. This is achieved through the provision of interim and annual reports; through meeting with shareholders and presentations to them in general meetings and after major Company announcements; by responses to individual enquiries; and through the Company's website, www.cleanairpower.com. The Annual General Meeting is the primary opportunity to meet individual shareholders, to make presentations to them, to encourage their participation through questions and to talk informally to them after the formal proceedings. Separate resolutions are proposed at the Annual General Meeting on each substantially separate issue. The Board is always ready, where practicable, to enter into dialogue with institutional and individual shareholders based on mutual understanding of objectives.

Independent Auditor's Report to the Members of Clean Air Power Limited

We have audited the financial statements of Clean Air Power Limited for the year ended 31 December 2010 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated and Company Statements of Financial Position, the Consolidated and Company Statements of Cash Flow and the Consolidated and Company Statements of Changes in Equity and the related notes 1 to 31. The financial reporting framework that has been applied in their preparation is International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the Company's members as a body, in accordance with our engagement letter dated 29 October 2008. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Statement of Directors' Responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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. In addition, we read all the financial and non-financial information in the Highlights, Chairman's Statement, Chief Executive's Review, Business and Financial Reviews, Directors' Report, Report on Directors' Remuneration and Corporate Governance Statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Group and Company's affairs as at 31 December 2010 and of the Group's loss for the year then ended; and
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Ernst & Young LLP

Manchester
6 May 2011

Consolidated Income Statement

	Notes	Year ended 31 December 2010 £'000	Year ended 31 December 2009 £'000
Revenue	3	5,788	5,793
Cost of Sales		(2,754)	(2,822)
Gross profit		3,034	2,971
Administrative expenses		(4,761)	(5,127)
Share-based payments charge	27	(110)	(105)
Impairment charge	14	–	(55)
Operating loss before exceptional costs		(1,837)	(2,316)
Reorganisation costs	5	–	(142)
Loss on ordinary activities before net finance revenue and taxation		(1,837)	(2,458)
Finance revenue	7	17	23
Finance costs	8	–	(1)
Loss on ordinary activities before taxation		(1,820)	(2,436)
Tax expense	11	–	–
Loss for the period		(1,820)	(2,436)
Basic and diluted loss per share	12	(3.00p)	(4.75p)

All items dealt with in arriving at operating loss above relate to continuing operations.

Consolidated Statement of Comprehensive Income

	Notes	Year ended 31 December 2010 £'000	Year ended 31 December 2009 £'000
Loss for the period	3	(1,820)	(2,436)
Exchange differences on translation of foreign operations		101	(165)
Total comprehensive loss for the period		(1,719)	(2,601)
Attributable to:			
Equity holders of the parent		(1,719)	(2,601)

Consolidated Statement of Financial Position

	Notes	31 December 2010 £'000	31 December 2009 £'000
Assets			
Non-current assets			
Plant and equipment	13	269	337
Intangible assets	14	2,241	1,140
		2,510	1,477
Current assets			
Inventories	17	839	984
Trade and other receivables	18	1,342	1,540
Cash and cash equivalents	19	2,410	2,938
		4,591	5,462
TOTAL ASSETS		7,101	6,939
Equity and liabilities			
Equity attributable to equity holders of the parent			
Ordinary share capital	20	44	33
Accumulated loss		(45,499)	(43,789)
Other reserves		33,504	33,504
Share premium		16,219	14,048
Translation reserve		1,084	983
Total equity		5,352	4,779
Non current liabilities			
Other payables	24	–	1
		–	1
Current liabilities			
Trade and other payables	21	1,132	1,178
Provisions	22	460	392
Deferred revenue	23	157	589
		1,749	2,159
TOTAL LIABILITIES		1,749	2,160
TOTAL EQUITY AND LIABILITIES		7,101	6,939

The financial statements were approved by the Board of Directors on 6 May 2011 and were signed on its behalf by:

Peter Rowse
Director

Company Statement of Financial Position

		31 December 2010 £'000	31 December 2009 £'000
Assets			
Non-current assets			
Investments	15	1,649	320
Other financial assets	16	15,944	13,985
		17,593	14,305
TOTAL ASSETS		17,593	14,305
Equity and liabilities			
Equity attributable to equity holders of the parent			
Ordinary share capital	20	44	33
Share premium		16,219	14,048
Accumulated profit		1,330	224
Total equity		17,593	14,305
TOTAL LIABILITIES		–	–
TOTAL EQUITY AND LIABILITIES		17,593	14,305

The financial statements were approved by the Board of Directors on 6 May 2011 and were signed on its behalf by:

Peter Rowse
Director

Consolidated Statement of Cash Flows

Consolidated cash flow statement	Notes	Year ended 31 December 2010 £'000	Year ended 31 December 2009 £'000
Cash flows from operating activities			
Loss on ordinary activities before taxation		(1,820)	(2,436)
Adjustments for:			
Net finance income		(17)	(22)
Depreciation of plant and equipment	13	139	147
Amortisation of intangibles	14	332	601
Impairment of intangibles	14	–	55
Share-based payments	27	110	105
Decrease in trade and other receivables		197	397
(Decrease) in trade and other payables		(46)	(532)
Decrease in inventories		145	606
Increase/(Decrease) in provisions		68	(251)
(Decrease)/increase in deferred revenue		(432)	589
Other non-cash movements		(24)	10
Net cash outflow from operating activities		(1,348)	(731)
Investing activities			
Interest received	7	17	23
Payments to acquire plant and equipment	13	(62)	(33)
Payments to acquire intangible assets	14	(1,397)	(748)
Net cash outflow from investing activities		(1,442)	(758)
Financing activities			
Interest paid	8	–	(1)
Proceeds from the issue of ordinary share capital	30	2,285	3,027
Share issue costs	30	(103)	(201)
Net cash inflow from financing activities		2,182	2,825
Net (decrease)/increase in cash and cash equivalents		(608)	1,336
Net foreign exchange differences		80	(24)
Cash and cash equivalents at 1 January		2,938	1,626
Cash and cash equivalents at 31 December	19	2,410	2,938

Company Statement of Cash Flows

For the year ended 31 December 2010

		Year ended 31 December 2010 £'000	(restated) ¹ Year ended 31 December 2009 £'000
Company cash flow statement			
Cash flows from operating activities			
(Loss)/profit before taxation		(223)	(231)
Net cash outflow from operating activities		(223)	(231)
Investing activities			
(Increase) in funding loans to subsidiary undertakings		(1,959)	(2,595)
Net cash inflow from investing activities		(1,959)	(2,595)
Financing activities			
Proceeds from the issue of ordinary share capital	30	2,285	3,027
Share issue costs	30	(103)	(201)
Net cash inflow from financing activities		2,182	2,826
Net increase in cash and cash equivalents		–	–
Cash and cash equivalents at 1 January		–	–
Cash and cash equivalents at 31 December		–	–

1 The comparatives have been restated to show the movement in amounts due from subsidiary undertakings as investing activities instead of operating activities as previously reported.

