

Soil Machine Dynamics Limited

Company Number: 01028571

Report and Financial Statements

31 December 2020



Directors

M T Jones
R H Howarth
P R Atkinson
D Zhu
K Yu

Secretary

R H Howarth

Independent Auditor

Deloitte LLP
Broad Chare
Newcastle
NE1 2HF

Bankers

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Strategic report

The directors present their strategic report and audited financial statements for the year ended 31 December 2020.

Principal activities and review of the business

Our vision is that:

'As the subsea division of CRRC Times Electric, SMD will be the most advanced supplier of subsea remotely operated and autonomous power and control solutions, worldwide. SMD is a technology-focused business, set up to apply clever engineering to take technologies from concept to maturity, in order to solve an increasingly wide range of challenges in ocean, underwater and hazardous environments.'

The Company has developed a strategy with a five-year horizon, focused on business groups covering the following:

- Equipment Supply;
- Services;
- China; and
- Innovation and Technology.

SMD's strategy is to achieve a significant growth in annual revenue by 2025, by applying our core skills to a wider group of markets, products, services and geographies. Our growth will be mainly organic. The growth engines are focused business units working in partnership with our customers, and a number of strategic programmes.

We will deliver all of this with a foundation of strong values which will shape the way we operate and behave.

Key performance indicators

The Company's key financial performance indicators for the year are shown below.

| | 2020 £000 | 2019 £000 |
|----------------------------------|--------------|--------------|
| Revenue | 39,510 | 49,358 |
| Gross profit | 8,815 | 11,450 |
| Gross profit % | 22% | 23% |
| Operating (loss)/profit | (2,284) | 1,909 |
| Operating (loss)/profit margin % | (6%) | 4% |

The Company was able to execute the contracts in hand to budget and has secured several new projects during the year. The results for the year show an operating loss of £2.3m (2019 – operating profit of £1.9m), driven by difficult trading environment due to the ongoing COVID-19 pandemic. Whilst the business has outperformed the initial modelling produced at the start of the UK and global lockdown in April 2020, the results are significantly below the original 2020 budget and objectives.

The Company generated revenue of £39.5m which represents a fall of c.20% on the prior year. However, costs of sales fell by a similar rate resulting in just 1% decrease in the gross profit margin. Licence fee income of £1.5m was recognised in the year. This is lower than the prior year's fee of £2.3m and represents the final part under the contract with Zhuzhou CRRC Times Electric Co., Ltd (Zhuzhou).

Despite measures implemented to reduce the Company's current cost base, administration expenses increased by £0.9m. This figure reflects a prior year bad debt provision release of £0.4m which reduced total administration expenses in 2019. In addition, the Company carried out a stock clearance exercise which resulted in £0.4m (2019 - £0.1m) of inventories being written off. Other factors affecting the result for the year ended 31 December 2020 include dilapidation accruals (increase of £0.1m).

Major trading events of the year were:

- The Trenching (TMR) business continued to execute contracts won in 2019 and saw the business secure further new contracts. Revenue fell by £16.5m from £29m in 2019 to £12.3m in 2020. Whilst the business has seen a downturn caused by a decline in oil and gas prices, it operates across a wider range of industries such as renewables (Offshore Wind is the major market SMD benefit from), telecoms and mining where numerous opportunities still exist in those areas. The business is expected to revive in 2021, although a full recovery is not expected until 2022/2023.

Principal activities and review of the business (continued)

Key performance indicators (continued)

- The Remotely Operated Vehicle (ROV) business continues to develop its product range. The order intake, whilst still weaker compared to the historical levels, has increased on the prior year by 96% and revenue was largely driven by three major contract wins in 2020, resulting in highest revenue for this business for a number of years. These contracts also saw the business diversifying into different markets to alleviate the impact of the depression in the oil and gas market. New business partnerships have been secured in 2020 and a further pickup in sales activity is expected from 2021 as the markets recover from the coronavirus pandemic.
- The Deck equipment business continued to support the equipment businesses through 2020. The business worked on three major direct sales during the year, with one of these projects completing in 2020. Sales activity continues in this market with revenues increasing by £2.7m in 2020.
- The Services business delivered on its traditional revenue streams in 2020 and saw a minimal impact of COVID-19 with revenues falling by just 3.5% to £12.2m. Alongside delivery, the team set about fine tuning its strategy and offerings to the market.

Capital expenditure

The Company invested £1,979,156 (2019 – £2,385,493) in capital expenditure to support business growth, which included capitalised product development costs of £1,706,891 (2019 - £2,052,659).

Taxation

A tax charge of £235,464 (2019 - charge of £814,213) was recognised against a pre-tax loss of £2,813,880 (2019 - profit of £1,229,783). The Company is carrying forward unused losses as a £2,435,631 deferred tax asset (2019 – asset of £2,179,249), where management expect this to be fully utilised against future taxable profits by 2025.