Consolidated Statement of Changes in Equity

For the year ended 31 December 2010

	Ordinary share capital £'000	Share premium £'000	Translation reserve £'000	Other reserves £'000	Accumulated loss £'000	Total equity £'000
Balance at 1 January 2009	24	11,231	1,148	33,504	(41,458)	4,449
Comprehensive loss for the period	–	–	(165)	–	–	(165)
Loss for the period	–	–	–	–	(2,436)	(2,436)
Total comprehensive loss for the period	–	–	(165)	–	(2,436)	(2,601)
Share-based payments	–	–	–	–	105	105
On issue of new shares	9	3,018	–	–	–	3,027
Share issuance costs	–	(201)	–	–	–	(201)
Balance at 31 December 2009	33	14,048	983	33,504	(43,789)	4,779
Comprehensive loss for the period	–	–	101	–	–	101
Loss for the period	–	–	–	–	(1,820)	(1,820)
Total comprehensive loss for the period	–	–	101	–	(1,820)	(1,719)
Share-based payments	–	–	–	–	110	110
On issue of new shares	11	2,274	–	–	–	2,285
Share issuance costs	–	(103)	–	–	–	(103)
Balance at 31 December 2010	44	16,219	1,084	33,504	(45,499)	5,352

Company Statement of Changes in Equity

For the year ended 31 December 2010

	Ordinary share capital £'000	Share premium £'000	Accumulated loss £'000	Total equity £'000
Balance at 1 January 2009	24	11,231	455	11,710
Loss for the period	–	–	(231)	(231)
Total comprehensive loss for the period	–	–	(231)	(231)
On issue of new shares	9	3,018	–	3,027
Share issuance costs	–	(201)	–	(201)
Balance at 31 December 2009	33	14,048	224	14,305
Loss for the period	–	–	(223)	(223)
Total comprehensive loss for the period	–	–	(223)	(223)
Share-based payments	–	–	1,329	1,329
On issue of new shares	11	2,274	–	2,285
Share issuance costs	–	(103)	–	(103)
Balance at 31 December 2010	44	16,219	1,330	17,593

Notes to the Consolidated Financial Statements

1. Authorisation of Financial Statements and Statement of Compliance with IFRSs

The Group and Company financial statements of Clean Air Power Limited for the year ended 31 December 2010 were authorised for issue by the Board of Directors on 6 May 2011 and the statements of financial position were signed on the Board's behalf by Peter Rowse. Clean Air Power Limited is a public limited Company incorporated in Bermuda whose shares are publicly traded.

The Group and Company's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU as they apply to the financial statements of the Group for the year ended 31 December 2010.

All of the revenue and profits and operating assets relate to the Group's principal business activities, being vehicle conversion sales, sales of components and an emissions reduction business. Revenue is stated net of value added tax. For further analysis please refer to the Directors' Report on pages 18 to 19.

2. Summary of Significant Accounting Policies

Basis of Preparation

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union. The consolidated financial statements have been prepared under the historical cost convention except where indicated below. The preparation of financial information in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial information are disclosed in the critical accounting estimates and judgements section.

The accounting policies that follow set out those policies that apply in preparing the financial statements for the year ended 31 December 2010. The Company and the Group have applied the same policies throughout the year.

Under the Bermuda Companies Act 1981 the Company is able to waive the presentation of the financial statements of the Company subject to the agreement in writing (or at a general meeting) of all the shareholders and Directors of the Company. Accordingly, the Company has not presented its own income statement as part of these financial statements. The Company made a loss for the year after taxation and before dividends of £223K (2009: £231K).

The Group and Company financial statements are presented in sterling and all values are rounded to the nearest thousand pounds (£'000) except where otherwise indicated.

Basis of Consolidation

The Group financial statements consolidate the financial statements of Clean Air Power Limited and its subsidiary undertakings drawn up to 31 December each year.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group, and deconsolidated from the date that control ceases. The financial statements of subsidiaries used in the preparation of the consolidated financial statements are prepared for the same reporting period of the parent Company and are based on consistent accounting policies. Intragroup transactions, balances and unrealised gains on transactions between Group companies are eliminated, including unrealised profits or losses.

The following new and amended IFRS and IFRIC interpretations as of 1 January 2010 did not have any impact on the accounting policies, financial position or performance of the Group.

IFRS 2	Group Cash-settled Share-based Payments Arrangement (Amendment)
IFRS 3	Business Combinations (revised)
IAS 27	Consolidated and Separate Financial Statements (amended)
IAS 39	Amendment of Eligible Hedged Item
IFRIC 17	Distributions of Non-cash Assets to Owners

New Standards and Interpretations not Applied

IASB and IFRIC have issued the following standards and interpretations with an effective date after the date of these financial statements.

International Accounting Standards (IAS/IFRS)		Effective date
IFRS 1	First-time Adoption of International Financial Reporting Standards	1 January 2011
IAS 24	Related party Disclosures (Revised)	1 January 2011
IAS 32	Financial Instruments: Presentation Classification of Rights Issues (Amendment)	1 January 2011
IFRS 9	Financial Instruments Classification and Measurement	1 January 2013
IAS 12	Recovery of Underlying Assets (Amendment)	1 January 2013
International Financial Reporting Interpretations Committee (IFRIC)		
IFRIC 14	Prepayments of a Minimum Funding Requirement (Amendment)	1 January 2011
IFRIC 19	Extinguishing Financial Liabilities with Equity Instruments	1 January 2011

Notes to the Consolidated Financial Statements

continued

2. Summary of Significant Accounting Policies continued

IFRS 1 'First-time Adoption of International Financial Reporting Standards' has been amended to allow first-time adopters to utilise the transitional provisions in IFRS 7 Financial Instruments: Disclosures as they relate to March 2009 amendments to the standard. These provisions give relief from providing comparative information in the disclosures required by the amendments in the first year of application. The Group does not expect any impact on its financial position or performance.

IAS 24 'Related Party Disclosures (Revised)' the amended standard clarified the definition of a related party to simplify the identification of such relationships and to eliminate inconsistencies in its application. The Group does not expect any impact on its financial position or performance.

IAS 32 'Financial Instruments: Presentation Classification of Rights Issues (amendment)'. The amendment to IAS 32 amended the definition of a financial liability in order to classify rights issues (and certain options or warrants) as equity instruments where such rights are given pro rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, or to acquire fixed number of the entity's own equity instruments for a fixed amount in any currency. The amendment will have no impact on the Group after initial application.

IFRS 9 'Financial Instruments: Classification and Measurement' reflects the first phase of the IASBs work on replacement of IAS 39 and applies to classification and measurement of financial assets as defined in IAS 39. In subsequent phases, the IASB will address classification and measurement of financial liabilities, hedge accounting and derecognition. The completion of this project is expected in early 2011. The adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of the Group's financial assets. The Group will quantify the effect in conjunction with the other phases, when issued, to present a comprehensive picture.

IAS 12 'The amendment introduces a presumption that recovery of the carrying amount of assets measured using the fair value model in IAS 40 will normally be through sale, for the purposes of measuring the associated deferred tax'. The Group does not expect any impact on its financial position or performance.

IFRIC14 'Prepayments of a Minimum Funding Requirement (Amendment)'. The amendment to IFRIC 14 is effective for annual periods beginning on or after 1 January 2011 with retrospective application. The amendment provides guidance on assessing the recoverable amount of a net pension asset. The amendment permits an entity to treat the prepayment of a minimum funding requirement as an asset. The amendment is deemed to have no impact on the financial statements of the Group.