Outlook

COVID-19 is having a major impact on a global scale to the way people live their lives and how businesses operate. We have experienced a year-on-year decline in revenues in the first four months of 2021 of 52%. The developments result in a preliminary operating loss of approximately £2.8m. There may be further demand reductions in other sectors driven by the economic effect of governmental restrictions. Increased operating costs are also likely to result from additional investment in personal protective equipment and the need to furlough staff, although the impact of this is being mitigated by government financial support arrangements. In addition, the successful vaccine rollout in the UK may be the blueprint for recovery and may reduce workforce sickness levels. Order backlog at 31 December 2020 was £10m (2019 - £22.8m) and the Company is currently involved in a number of tenders with new projects expected to be awarded in the coming months.

Financial risk management policies

The Company's activities expose it to a number of financial and other risks including contract risk, supplier risk, interest rate risk, credit risk, foreign currency risk, liquidity risk, political risk and economic environment risk. The factors affecting these risks are set out below.

Contract risk

The principal contractual risks the Company faces relate to scope of work and onerous commercial terms.

The most common risk in respect of scope of work is related to the complexity of the contract and hence the risk that the time and materials required to complete the contract may be underestimated, leading to a loss being recorded. This is mitigated by carrying out a comprehensive scoping exercise, as well as ongoing updates, at the time of enquiry, tender, negotiation and award. Thereafter, detailed time and cost budgets are prepared, and regular reviews are performed over the life of the contract to provide revised forecasts of expected profit. Further risks remain in relation to the failure of personnel to adhere to established procedures. Ongoing business improvement activities have focused on this area and tangible improvements have resulted.

Contract risk is mitigated, where possible, through the application of the Company's own terms and conditions. Variations to these standard terms such as liquidated damages, consequential loss or acceptance of certain customer terms and conditions are referred to the Company's senior management before accepting or declining a contract. We aim to further mitigate commercial risk by passing through to our supplier base the head contract terms. Contract risks include those relating to limited warranties given to customers concerning the performance of systems supplied. These risks are mitigated by an extensive quality control process at every stage of the design and manufacturing process.

Financial risk management policies (continued)

Supplier risk

The Company relies on the performance of suppliers and sub-contractors for parts, sub-assemblies and systems. There is a risk that suppliers or subcontractors do not perform to the required standard. These risks are mitigated by carefully selecting and then monitoring all suppliers.

Interest rate risk

The Company invests surplus cash in floating rate interest bearing deposits, so the Company's interest income is affected by changes in interest rates. The Company is part of the UK Group headed by Specialist Machine Developments (SMD) Limited ("SMD Group"), whose funding structure is in the form of fixed rate loan notes and an overdraft. The Company has historically used interest rate swaps to control interest rate exposures but there were no swaps in place at the year end.

Credit risk

The Company's principal financial assets are cash and trade and other receivables.

The Company's credit risk is primarily attributable to its trade receivables, accrued income and contract assets. Before extending credit, the risk that the other party will default on payment is assessed and special payment terms such as payment before delivery may be imposed in extreme cases. The amounts presented in the balance sheet for receivables are net of allowances for doubtful recovery. For further information on credit risk and the loss allowance recognised, please see Note 15.

The credit risk on liquid funds placed on deposit is limited because the banks are counterparties with high credit ratings assigned by international credit rating agencies.

Foreign currency risk

The Company's activities expose it to the financial risks of changes in foreign currency exchange rates. The Company's overriding objective is to avoid speculating on foreign currency movements, whether by actively trading in currency instruments or by failing to take available courses of action to protect against rate movements.

Where an individual contract involves both receipts and payments in the same foreign currency a 'natural hedge' occurs to the extent that the currency risks on the separate flows can be offset.

Any residual foreign currency inflow or outflow in excess of the amounts subject to the natural hedge, and all other foreign currency receipts and payments above a de minimis limit, are assessed on a case-by-case basis where:

- a) if a natural hedge can be used elsewhere in the Company, such as on the sale of spare parts or support services, it will do so; otherwise
- b) they will be considered for appropriateness of a foreign exchange contract which have the effect of fixing the rate at which the relevant amounts will be converted to or from sterling.

Liquidity risk

As a member of the Specialist Machine Developments (SMD) Group ('SMD'), the day-to-day management of cash and liquidity risk is deemed to be low as the Company has access, if required, to the facilities of its parent company.

Political risk

As a company operating in a range of markets the Company is exposed to political risk from time to time. Such risks are managed through the Company's commercial risk management process on a case-by-case basis. Recent sanctions with Russia resulted in the rejection of an export licence which significantly impacted the Company's revenue.

Economic environment risk

SMD operates in multiple markets worldwide with a portfolio of clients and technical solutions that means the Group can withstand slowdowns in any of its markets; the current depression in the oil and gas market has had a significant and on-going effect on revenue and margin. COVID-19 sent shocks through global oil markets, with oil demand and supply still struggling to return to pre-pandemic levels. A number of strategic actions are in place to reduce the reliance on particular markets in future.

Coronavirus

The global coronavirus pandemic involving the spread of COVID-19 presents a number of different risks to the business. The Company has a global customer base located in more than 10 countries. It follows that

Coronavirus (continued)

the risks of adverse health and safety, operational and financial impacts arising from the pandemic and the associated governmental responses in the markets where SMD operate could be significant.

Countries are currently at different stages of the pandemic. At the time of this report, a third wave is sweeping the continent and several European countries are extending or reintroducing lockdown. Nevertheless, global recovery is in sight, driven by the vaccine rollout. Activity in many sectors has picked up and partially adapted to pandemic restrictions.

The safety of the Company's staff is the first priority and is at the forefront of SMD's response to the pandemic. The counter measures adopted by governments around the world as they seek to mitigate the impact of the pandemic, the resultant disruption and economic effect in the countries where SMD operate and the actions taken by our customers in response will continue to impact on operations and financial results in 2021 leading to potential decreases in revenue, increases in costs and adverse effects on profits and cash flows.

There may be further demand reductions in other sectors driven by the economic effect of governmental restrictions. Increased operating costs are also likely to result from additional investment in personal protective equipment and the need to furlough staff, although the impact of this is being mitigated by government financial support arrangements.

In response to the global pandemic, a task force was set up at SMD to oversee the epidemic control measures with the primary aim to keep people safe and follow the UK government guidelines. A set of guiding principles which form basis for decision making and planning during the outbreak has been developed and communicated across the business.

SMD has taken action across a wide range of fronts in mitigation of the risks presented by the pandemic, for instance staff wearing protective equipment, social distancing and working from home. Management have reviewed cash flow and working capital projections, including running scenarios on profit and loss, balance sheet and cash-flows with various degrees of interruption. The analysis of SMD's current cost base has allowed management to take actions around overheads through eliminating or reducing discretionary and other non-essential costs, for instance recruitment and marketing.

Section 172(1) statement

The Board of Directors, in line with their duties under s172 of the Companies Act 2006, act in a way they consider, in good faith, would be most likely to promote the success of the Company for the benefit of its members as a whole, and in doing so have regard to a range of matters when making decisions for the long term. Key decisions and matters that are of strategic importance to the Company are appropriately informed by s172 factors.

Through an open and transparent dialogue with our key stakeholders, we have been able to develop a clear understanding of their needs, assess their perspectives and monitor their impact on our strategic ambition and culture. As part of the Board's decision-making process, the Board considers the potential impact of decisions on relevant stakeholders whilst also having regard to a number of broader factors, including the impact of the Company's operations on the community and environment, responsible business practices and the likely consequences of decisions in the long term.

The table below sets out our key stakeholder groups and examples of how we engaged with them throughout the year.

| Stakeholder | Stakeholder views | Examples |
|---------------------------|--|---|
| Shareholders | Our shareholders want us to maximise returns in a responsible way and support our strategic aims. | We have an open dialogue with our shareholders through one-to-one meetings, group meetings, webcasts and the Annual General Meeting. Discussions with shareholders cover a wide range of topics including financial performance, strategy, outlook, governance, and ethical practices. Shareholder feedback is regularly reported to and discussed by the Board and their views are considered as part of decision-making. The annual strategic planning and budgeting process also provides the Board with the opportunity to understand and challenge the long-term business strategy to help deliver growth and future success of the Group. |
| Government and regulators | The government and regulators want us to operate in an ethical way and comply with laws and regulations. | We engage with the government and regulators through a range of industry consultations, forums, meetings and conferences to communicate our views to policy makers relevant to our business. Key areas of focus are compliance with laws and regulations, health and safety and product safety. The Board is updated on legal and regulatory developments and takes these into account when considering future actions |

Section 172(1) statement (continued)