IFRIC19 'Extinguishing Financial Liabilities with Equity Instruments'. IFRIC 19 clarifies that equity instruments issued to a creditor to extinguish a financial liability qualify as a consideration paid. The equity instruments issued are measured at their fair value. In case this cannot be reliably measured, the instruments are measured at the fair value of the liability extinguished. Any gain or loss is recognised immediately in profit or loss. The Group does not expect any impact on its financial position or performance.

The Directors do not anticipate that the adoption of these standards and interpretations will have a material impact on the Group's financial statements in the period of initial application.

Plant and Equipment

Plant and equipment is stated at cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight-line basis over the expected useful life of the asset using the following rates:

- Plant and equipment – 3 to 5 years

The carrying values of plant and equipment are reviewed for impairment either annually, or when events or changes in circumstances indicate the carrying value may not be recoverable (whichever is earlier). If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amount.

An item of plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year the item is derecognised.

Residual values and estimated remaining lives are reviewed annually.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost includes all costs incurred in bringing each product to its present location and condition on a moving weighted average cost basis. Net realisable value is the estimated selling price in the ordinary course of business, less any further costs expected to be incurred to completion and disposal.

Work in Progress

Work in progress is the cost of direct materials and labour.

Leases

Leases are classified as finance lease whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the Group. All other leases are classified as operating leases.

Assets held under finance lease are recognised as assets of the Group at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability is to be included in the statement of financial position as a finance lease obligation. The interest element of leasing payments represents a constant proportion of the capital balance outstanding and is charged to the income statement over the period of the lease.

Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight line basis over the lease term.

Foreign Currency

The Group's consolidated financial statements are presented in sterling, which is also the parent Company's functional currency. Each entity in the Group determines its own financial currency and items included in the financial statements of each entity are measured using that functional currency. The Group has elected to recycle the gains or loss that arises from the direct method of consolidation, which is the method the Group uses to complete its consolidation.

Transactions in foreign currencies are initially recorded in the functional currency by applying the spot exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the income statement, except for differences on monetary assets and liabilities that form part of the Group's net investment in a foreign operation. These are taken directly to equity until the disposal of the net investment, at which time they are recognised in profit or loss.

The assets and liabilities of foreign operations are translated into sterling at the rate of exchange ruling at the balance sheet date. Income and expenses are translated at weighted average exchange rates for the year. The resulting exchange differences are taken directly to a separate component of equity. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the income statement.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Intangible Assets

Research and Development Costs

Research costs are expensed as incurred. An intangible asset arising from development expenditure on an individual project is recognised only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the ability of resources to complete and the availability to measure reliably the expenditure during the development. Following the initial recognition of the development expenditure, the cost model is applied requiring the asset to be carried at cost less any accumulated amortisation and accumulated impairment losses. Any expenditure capitalised is amortised over the period of expected future sales from the related project as follows:

- Development expenditure – 18 months to five years.

Computer Software

Computer software is carried at cost less accumulated amortisation. Computer software has a finite life with no residual value and is amortised on a straight line basis over the expected useful life as follows:

- Computer software – three years.

The carrying value of intangible assets is reviewed for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. In addition, the carrying value of capitalised development expenditure is reviewed for impairment annually before being brought into use.

Cash and Cash Equivalents

Cash and cash equivalents in the statement of financial position comprise cash at bank and in hand and short-term deposits with an original maturity date of three months or less.

Investments

Investments in subsidiary undertakings are stated at cost less any provision for any impairment that the Directors consider necessary.

Provisions

Provisions are recognised when the Group has a present legal or constructive obligation and it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

Notes to the Consolidated Financial Statements

continued

2. Summary of Significant Accounting Policies continued

Deferred Income Taxes

Deferred income tax is provided using the liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences, except:

- where the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised except:

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Unrecognised deferred income tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date:

- Deferred income tax relating to items recognised directly in equity is recognised in equity and not in profit or loss.

Pensions

The Group contributes on behalf of its employees to individual personal defined contribution plans. The contributions made by the Group are recognised as an expense in the period they fall due.

Share-Based Payment Transactions

The cost of equity settled transactions with employees is measured by reference to the fair value at the date on which they are granted. The fair value is determined by an external valuer using an appropriate pricing model. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of the Company ('market conditions'), if applicable.

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 conditions are satisfied.

At each balance sheet date before vesting, the cumulative expense is calculated, representing the extent to which the vesting period has expired and management's best estimate of the achievement or otherwise of non-market conditions number of equity instruments that will ultimately vest or in the case of an instrument subject to a market condition, be treated as vesting as described above. The movement in cumulative expense since the previous balance sheet date is recognised in the income statement, with a corresponding entry in equity.

Where the terms of an equity-settled award are modified or a new award is designated as replacing a cancelled or settled award, the cost based on the original award terms continues to be recognised over the original vesting period. In addition, an expense is recognised over the remainder of the new vesting period for the incremental fair value of any modification, based on the difference between the fair value of the original award and the fair value of the modified award, both as measured on the date of the modification. No reduction is recognised if this difference is negative.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any cost not yet recognised in the income statement for the award is expensed immediately. Any compensation paid up to the fair value of the award at the cancellation or settlement date is deducted from equity, with any excess over fair value being treated as an expense in the income statement.

The cost of share options granted by the Company for the benefit of employees of its subsidiaries is recorded as an increase in the cost of the Company's investment in the shares of its subsidiary. A corresponding credit is recorded in equity.

Ordinary Share Capital

Ordinary share capital is held in US\$ and translated at spot rate when shares are issued.

Trade and Other Receivables

Trade receivables, which generally have 30 day terms, are recognised and carried at original invoice amount less an allowance for any uncollectible amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable, bad debts are written off when identified.

Interest Bearing Loans and Borrowings

All loans and borrowings are initially recorded at fair value net of issue costs associated with the borrowing.

Interest bearing bank loans and overdrafts are recorded at the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an amortised cost basis and charged to the Income Statement using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled during the period in which they arise.

Trade Payables

Trade payables are not interest bearing and are stated at their nominal value.

Financial Liabilities and Equity Instruments

Financial liabilities and equity instruments are all instruments that are issued by the Group as a means of raising finance, including shares, loan notes, debentures, debt instruments and options and warrants that give the holder the right to subscribe for or obtain financial liabilities and equity instruments. An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. All equity instruments are included in shareholders' funds. The finance costs incurred in respect of an equity instrument are charged directly to the income statement. Other instruments are classified as financial liabilities if they contain a contractual obligation to transfer economic benefits.

Borrowing Costs

Borrowing costs are recognised as an expense when incurred or capitalised where such costs relate to a qualifying asset. The amount of borrowing costs capitalised during the period was £nil.

Revenue Recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received, excluding discounts, rebates, VAT and other sales taxes or duty. The following criteria must also be met before revenue is recognised.

Sale of Goods

Revenue from the sale of goods is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer, usually on despatch of the goods.

Within the Emissions Reduction segment, revenue is recognised to the extent of costs incurred where it is probable that those costs will be recoverable. If the total contract costs exceed total contract revenue, the expected loss is recognised immediately.

Rendering of Services

Revenues from development programmes are recognised as development work is performed during the contractual term, as measured by performance milestones. Revenue is not recognised where there is uncertainty regarding the achievement of milestones.