| Stakeholder | Stakeholder views | Examples |
|---------------------------|---|---|
| Colleagues | Our colleagues want to be kept informed of changes to the business and to be listened to in relation to changes which will affect them and their teams. They also want the business to provide security and opportunities to develop. | <p>We are committed to providing an environment which is stimulating, enjoyable and equitable, which also promotes a passion for excellence and empowers people to make courageous decisions.</p> <p>Our people are key to our success and we want them to be successful individually and as a team. There are many ways we engage with and listen to our people including newsletters, colleague surveys, forums, face-to-face briefings, internal communities, and staff committees. Regular meetings are held between local management and employees to allow a free flow of information and ideas.</p> <p>Key areas of focus include safety, health and well-being, development, opportunities, pay and benefits. Regular reports about what is important to our colleagues are made to the Board ensuring consideration is given to colleague needs.</p> |
| Customers | Our customers want propositions that work for them and for the business to operate in an ethical way. | <p>We foster close partnerships with our customers, which together with our creativity and innovation, ensures they get the best possible value.</p> <p>We strive to improve our understanding of customer needs and exceed our customers' expectations through performance in technology, delivery and support.</p> <p>We focus on quality in all we do - "Safety is the priority; quality is the standard".</p> |
| Suppliers | Our suppliers want to work in a world-class supply chain that offers opportunity for future growth. | <p>We build strong relationships with our suppliers to develop mutually beneficial and lasting partnerships that enhance our collective capability.</p> <p>Key areas of focus include innovation, product development, health and safety and sustainability. The Board recognises that relationships with suppliers are important to the Company's long-term success and is briefed on supplier feedback and issues on a regular basis.</p> |
| Communities | Our communities want our continued support with local causes and issues. | <p>We engage with the communities in which we operate to build trust and understand the local issues that are important to them. Key areas of focus include how we can support local causes and issues, create opportunities to recruit and develop local people and help to look after the environment.</p> <p>The impact of decisions on the environment is considered with such considerations as the air, water and noise pollution from our premises, and waste management (including electrical and electronic equipment) and how this might be minimised.</p> |
| Government and regulators | The government and regulators want us to operate in an ethical way and comply with laws and regulations. | <p>We engage with the government and regulators through a range of industry consultations, forums, meetings and conferences to communicate our views to policy makers relevant to our business.</p> <p>Key areas of focus are compliance with laws and regulations, health and safety and product safety. The Board is updated on legal and regulatory developments and takes these into account when considering future actions</p> |

The report has been approved by the Board of Directors and authorised for issue on 11 May 2021 and was signed on its behalf by



R H Howarth
Secretary

11 May 2021

Directors' report

The directors present their report and audited financial statements for the year ended 31 December 2020.

The Company has chosen, in accordance with section 414(c)(ii) of the Companies Act 2006 to set out in their strategic report the following which the directors' believe to be of significant importance:

- Financial risk management policies
- Review of the business
- Section 172(1) statement

Results and dividends

The loss for the year after taxation amounted to £3,049,344 (2019 – profit of £415,570). The ongoing coronavirus pandemic has had a significant impact on the 2020 results and the level of business activity to date. Whilst the gross margin percentage was largely unaffected, it fell by £2,635,630 driven by a 20% fall in revenue. The analysis of the Company's current cost base has allowed management to take actions around overheads through eliminating or reducing discretionary and other non-essential costs, for instance catering and recruitment. Despite these measures, administration expenses increased by £864,324. This figure reflects a prior year bad debt provision release of £420,304 which reduced total administration expenses in 2019. Other factors affecting the result for the year ended 31 December 2020 include dilapidation accruals (increase of £103,500). In addition, the Company carried out a stock clearance exercise which resulted in £390,775 (2019 - £117,133) of inventories being written off.

The directors do not recommend a final dividend (2019 – £nil).

Going concern

The directors have adopted the going concern basis in preparing these accounts after assessing the principal risks and having considered the impact of COVID-19. Management has produced forecasts for a period of 12 months from the date of approval of these financial statements which have been reviewed by the directors. These demonstrate the Company has access to sufficient financial facilities to enable it to meet its obligations as they fall due for a period of at least 12 months from the date of signing of these financial statements. In making this assessment the directors considered a letter of support received from the parent entity Zhuzhou CRRC Times Electric Co. Limited. The directors have assessed the ability of this entity to provide support such that be required and have concluded that it is able to do so. As such, the directors are satisfied that the Company has adequate resources to continue to operate for at least 12 months from the date of approval of these financial statements. For this reason, they continue to adopt the going concern basis for preparing these financial statements.

Research and development

The Company has a dedicated R&D function which is underpinned by a long-term strategy to ensure that constantly changing market demands across all business streams are met by appropriate product development, application of the latest technologies and ongoing innovation and research.

Historically, the majority of the Company's innovative developments have been an integral element of commercial contracts. In such circumstances the associated costs are not easily identifiable. More recently, a greater focus has been placed on internally funded developments as a means of maintaining competitive advantage by anticipating future customer needs and market trends.

Disabled employees

The Company gives full consideration to applications for employment from disabled persons where the candidate's particular aptitudes and abilities are consistent with adequately meeting the requirements of the job. Opportunities are available to disabled employees for training, career development and promotion. Where existing employees become disabled, it is the Company's policy to provide continuing employment wherever practicable in the same or an alternative position and to provide appropriate training to achieve this aim.

Directors' report (continued)

Employee involvement

The Company operates a framework for employee information and consultation which complies with the requirements of the Information and Consultation of Employees Regulations 2004. During the year, the policy of providing employees with information about the Company has been continued through the newsletter 'ROView' in which employees have also been encouraged to present their suggestions and views on the Company's performance. Regular meetings are held between local management and employees to allow a free flow of information and ideas.

Future developments

Whilst the long-term impact of COVID-19 and the ongoing global pandemic remain uncertain as the situation evolves daily, the directors have assumed that the Company would continue to be able to trade beyond 2021 and anticipate a recovery in the following years. The Company will continue to work closely with customers in 2021 providing both technical and financial solutions. The Company will continue to invest in R&D, which underpins the long-term strategy, and will increase integration with its Chinese parent to use this as a platform to gain greater access to the Far East Asian market.

Brexit

Following the UK departure from the EU on 31 January 2020, there was a transition period that provided time to negotiate a new EU/UK partnership. The transition period ended on 31 December 2020. The UK has already signed a number of trade agreements and is currently in discussions with various other countries and trading blocs.

Brexit is not expected to have a significant impact on the Company. Approximately 77% of revenue comes from sales to non-EU customers. In addition, SMD source the majority of its supplies from the UK. The Company is in regular contact with its suppliers and is aware of the steps they are taking to prevention to supply. Sale contracts with EU customers include terms on duties and customs which may be applied as a result of Brexit.

Streamlined energy and carbon reporting

Under the Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018, the Company is required to report information on greenhouse gas (GHG) emissions. This information can be found in the consolidated financial statements of the Specialist Machine Developments (SMD) Group.

Directors

The directors who served the Company during the year and up to the date of approval of the Report and Financial Statements were as follows:

| | |
|--------------|------------------------------|
| M T Jones | |
| R H Howarth | |
| J Chen | (resigned 27 March 2020) |
| P R Atkinson | |
| D Zhu | |
| X Zhang | (resigned 19 February 2021) |
| K Yu | (appointed 19 February 2021) |

Directors' report (continued)

Disclosure of information to the auditors

Each of the persons who is a director at the date of approval of this report confirms that:

- so far as the director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- the director has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

Deloitte LLP have indicated their willingness to continue in office and a resolution concerning their re-appointment will be proposed at the Annual General Meeting.

The report has been approved by the Board of Directors and was signed on its behalf by:



R H Howarth
Director

11 May 2021

Statement of directors' responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 101 "Reduced Disclosure Framework". Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditor's report to the members of Soil Machine Dynamics Limited

Report on the audit of the financial statements

Opinion

In our opinion the financial statements of Soil Machine Dynamics Limited (the 'company'):

- give a true and fair view of the state of the company's affairs as at 31 December 2020 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 "Reduced Disclosure Framework"; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the profit and loss and other comprehensive income;
- the statement of financial position;
- the statement of changes in equity; and
- the related notes 1 to 24.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 101 "Reduced Disclosure Framework" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of these matters.

Other information

The directors are responsible for the other information. The other information comprises the information included in the report, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

Independent auditor's report to the members of Soil Machine Dynamics Limited (continued)

We have nothing to report in respect of these matters.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

Matters on which we are required to report by exception

Under the Companies Act 2006 we are required to report in respect of the following matters if, in our opinion:

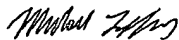
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in respect of these matters.

Independent auditor's report to the members of Soil Machine Dynamics Limited (continued)

Use of our report

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



Michael Jeffrey, FCA (Senior statutory auditor)

For and on behalf of Deloitte LLP

Statutory Auditor

Newcastle, United Kingdom

11 May 2021

Profit and loss and other comprehensive income

for the year ended 31 December 2020

| | Note | 2020 £ | 2019 £ |
|---|------|--------------|--------------|
| Revenue | 4 | 39,510,358 | 49,357,962 |
| Cost of sales | | (30,695,726) | (37,907,700) |
| Gross profit | | 8,814,632 | 11,450,262 |
| Administrative expenses | | (12,667,205) | (11,796,148) |
| Other operating income | 5 | 1,568,091 | 2,255,336 |
| Operating (loss)/profit | 5 | (2,284,482) | 1,909,450 |
| Finance income | 8 | - | 1,392 |
| Finance costs | 9 | (529,398) | (681,059) |
| Finance costs - net | | (529,398) | (679,667) |
| (Loss)/profit before taxation | | (2,813,880) | 1,229,783 |
| Tax on (loss)/profit | 10 | (235,464) | (814,213) |
| (Loss)/profit for the year | | (3,049,344) | 415,570 |
| Other comprehensive income | | - | - |
| Total comprehensive (loss)/income for the year attributable to the owners of the company | | (3,049,344) | 415,570 |

All amounts relate to continuing activities.