Interest Income

Revenue is recognised as interest accrues using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to its net carrying amount.

Critical Accounting Policies, Judgements and Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported for assets and liabilities as at the balance sheet date and the amounts reported for revenues and expenses during the year. The nature of estimation means that actual outcomes could differ from those estimates. Key sources of estimation uncertainty and critical accounting judgements are as follows:

Deferred Taxation

In the preparation of the financial statements, the Group estimates the income taxes in each of the taxing jurisdictions in which the Group operates as well as any deferred taxes based on temporary differences. Deferred tax assets relating to tax loss carry-forwards and temporary differences are recognised in those cases when future taxable income is expected to permit the recovery of those tax assets. Changes in assumptions in the projections of future taxable income, as well as changes in tax rates could result in significant differences in the valuation of deferred taxes.

Intangible Assets

Development costs are capitalised in accordance with the accounting policy. Initial capitalisation of costs is based on management's judgement that technology and economical feasibility is confirmed, usually when project development has reached a defined milestone. In determining the amounts to be capitalised management makes assumptions regarding the expected future cash generation of the assets, discount rates to be applied and the expected period of benefits.

Notes to the Consolidated Financial Statements

continued

2. Summary of Significant Accounting Policies continued

Provisions

The Group recognises a provision for liabilities associated with vehicle and parts warranty. The Group has made assumptions in relation to historical claims and the expected cost of claims. In relation to future claims, the Group has made assumptions based on the warranty expiry dates and the history of previous claims.

Share-Based Payments

The estimation of share-based payment costs requires the selection of an appropriate valuation model, consideration as to the inputs necessary for the valuation chosen and the estimation of the number of awards that will ultimately vest, inputs which arise from judgements relating to the continuing participation of employees.

3. Segment Information

Revenue by Business Segment

For management purposes the Group is organised into business units based on their products and services, and has three reportable operating segments as follows:

The vehicle conversions segment allows a standard diesel engine to operate on natural gas without any major changes to the engine.

The components segment designs and delivers innovative hydraulic valves and natural gas injector components for natural gas engines that enable automotive and truck manufacturers to build low-emission gasoline, natural gas and diesel vehicles that meet worldwide emissions regulations.

The emissions reduction segment offers emissions reduction solutions that reduce regulated engine emissions by post combustion after-treatment of an engine's exhaust gasses.

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit or loss and is measured consistently with operating profit or loss in the consolidated financial statements. However, financing and income taxes are managed on a Group basis and are not allocated to operating segments.

Transfer prices between operating segments are on an arm's length basis in a manner similar to transactions with third parties.

	Year ended 31 December 2010 £'000				
	Dual-Fuel™	Components	Emissions Reduction	Adjustments and eliminations	Total
Revenue					
Third party ^{(1) (8)}	2,762	2,108	918	–	5,788
Inter-segment ⁽²⁾	980	–	–	(980)	–
Total revenue	3,742	2,108	918	(980)	5,788
Results					
Depreciation and amortisation ⁽³⁾	(403)	(72)	(6)	10	(471)
Segment (loss) ⁽⁴⁾	(1,219)	(9)	(244)	(365)	(1,837)
Net finance income	–	–	–	–	17
Loss for the period	–	–	–	–	(1,820)
Assets					
Operating assets ⁽⁵⁾	1,796	1,875	949	(29)	4,591
Provisions ⁽⁶⁾	139	275	88	(9)	493
Operating liabilities including provisions ⁽⁶⁾	767	715	302	(9)	1,775
Other disclosures					
Capital expenditure ⁽⁷⁾	1,468	25	13	(47)	1,459

1. Dual-Fuel™ conversion segment includes revenue arising from development activity.

2. Inter-segment revenues are eliminated on consolidation (£980,000) (Note: 28).

3. Depreciation eliminated (£9,611) following transfer of intangible assets to Clean Air Power Inc.

4. Elimination of intragroup management charges (£223,000) and intragroup gains and losses (£142,000).

5. Adjustment to profit in inventory (£29,187) and excluding intangible assets (£2,241,000) and tangible assets (£269,000).

6. Adjustment to provisions of (£8,532).

7. Capital expenditure consists of additions to plant and equipment and intangible assets.

8. Revenue from one customer amounted to £1,167,322 (2009: £279,655), arising from sales related to the vehicle conversions segment.

Year ended 31 December 2009 £'000

	Dual-Fuel™	Components	Emissions Reduction	Adjustments and eliminations ³	Total
Revenue					
Third party	1,813	2,897	1,083	–	5,793
Inter-segment ⁽¹⁾	513	–	–	(513)	–
Total revenue	2,326	2,897	1,083	(513)	5,793
Results					
Depreciation and amortisation	(674)	(89)	(5)	20	(748)
Impairment	(55)	–	–	–	(55)
Segment (loss)/profit ⁽⁴⁾	(1,660)	86	(153)	(589)	(2,316)
Reorganisation costs	–	–	–	–	(142)
Net finance income	–	–	–	–	22
Loss for the period	–	–	–	–	(2,436)
Assets					
Operating assets	2,051	2,463	974	(26)	5,462
Provisions	265	47	100	(20)	392
Operating liabilities including provisions	1,489	435	256	(20)	2,160
Other disclosures					
Capital expenditure ⁽²⁾	776	5	–	–	781

1. Inter-segment revenues are eliminated on consolidation.

2. Capital expenditure consists of additions to plant and equipment and intangible assets.

3. Adjustments and eliminations relate to consolidation eliminations and holding company items.

4. Elimination of intragroup management charges (£230,720) and intragroup gains and losses (£358,648).

Geographical Information

	Year ended 31 December 2010 £'000	Year ended 31 December 2009 £'000
Revenues from external customers:		
UK	266	241
USA	1,812	2,551
Australia	1,074	954
Rest of Europe	1,754	1,474
Rest of World	882	573
	5,788	5,793

The revenue information is based on the location of the customer.

Non-Current Assets

	Year ended 31 December 2010 £'000	Year ended 31 December 2009 £'000
UK	61	100
USA	2,443	1,373
Australia	6	4
	2,510	1,477

Non-current assets for this purpose consist of plant and equipment and intangible assets.

Notes to the Consolidated Financial Statements

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4. Operating Loss

Loss on ordinary activities before taxation is stated after charging:

	Year ended 31 December 2010 £'000	Year ended 31 December 2009 £'000
Inventory expensed in the period	2,200	2,352
Depreciation of property, plant and equipment	139	147
Amortisation of capitalised development expenditure	332	601
Impairment charge	–	55
Loss on disposal of fixed assets	–	(7)
Foreign exchange differences	81	(24)
Operating lease rentals		
– Other	74	71
– Land and buildings	408	336
Research and development expensed to income statement	479	600

5. Reorganisation Costs

During 2009 we undertook a fundamental review of our operations in order to reduce costs and simplify our operations. This resulted in a one off reorganisation charge of £142,000 being incurred during 2009. In preparing the 30 June 2009 interim financial statements these costs were reported as non-operating costs. Since this date, the emerging practice in disclosing such costs under IAS 1 is to reflect them within operating profit or loss.