Statement of changes in equity

for the year ended 31 December 2020

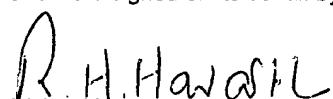
| | Share capital £ | Retained earnings/ (deficit) £ | Total equity £ |
|---|--------------------|---|-------------------|
| Balance 1 January 2019 | 938,950 | 406,532 | 1,345,482 |
| Total comprehensive income for the year | - | 415,570 | 415,570 |
| Balance at 31 December 2019 | 938,950 | 822,102 | 1,761,052 |
| Total comprehensive loss for the year | - | (3,049,344) | (3,049,344) |
| At 31 December 2020 | 938,950 | (2,227,242) | (1,288,292) |

Statement of financial position

As at 31 December 2020

| | Note | 2020 £ | 2019 £ |
|--|------|--------------------|--------------------|
| Fixed assets | | | |
| Property, plant and equipment | 11 | 4,633,112 | 4,970,692 |
| Intangible assets | 13 | 6,390,939 | 4,714,952 |
| | | <u>11,024,051</u> | <u>9,685,644</u> |
| Current assets | | | |
| Inventories | 14 | 2,965,919 | 3,561,991 |
| Contract assets | 4 | 8,004,051 | 5,712,645 |
| Trade and other receivables falling due within one year | 15 | 10,209,485 | 9,403,676 |
| Trade and other receivables falling due after more than one year | 15 | 1,660,372 | 1,771,093 |
| Cash and cash equivalents | 16 | 336,102 | 281,417 |
| | | <u>23,175,929</u> | <u>20,730,822</u> |
| Creditors: amounts falling due within one year | 17 | (30,179,828) | (18,087,572) |
| Contract liabilities | 4 | (1,463,671) | (4,184,382) |
| Net current liabilities | | <u>(8,467,570)</u> | <u>(1,541,132)</u> |
| Total assets less current liabilities | | <u>2,556,481</u> | <u>8,144,512</u> |
| Creditors: amounts falling due after more than one year | 18 | (2,993,415) | (5,625,043) |
| Provisions | 19 | (851,358) | (758,417) |
| Net (liabilities)/assets | | <u>(1,288,292)</u> | <u>1,761,052</u> |
| Equity | | | |
| Share capital | 20 | 938,950 | 938,950 |
| Retained earnings | | (2,227,242) | 822,102 |
| Total shareholders' (deficit)/funds | | <u>(1,288,292)</u> | <u>1,761,052</u> |

The financial statements were approved by the Board of Directors and authorised for issue on 11 May 2021 and were signed on its behalf by:


 Richard Howarth
 Director

The notes on pages 14 to 33 form part of these financial statements.

Notes to the financial statements

for the year ended 31 December 2020

1. General information

Soil Machine Dynamics Limited is a private company limited by shares, incorporated in the United Kingdom and registered in England and Wales. The registered office is at Turbinia Works, Davy Bank, Wallsend, Tyne and Wear, NE28 6UZ.

The Company is principally engaged in the development and construction of subsea remote operated vehicles (ROVs) and trenching and mining equipment. At the beginning and end of the year the Company's ultimate controlling party was the CRRC Corporation Limited.

2. Accounting policies

Basis of preparation

The financial statements of Soil Machine Dynamics Limited have been prepared in accordance with United Kingdom Generally Accepted Accounting Practice (UKGAAP) FRS 101 'Reduced Disclosure Framework'. The financial statements are presented under the historical cost convention and the functional currency of the Company is GBP Sterling (£). The Company has taken advantage of the following disclosure exemptions under FRS 101:

- a) The requirements of IFRS 7 Financial Instrument Disclosures and equivalent disclosures are included in the consolidated financial statements of Specialist Machine Developments (SMD) Limited, in which the entity is consolidated;
- b) The requirements of paragraphs 91-99 of IFRS 13 Fair Value Measurement and equivalent disclosures are included in the financial statements of Specialist Machine Developments (SMD) Limited, in which the entity is consolidated;
- c) The requirement in paragraph 38 of IAS 1 'Presentation of Financial Statements' to present comparative information in respect of:
 - i. paragraph 79(a)(iv) of IAS 1;
 - ii. paragraph 73(e) of IAS 16 Property, Plant and Equipment;
 - iii. paragraph 118(e) of IAS 38 Intangible Assets.
- d) The requirements of paragraphs 10(d), 10(f) 16, 38A, 38B, 38C, 38D, 40A, 40B, 40C, 40D, 111 and 134-136 of IAS 1 Presentation of Financial Statements;
- e) The requirements of IAS 7 Statement of Cash Flows;
- f) The requirements of paragraphs 30 and 31 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors;
- g) The requirements of paragraphs 17 and 18A of IAS 24 Related Party Disclosures; and
- h) The requirements in IAS 24 Related Party Disclosures to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member.

The financial statements have been prepared using the significant accounting policies and measurement bases that are in effect at the end of the reporting period on 31 December 2020 as defined below. These policies have been consistently applied to all the years presented, unless otherwise stated.

Going concern

The directors have adopted the going concern basis in preparing these accounts after assessing the principal risks and having considered the impact of COVID-19. Management has produced forecasts for a period of 12 months from the date of approval of these financial statements which have been reviewed by the directors. These demonstrate the Company has access to sufficient financial facilities to enable it to meet its obligations as they fall due for a period of at least 12 months from the date of signing of these financial statements. In making this assessment the directors considered a letter of support received from the parent entity Zhuzhou CRRC Times Electric Co. Limited. The directors have assessed the ability of this entity to provide support such that be required and have concluded that it is able to do so. As such, the directors are satisfied that the Company has adequate resources to continue to operate for at least 12 months from the date of approval of these financial statements. For this reason, they continue to adopt the going concern basis for preparing these financial statements.

In making this assessment the directors acknowledge the following:

- I. The Company has net liabilities of £1.3m (2019 – net assets of £1.8m) and net current liabilities of £8.5m (2019 – £1.5m);
- II. Management are confident when markets return the Company is in a strong position to capitalise on opportunities;

Going concern (continued)

- III. The Company remains within the limits of the current facilities agreement with Barclays, which contains no expiry date, but is underpinned by a letter of support from the ultimate parent company, Zhuzhou CRRC Times Electric Co. Limited. In March 2020 the Group Board confirmed that it would continue to provide dedicated facilities of 300m RMB (c.£33m), and the most recent letter of support to the bank was renewed in October 2020;
- IV. In addition, the UK Group headed by Specialist Machine Developments (SMD) Limited has also received a separate letter of support from the ultimate parent company guaranteeing both financial support to the Group in reference to the facility agreement cited in point III above and to refrain from recalling the £62.4m loan notes until the Group has enough funds to make the repayment; and
- V. The Company has already secured a number of new projects in 2021, including major wins awarded despite the global pandemic. As the global economy recovers, driven by the vaccine rollout, we anticipate an increase in business activity.

As such, the directors are satisfied that the Company has adequate resources to continue to operate for the foreseeable future. For this reason, they continue to adopt the going concern basis for preparing these financial statements.

Revenue

Revenue accounting policies are discussed in Note 4 Significant accounting judgements, estimates and assumptions.

Contract assets are the Company's conditional right to consideration in exchange for goods and services the entity has transferred to a customer. When the entity is entitled to invoice the customer in accordance with the billing schedule established in the contract (which is generally based on meeting contractual milestones), the right to consideration is unconditional (other than the passage of time) and is recognised in trade receivable or accrued income (as appropriate).

Billing schedules typically comprise of an advanced payment to secure the contract followed by future payments in accordance with key milestones throughout the contract, including design completion, build completion, successful testing and delivery. Occasionally billing schedules also include a retention, allowing the customer to defer payment until a period after the delivery of goods. Historically, retentions are due within 12 months of satisfaction of the performance obligation and on this basis, it was deemed immaterial for retentions to factor the time value of money.

Contract liabilities arise where payments are received from the customer in advance of satisfaction of the performance obligations in the contract. Often this is at the beginning of the contract when advanced payments are received. In addition, all contracts include warranty on equipment only (typically covering a 12-month period) and is therefore not deemed to be a separate performance obligation. Please see Note 19 for further details on warranties held by the Company.

In addition to revenue, the Company recognised other operating income of £1,464,388 (2019: £2,255,336) that also falls under the scope of IFRS 15. The entirety of other operating income relates to licence fees received from Zhuzhou CRRC Times Electric Co., Ltd, "Zhuzhou", (the parent of the Group's parent company and based in China) to transfer intellectual property rights of SMD technology to the CRRC Group. This income is recognised over time, by reference to the costs incurred in delivering training required to SMD Shanghai, to effect the transfer of the license. Licence fees are disclosed separately as other operating income so as not to distort revenue from ordinary activities.

Government grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received, and the company will comply with all attached conditions. Note 4 provides further information on how the Company accounts for government grants.

Current taxation

Current tax is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

A provision is recognised for those matters for which the tax determination is uncertain, but it is considered probable that there will be a future outflow of funds to a tax authority. The provisions are measured at the best estimate of the amount expected to become payable. The assessment is based on the judgement of tax professionals within the Company supported by previous experience in respect of such activities and in certain cases based on specialist independent tax advice.

Deferred taxation

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are

Deferred taxation (continued)

differences between the Company's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

Unrelieved tax losses and other deferred tax assets are recognised only to the extent that, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

When the amount that can be deducted for tax for an asset (other than goodwill) that is recognised in a business combination is less (more) than the value at which it is recognised, a deferred tax liability (asset) is recognised for the additional tax that will be paid (avoided) in respect of that difference. Similarly, a deferred tax asset (liability) is recognised for the additional tax that will be avoided (paid) because of a difference between the value at which a liability is recognised and the amount that will be assessed for tax. The amount attributed to goodwill is adjusted by the amount of deferred tax recognised.

Deferred tax is measured using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date that are expected to apply to the reversal of the timing difference. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Where items recognised in other comprehensive income or equity are chargeable to or deductible for tax purposes, the resulting current or deferred tax expense or income is presented in the same component of comprehensive income or equity as the transaction or other event that resulted in the tax expense or income.