6. Auditors' Remuneration

	2010 £'000	2009 £'000
Audit of the financial statements	58	58
	58	58

In 2010 there were no other fees (2009: £nil)

7. Finance Income

	2010 £'000	2009 £'000
Bank interest receivable	17	23

8. Finance Costs

	2010 £'000	2009 £'000
Other interest payable	–	1

9. Staff Costs

The average monthly number of employees of the Group during the period, including Executive Directors, was as follows:

	2010 Number	2009 Number
Operational	35	32
Administrative	22	22
	57	54

Staff costs for all employees, including Executive Directors, consist of:

	2010 £'000	2009 £'000
Wages and salaries	2,943	2,826
Social security costs	253	253
Other pension costs	99	120
Expense of share-based payments	110	105
	3,405	3,304

The Group operates money purchase (defined contribution) pension schemes. The assets of these schemes are held separately from those of the Group in independently administered funds. The pension cost for the period represents contributions payable by the Group to these funds and amounted to £99,237 (31 December 2009: £120,223). Unpaid pension costs at the year end amounted to £20,459 (2009: £17,647).

10. Directors' Emoluments

	Year ended 31 December 2010 £'000	Year ended 31 December 2009 £'000
Emoluments:		
Remuneration for management/non-executive services	517	551
Consultancy paid to Non-Executive Director	13	21
Defined contribution pension payments	17	24
	547	596

At the year end, there were £990 unpaid pension contributions (2009: £990).

Pension contributions were made to personal plans of two of the Executive Directors (2009: two).

	Year ended 31 December 2010 £'000	Year ended 31 December 2009 £'000
Highest paid Director:		
Emoluments	295	308
Defined contribution pension payments	10	17
	305	325

Disclosures of Directors' remuneration, share options and pension contributions are on pages 20 to 22 within the Remuneration Report.

11. Taxation

	Year ended 31 December 2010 £'000	Year ended 31 December 2009 £'000
Analysis of charge in the year		
Corporation tax at 28%	–	–
Deferred tax	–	–
	–	–

	2010 £'000	2010 %	2009 £'000	2009 %
Reconciliation of tax charge				
Loss on ordinary activities before tax	(1,820)	100	(2,436)	100
Tax at 28%	(510)	28	(682)	28
Tax effect of expenses that are not deductible in determining taxable profit	35	(2)	64	(3)
Losses arising in the year not recognised in deferred tax	742	(41)	727	(30)
Movement in temporary differences not recognised in deferred tax	(330)	18	(170)	7
Tax losses utilised	–	–	(4)	–
Effect of different tax rates of group companies operating in other jurisdictions	63	(3)	65	(2)
Current tax for the period	–	–	–	–

Notes to the Consolidated Financial Statements

continued

11. Taxation continued

Deferred Tax

The deferred tax asset/(liability) recognised/(provided) at 31 December is as follows:

	2010 £'000	2009 £'000
Deferred tax asset/(liability)		
Plant and equipment	(851)	(406)
Short-term temporary differences	633	406
Tax losses	218	–
	–	–

At the balance sheet date the Group has an unrecognised deferred tax asset in relation to unused tax losses of £15.2m (2009: £14.7m) available to offset against future profits. No deferred tax asset has been recognised in respect of these losses due to the unpredictability of future profit streams. At 31 December 2009 the Group also had an unrecognised deferred tax asset in respect of short-term temporary differences amounting to £0.3m which had not been recognised due to the unpredictability of future profit streams.

The Group's unrecognised deferred tax asset includes £3.3m in respect of its UK subsidiary. The Government announced in June 2010 that it intended to reduce the rate of corporation tax from 28% to 24% over four years, and Finance Act 2010, which was substantively enacted in July 2010, included provisions to reduce the rate of corporation tax to 27% with effect from 1 April 2011. Accordingly, the unrecognised deferred tax balances disclosed have been calculated at the lower rate of 27%.

On 23 March 2011 the government announced that it intends to further reduce the rate of corporation tax to 26% with effect from 1 April 2011 and then by 1% per annum to 23% by 1 April 2014. As this legislation was not substantively enacted by 31 December 2010, the impact of the anticipated rate change is not reflected in the tax provisions reported in these accounts. If the deferred tax assets and liabilities of the Company were all to reverse after 1 April 2014, the effect of the changes from 27% to 23% would be to reduce the unrecognised deferred tax asset by £496,232. To the extent that the deferred tax reverses more quickly than this the impact on the net deferred tax asset will be reduced.

Unrecognised tax losses carried forward against certain future overseas corporation tax liabilities have the following expiration dates.

	2010 £'000	2009 £'000
2010	–	922
2011	688	676
2012	–	–
2013	–	–
2014	5,146	1,553
2015 and later	46,975	46,755
Available indefinitely	13,225	12,135
Unrecognised tax losses available to carry forward	66,034	62,041
Amount of tax losses recognised in the deferred tax asset	805	–
Total gross amounts of tax losses available to carry forward	65,229	62,041

12. Loss per Share

Basic

Basic loss per share is calculated by dividing net loss for the year attributable to equity holders of the parent by the weighted average number of Common Shares in issue during the year.

	2010	2009
Loss for the period	(1,820)	(2,436)
Weighted average number of shares	60,709,907	51,333,919
Basic and diluted loss per share	(3.00p)	(4.75p)

The loss for the period and the weighted average number of Ordinary Shares for calculating the diluted earnings per share for the period to 31 December 2010 are identical to those used for the basic earnings per share. This is because the outstanding share options would have the effect of reducing the loss per Ordinary Share and would therefore not be dilutive.

13. Plant and Equipment – Group

	Plant and equipment £'000	Total £'000
Cost		
At 1 January 2009	1,073	1,073
Additions	33	33
Disposals	(16)	(16)
Exchange differences	74	74
At 31 December 2009	1,164	1,164
Additions	62	62
Exchange differences	32	32
At 31 December 2010	1,258	1,258
Depreciation		
At 1 January 2009	579	579
Depreciation charge for the year	150	150
Disposals	(9)	(9)
Exchange differences	107	107
At 31 December 2009	827	827
Charge for the period	139	139
Exchange differences	23	23
At 31 December 2010	989	989
Net book value		
At 31 December 2010	269	269
At 31 December 2009	337	337
At 1 January 2009	494	494

The carrying value of plant and equipment held under finance leases and hire purchase contracts at 31 December 2010 was £3,330 (2009: £5,550).

14. Intangible Assets – Group

	Capitalised development expenditure £'000	Software £'000	Total £'000
Cost			
At 1 January 2009	2,182	187	2,369
Additions – Internal development	741	7	748
Exchange differences	(531)	(16)	(547)
At 31 December 2009	2,392	178	2,570
Additions – Internal development	1,377	20	1,397
Exchange differences	71	4	75
At 31 December 2010	3,840	202	4,042
Amortisation			
At 1 January 2009	1,039	169	1,208
Charge for the period	600	11	611
Impairment	55	–	55
Exchange differences	(428)	(16)	(444)
At 31 December 2009	1,266	164	1,430
Charge for the period	321	11	332
Exchange differences	35	4	39
At 31 December 2010	1,622	179	1,801
Net book value			
At 31 December 2010	2,218	23	2,241
At 31 December 2009	1,126	14	1,140
At 1 January 2009	1,143	18	1,161

Notes to the Consolidated Financial Statements continued

14. Intangible Assets – Group continued

Capitalised development expenditure mostly relates to the Groups Dual-Fuel™ products, which is amortised over periods between 18 months and five years.

The largest 2010 addition £703,009 relates to the Volvo development, the carrying value at the end of the year was £1,150,032. The project is expected to be complete in 2011 and expenditure will be amortised over period of 3.5 years.

Amortisation expenses are charged through administration expenses in the consolidated income statement.

15. Investments – Company

	Total £'000
At 1 January 2009	320
Increase in respect of share-based payments	–
At 31 December 2009	320
Increase in respect of share-based payments	1,329
At 31 December 2010	1,649

The cumulative cost of share options granted by the Company for the benefit of employees of its subsidiaries has been recorded as an increase in the cost of the Company's investment in the shares of its subsidiary.

The following unlisted subsidiary undertakings at the end of the period have all been included in the consolidated accounts.

Name	Country of registration	Proportion of voting rights and ordinary share capital	Nature of business
Clean Air Power Limited	England and Wales	100%	Vehicle Conversions and Product Support
Clean Air Power Inc	USA	100%	Vehicle Conversion, Emissions Reduction and Product Support
Clean Air Power Pty Ltd	Australia	100%	Vehicle Conversions and Product Support

16. Other Financial Assets (Non-Current) – Company

	2010 £'000	2009 £'000
Amounts owed by subsidiary undertakings	15,944	13,985
	2010 £'000	2009 £'000
Amounts due from 1 January 2012 with an option to extend this deadline.	15,944	13,985

The amounts are not interest bearing. Amounts due from subsidiary undertaking are recorded at amortised cost.

17. Inventories – Group

	2010 £'000	2009 £'000
Raw materials	737	894
Work in progress	30	40
Finished goods	72	50
	839	984

There is no significant difference between the replacement value of stock and the amount at which it is stated in the financial statements.

During 2010 the amount of inventories write down is £158,798 (2009: £67,237) which has been expensed to cost of sales.

18. Trade and Other Receivables (Current) – Group

	2010		2009	
	Group £'000	Company £'000	Group £'000	Company £'000
Trade receivables	768	–	1,302	–
Prepayments and accrued income	547	–	220	–
VAT receivables	27	–	17	–
Other non-trade receivables	–	–	1	–
	1,342	–	1,540	–

Trade receivables are non-interest bearing and are generally on 30-day terms, apart from vehicle conversions which are settled on collection of the vehicle conversion. The credit quality of trade receivables that are neither past due nor impaired is assessed on an individual customer basis by the Group's credit control procedures.

As at 31 December 2010, trade receivables at nominal value of £5,703 (2009: £nil) were impaired and fully provided for due to poor payment history.

Movements in the provision for impairment of receivables were as follows:

	Total £'000
At 1 January 2010	–
Additional provision in year	6
At 31 December 2010	6

As at 31 December, the ageing analysis of trade receivables that were past due but not impaired is as follows:

	Total £'000	Neither past due nor impaired <30 days £'000	30–60 days £'000	61–90 days £'000	91–120 days £'000	>120 days £'000
2010	768	536	93	128	6	5
2009	1,302	549	100	4	649	–

19. Cash and Cash Equivalents

	2010 £'000	2009 £'000
Cash at bank and on hand		
Sterling	1,775	1,218
US Dollar	455	1,335
Australian Dollar	180	385
	2,410	2,938

Cash at bank and in hand earns interest at floating rates based on daily bank deposit rates.

20. Share Capital

	2010 £'000	2009 £'000
Authorised		
120,000,000 (31 December 2009: 120,000,000 Common Shares of US\$0.001)		
Common Shares of US\$0.001 each	67	67
Issued and paid up		
73,977,244 (31 December 2009: 55,783,682 Common Shares of US\$0.001 each)		
Common Shares of US\$0.001 each	44	33

During 2010, 193,562 Ordinary Shares were issued in lieu of cash bonus to senior management team. For details of other shares issued, please refer to note 30.

Notes to the Consolidated Financial Statements

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21. Trade and Other Payables (Current) – Group and Company

	Year ended 31 December 2010		Year ended 31 December 2009	
	Group £'000	Company £'000	Group £'000	Company £'000
Trade payables	328	–	442	–
Taxation and social security	20	–	58	–
Other payables	–	–	4	–
Accruals	783	–	671	–
Obligations under finance lease	1	–	3	–
	1,132	–	1,178	–

Terms and conditions of the above financial liabilities:

- Trade payables are non-interest bearing and are normally settled on 30-day terms.
- For terms and conditions relating to related parties, refer to note 28.

22. Provisions – Group

	Other £'000	Engine maintenance provisions £'000	Total £'000
At 1 January 2010	–	392	392
Additional provisions in year	7	292	299
Utilisation of provisions	–	(60)	(60)
Unused amounts reversed	–	(183)	(183)
Exchange differences	–	12	12
At 31 December 2010	7	453	460

Other provisions relate to onerous leases and are expected to be fully utilised within one year.

Engine maintenance provision relate to warranties given by the Group in respect of products sold. The warranty period in most cases is 12 months or 250,000 miles, whichever comes first. In certain cases, the customer may negotiate a period longer than 12 months. This expenditure arises over different times over the life of the product and is expected to be fully utilised within one year.

The Group has made assumptions in relation to historical warranty claims and the expected cost of setting such claims. In relation to future claims, the Group has made assumptions based on warranty expiry dates and the history of previous claims.

23. Deferred Revenue – Group

	2010 £'000	2009 £'000
Deferred revenue	157	589

The deferred revenue refers to vehicle conversions that have been invoiced but not completed at 31 December 2010.

24. Other Payables (Non Current) – Group

	Year ended 31 December 2010		Year ended 31 December 2009	
	Group £'000	Company £'000	Group £'000	Company £'000
Obligations under finance lease	–	–	1	–

25. Financial Instruments

In the normal course of business, the Group uses certain financial instruments including cash, equity rights and various items such as trade debtors and trade creditors that arise directly from its operations. The main purpose of these instruments is to provide finance for the Group's operations.

All financial assets are classified as 'loans and receivables' under IAS 39 and all financial liabilities are carried at amortised cost.

The main risks arising from the Group's financial instruments are market price risk, liquidity risk, foreign currency risk and interest rate risk. The Group's policies and objectives in each of these areas are noted below.

Treasury Policies and Financial Risk

Surplus funds are intended to support the Group and Company's short-term working capital requirements. These funds are invested through the use of overnight deposits and the policy is to maximise fixed interest returns as well as provide the flexibility required to fund on-going operations. It is not the Group's policy to invest in financial derivatives.

Market Price Risk

The Group's main exposure to market risk is currency risk due to the different countries it operates in. It constantly monitors these risks by analysing interest rates and exchange rates in the different markets.

Liquidity Risk

The Group had no borrowing facilities at 31 December 2010 (2009: £nil).

As described on page 19, the Directors believe that the delivery of additional equity funds in September 2010 and May 2011 has ensured that the Group has adequate resources to continue in operational existence for the foreseeable future.

The Group seeks to manage financial risk, and in particular liquidity risk, ensuring that sufficient liquidity is available to meet foreseeable requirements and to invest surplus cash in low risk overnight deposits with reputable institutions.

Capital Risk Management

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximise shareholder value. Capital represents share capital, share premium and other reserves. The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions and the Group's resource requirements. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders or issue new shares. No changes were made in the objectives, policies or processes during the years end 31 December 2010 and 31 December 2009.

Foreign Currency Risk

Foreign currency is mitigated wherever possible by matching the currency that purchases are made with receipts from debtors denominated in that currency. The Group hedges its foreign currency position by operating non-sterling currency bank accounts. This policy is regularly reviewed.

The table below shows the Group's net foreign currency monetary assets which give rise to net currency gains and losses recognised in the Group income statement. At 31 December 2010, these currency exposures, excluding the net assets of foreign operations was as follows:

Functional Currency of Group Operations

	Net foreign currency monetary assets		
	AUS Dollar £'000	Euro £'000	Total £'000
2010			
Sterling	71	4	75
Total	71	4	75
2009			
Sterling	–	23	23
Total	–	23	23

The sensitivity to a possible change in the pound against the AUS dollar and Euro, with all variables held constant, of the Group's profit before tax due to foreign exchange translation of these monetary assets and liabilities is not material. The Group's equity is not sensitive to such changes as there are no forward currency hedges or net investment hedges.

Interest rate risk

The Group finances its operations through cash reserves and issuance of shares. The interest rate policy depends on economic and market conditions. Surplus cash deposits are held on overnight deposit with a view to maximising the return on surplus funds.

Notes to the Consolidated Financial Statements continued

25. Financial Instruments continued

The following table demonstrates the sensitivity to a possible change in the interest rate with all variables held constant, of the Group's profit before tax and the Group's equity:

	Increase/ decrease in interest rate	Effect on profit before tax	Effect on equity
2010			
Increase in base rate of interest	1%	21	21
Decrease in base rate of interest	-1%	(8)	(8)
2009			
Increase in base rate of interest	1%	22	22
Decrease in base rate of interest	-1%	(16)	(16)

Credit Risk

There are no significant concentrations of credit risk within the Group unless otherwise disclosed. The maximum credit risk exposure relating to financial assets is represented by carrying value as at the balance sheet date.

The Group has established procedure to minimise the risk of default by trade debtors including detailed credit checks undertaken before a customer is accepted. Historically, these procedures have proved effective in minimising the level of impaired and past due debtors.

Borrowing Facilities

The Group has no borrowing facilities available to it at 31 December 2010 (2009: nil).

Interest Rate Risk Profile of Financial Assets

The interest rate profile of the interest bearing financial assets (only cash and cash equivalents) of the Group at 31 December 2010 is as follows:

	Floating rate financial assets £'000
2010	
Sterling	1,775
US Dollar	455
AUS Dollar	180
	2,410
2009	
Sterling	1,218
US Dollar	1,335
AUS Dollar	385
	2,938

Fair Values of Financial Instruments

In the opinion of the Directors, the book value of the financial instruments is not materially different from their fair values. The book value of the financial assets is considered equal to their fair value because of the short maturity period.

All financial liabilities are expected to be settled at their carrying amount within the next 12 months, except for certain obligations under finance leases which are detailed in note 24.

26. Commitments and Contingencies

Operating Lease Commitments – Group as Lessee

The Group has entered into commercial leases on certain properties, motor vehicles and items of equipment. The leases have an average life of between three and five years. There are no restrictions on the Group by entering into these leases.

Operating Leases

The future minimum rentals payable under non-cancellable operating leases at 31 December 2010 are as follows:

	2010 £'000	2009 £'000
Land and buildings – Less than 1 year	308	360
– After 1 year but no more than 5 years	688	653
– More than 5 years	208	301
	1,204	1,314
Plant and Machinery – Less than 1 year	22	25
– After 1 year but no more than 5 years	26	2
	48	27
Vehicles – Less than 1 year	27	32
– After 1 year but no more than 5 years	3	41
	30	73

No operating leases have any escalation clauses or purchase options attached to the leases.

Finance Lease and Hire Purchase Commitments

The Group has entered into a hire purchase contract for one item of equipment. Future minimum lease payments under hire purchase contracts together with the present value of the net minimum lease payments are as follows:

	2010		2009	
	Minimum payments £'000	Present value of payments £'000	Minimum payments £'000	Present value of payments £'000
Within one year	1	1	3	3
After one year but no more than five years	–	–	1	1
Total minimum lease payments	1	1	4	4
Less amounts representing finance charges	–	–	–	–
Present value of minimum lease payments	1	1	4	4

27. Share-Based Payments

The Group operates an Incentive Plan under which employees of the Group are granted options to subscribe for new Ordinary Shares of the Company. Options are exercisable at a price equal to the average quoted market price of the Company's shares at the date of the grant. Options are forfeited if the employee leaves the Group before the options vest. The contractual life of each option granted is ten years and the vesting conditions relate only to the service periods of employees (non-market related). The vesting period is between one and three years. There are no market related performance conditions attached to the options.

The Group recognised total expenses of £110,198 (2009: £105,495) related to equity-settled share-based payments transactions during the year, of which £74,877 (2009: £99,654) has been expensed in Clean Air Power Limited UK, £33,332 (2009: £5,344) has been expensed in Clean Air Power Inc and £1,989 (2009: £497) has been expensed in Clean Air Power Pty Ltd.

On 31 March 2010, the Company issued shares in lieu of cash bonuses that had been earned under the Company's Senior Management 2008 bonus scheme. The Directors along with other senior managers in the scheme have agreed to hold the shares for a minimum of 12 months. The number of shares issued was 193,562 and the fair value as measured by reference to the market price of the shares at the date was £35,808.

The fair value of the options is estimated at the grant date using Black-Scholes pricing model, taking into account the terms and conditions upon which the instruments were granted.

Notes to the Consolidated Financial Statements

continued

27. Share-Based Payments *continued*

Movements in share options granted post 28 February 2006 and outstanding at the balance sheet date, together with weighted average exercise price were as follows:

	2010		2009	
	Number of shares	Weighted average exercise price (£)	Number of shares	Weighted average exercise price (£)
Outstanding at the beginning of the year	6,354,662	0.41	4,525,117	0.50
Granted during the year	–	–	2,065,000	0.26
Forfeited during the year	–	–	(235,455)	0.10
Exercised during the year	–	–	–	–
Outstanding at the end of the year	6,354,662	0.41	6,354,662	0.41
Exercisable at the end of the year	2,677,662	0.65	2,471,372	0.68

The estimated fair value of the options granted is as follows:

	£'000
27 February 2006	821,918
28 February 2006	89,379
23 June 2006	3,440
18 September 2006	1,390
13 April 2007	23,867
13 June 2007	3,092
14 May 2008	109,616
11 November 2009	274,645
	1,327,347

The weighted average remaining contractual life for the share options outstanding as at 31 December 2010 is 7.4 years (2009: 8.4 years).

The weighted average fair value of options granted during the year was £nil (2009: £0.13).

The range of exercise prices for options outstanding at the year end was £0.19 – £1.00 (2009: £0.19 – £1.00).

The following table lists inputs to the model used for the years ended 31 December 2010 and 31 December 2009.

	2010	2009
Expected volatility (%)	–	76.00
Expected life (months)	–	36
Risk free rate (%)	–	2
Expected dividends	–	Nil
Model used	–	Black-Scholes

Expected volatility was found by using a historical volatility calculator applied to the Company's Share Price and assumes that historical volatility is indicative of future trends. The expected life used in the model is a weighted average based on the vesting period of the options.

28. Related Party Disclosures

The financial statements include the financial statements of Clean Air Power Limited (Bermuda) and the subsidiaries in the following table:

Name	Country of incorporation	% equity interest 2010	% equity interest 2009
Clean Air Power Inc.	United States	100	100
Clean Air Power Limited	England & Wales	100	100
Clean Air Power Pty Ltd	Australia	100	100

Clean Air Power Limited (Bermuda) is the ultimate parent of the Group. Transactions and balances made on an arms' length basis with Group entities are eliminated in the consolidated financial statements.

During the year Clean Air Power Inc. sold £127,868 (2009: £44,941) of vehicle components to Clean Air Power Limited (UK).

During the year Clean Air Power Inc. sold £52,771 (2009: £108,174) of vehicle components to Clean Air Power Pty Ltd.

During the year Clean Air Power Ltd (UK) sold £182 (2009: £1,572) of vehicle components to Clean Air Power Inc.

During the year Clean Air Power Ltd (UK) sold £20,242 (2009: £1,137) of vehicle components to Clean Air Power Pty Ltd.

During the year Clean Air Power Ltd (UK) sold £771,318 (2009: £348,879) of intangible assets to Clean Air Power Inc.

During the year Clean Air Power Pty Ltd sold £7,331 (2009: £12,113) of intangible assets to Clean Air Power Inc.

The following table provides the total balances, which have been entered into with related parties for the relevant financial year.

	Amounts owed to related parties 2010 £'000				Total
	Clean Air Power Limited (Bermuda)	Clean Air Power Limited	Clean Air Power Inc.	Clean Air Power Pty Ltd	
Amounts owed by related parties					
Clean Air Power Limited (Bermuda)	–	15,944	–	–	15,944
Clean Air Power Limited	(15,944)	–	(266)	112	(16,098)
Clean Air Power Inc.	–	266	–	688	954
Clean Air Power Pty Ltd	–	(112)	(688)	–	(800)
Total	(15,944)	16,098	(954)	800	–

The terms relating to amounts owed by Clean Air Power Limited to Clean Air Power Limited (Bermuda) are described in note 16. Other intragroup balances are expected to be settled in a normal trading cycle.

	Amounts owed to related parties 2009 £'000				Total
	Clean Air Power Limited (Bermuda)	Clean Air Power Limited	Clean Air Power Inc.	Clean Air Power Pty Ltd	
Amounts owed by related parties					
Clean Air Power Limited (Bermuda)	–	13,985	–	–	13,985
Clean Air Power Limited	(13,985)	–	(341)	351	(13,975)
Clean Air Power Inc.	–	341	–	772	1,113
Clean Air Power Pty Ltd	–	(351)	(772)	–	(1,123)
Total	(13,985)	13,975	(1,113)	1,123	–

Compensation of Key Management Personnel

	2010 £'000	2009 £'000
Short-term employee benefits	620	585
Pension	26	33
Share-based payments	89	41
	735	659

Details of the Directors' interests are included in the Directors' Remuneration Report on pages 20 to 22.

Transactions with Related Parties

The Group receives consultancy services from Hans Gunnar Folkesson (resigned 3 August 2010), Prof. Dr. Karl Victor Schaller, Non-Executive Directors of Clean Air Power Limited (Bermuda) and Gary Ireson, the Director of Clean Air Power Pty Ltd.

Notes to the Consolidated Financial Statements

continued

28. Related Party Disclosures continued

The following table provides the total amount of transactions, which have been entered into on an arms length basis with related parties for the relevant financial year.

	2010 £'000	2009 £'000
Hans Gunnar Folkesson		
Services received from related parties	11	21
Amounts owed to related parties	–	–
Gary Ireson		
Services received from related parties	34	24
Amounts owed to related parties	2	3
Prof. Dr. Karl Victor Schaller		
Services received from related parties	2	–
Amounts owed to related parties	–	–

29. Description of Reserves

Issued Capital

The balance classified as share capital includes the total net proceeds on issue of the Company's equity share capital, comprising of \$0.001 Ordinary Shares.

Share Premium

The balance on the share premium reserve represents the fair value of the consideration given in excess of the nominal value of the Ordinary Shares issued in an acquisition made by the issue of shares.

Translation Reserve

The translation reserve contains all foreign exchange differences arising from the translation of the Group's net investment in overseas subsidiaries.

Other Reserves

Other reserves mainly relates to the additional paid in capital following the reorganisation of the Group in 2006. This amount is the excess of par paid by the original investors of Clean Air Power Inc.

30. Financing

On 6 February 2009, the fifth tranche of £0.5m was received; this increased the ordinary share capital to £25,951 by the creation of an additional 2,143,272 Ordinary Shares with a nominal value of \$US0.001 each and a market price of 23.3 pence per share. The difference between the consideration received of £0.5m less costs of £0.025m, and the nominal value of the shares £2,143 has been transferred to the share premium account.

On 14 May 2009, the Company successfully raised a further £2.38m; this increased the ordinary share capital to £32,799 by the creation of an additional 10,883,706 Ordinary Shares with a nominal value of \$US0.001 each and a market price of 21.8 pence per share. The difference between the consideration received of £2.38m less costs of £0.133m, and the nominal value of the shares £7,146 has been transferred to the share premium account.

The amounts received in 2009 completed the finance package agreed in April 2008. For every two common shares subscribed for pursuant to the financing package, the Company issued a warrant for the purchase of one additional common share, exercisable within three years, with an exercise price at a 40% premium to the issue price.

On 29 September 2010, the Company successfully raised £2.25m before expenses; this increased the ordinary share capital to £44,298 by the creation of an additional 18,000,000 Ordinary Shares with a nominal value of \$US0.001 each and a market price of 12.5 pence per share. The difference between the consideration received of £2.25m less costs of £0.103m, and the nominal value of the shares £11,498 has been transferred to the share premium account.

The Company Bye-laws incorporate by reference various provisions of the City Code, including Rule 9 of the City Code. However, this requirement may be waived by an independent vote at a meeting of the Company shareholders and, consequently, a resolution, with regards to acquisition of Ordinary Shares by Endeavor or its Affiliates, was passed at a Special General Meeting.

31. Events After the Balance Sheet

In May 2011, the Company successfully raised approximately £1.50m from a combination of new and existing investors; this increased the ordinary share capital to £56,837 by the creation of an additional 20,689,650 Ordinary Shares with a nominal value of \$US0.001 each and a market price of 7.25 pence per share.

Corporate Information

Directors

Non-Executive Chairman	Rodney Westhead"##
Non-Executive Deputy Chairman	Bernard Lord"*+#
President & Chief Executive	John Pettitt
Group Financial Director	Peter Rowse
Non-Executive Director	Dr. Ulrich Wöhr"*+#
Non-Executive Director	Prof. Dr. Karl Victor Schaller (appointed 19 October 2010)*+#
Non-Executive Director	Hans Gunnar Folkesson (resigned 3 August 2010)

* Member of the Audit Committee.

+ Member of the Remuneration Committee.

Member of the Nomination Committee.

" Independent.

Secretary

Evelou Mosley (resigned 9 August 2010)
Codan Services Limited (appointed 9 August 2010)

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