Research and development expenditure credit (RDEC)

As a result of investment in R&D activities, the Company applies for an above the line tax credit under the government's RDEC scheme. The Company recognises amounts received under this scheme as a credit against cost of sales and is therefore a taxable item.

Inventories

Inventories and work in progress (WIP) are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. The cost of finished goods and work in progress comprises design costs, raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). It excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses

Tangible fixed assets

All tangible fixed assets are recorded at cost less accumulated depreciation and any provision for impairment. Depreciation is calculated so as to write off the cost of the asset, less its estimated residual value, over the useful economic life of that asset as follows:

| | | |
|---------------------------------------|---|-----------------------------------|
| Freehold property | – | 50 years |
| Leasehold properties and improvements | – | Minimum lease term (3 – 20 years) |
| Fixtures and fittings | – | 4-10 years |
| Motor vehicles | – | 4 years |
| Computer Equipment | – | 4 years |

Freehold land is not depreciated. Residual value is the estimated value of a fixed asset at the end of its lease term or useful economic life.

Intangibles

(a) Computer software

Computer software is recognised as an intangible asset when it is not found to be integral to hardware. It is recorded at cost less amortisation with a useful life of the length of the software license or 4-5 years where the license is indefinite.

(b) Research and development

The Company does not capitalise research expenditure as it is recognised as an expense when it is incurred. Development costs are assessed on a case-by-case basis on whether they are capitalised as an intangible asset or expensed, applying the criteria of IAS 38.57(a-f) (intangible assets) which includes the ability to use or sell the asset, the resources and intention to complete development of the asset, if it will generate probable future economic benefits and if the expenditure can be measured reliably. It is then amortised over the period of the asset generating economic benefit, estimated at 4-5 years on average.

(a) Research and development (continued)

Product development costs are tested annually for impairment while the development is not yet available for use.

Financial instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Note, whilst the Company uses forward contracts in its financial planning, no forward contracts were in existence at 31 December 2020 (31 December 2019: none). The Company does not apply hedge accounting.

(a) Financial assets

Financial assets consist of trade debtors, cash and cash equivalents and foreign exchange forward contracts.

Trade debtors are amounts due from customers for goods sold or services performed in the ordinary course of business. They are generally due for settlement between 30 to 60 days and hence are all classified as current. As the Company does not engage in trade debtors which contain a significant financing component, all trade debtors are recognised at the amount of consideration that is unconditional. Aged debtors are continually reviewed for impairment and all debtors undergo an impairment review at the reporting date. In making this assessment management have not identified any indicators of impairment. Please see Note 15 for further information.

All of the Company's forward contracts qualify to be classified as fair value through the profit or loss. They are carried on the balance sheet at fair value with net changes in fair value presented as admin costs. For derivatives the Company uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

Financial assets are primarily derecognised when the rights to receive cash flows from the asset have expired or when substantially all risks and rewards of the asset have been transferred.

(b) Financial liabilities

Financial liabilities consist of trade creditors and a bank overdraft.

Trade creditors represent liabilities for goods and services provided to the Company prior to the end of financial year which are unpaid. The amounts are unsecured and are usually paid within 30 to 60 days of recognition. Trade creditors are presented as current liabilities unless payment is not due within 12 months after the reporting period in which case they are treated as non-current. Note there were no trade creditors that have a due date greater than 12 months after the end of the reporting period, hence all trade creditors are classified as current.

The bank overdraft is part of a revolving credit facility which accrues interest on a daily basis at the Bank of England, "BoE", base rate. The Company recognises the overdraft liability equal to the total amount outstanding including accrued interest at the end of the reporting period, where interest charges incurred during the year are recognised within finance costs in the income statement.

(c) Financial asset impairment

The Company recognises an allowance for expected credit losses (ECLs) for all debt instruments not held at fair value through profit or loss. ECLs are based on the difference between the contractual cash flows due in accordance with the contract and all the cash flows that the Company expects to receive, discounted at an approximation of the original effective interest rate. The expected cash flows will include cash flows from the sale of collateral held or other credit enhancements that are integral to the contractual terms.

ECLs are recognised in two stages. For credit exposures for which there has not been a significant increase in credit risk since initial recognition, ECLs are provided for credit losses that result from default events that are possible within the next 12-months (a 12-month ECL). For those credit exposures for which there has been a significant increase in credit risk since initial recognition, a loss allowance is required for credit losses expected over the remaining life of the exposure, irrespective of the timing of the default (a lifetime ECL).

For trade receivables and contract assets, the Company applies a simplified approach in calculating ECLs. Therefore, the Company does not track changes in credit risk, but instead recognises a loss allowance based on lifetime ECLs at each reporting date. The Company has established a provision matrix that is based on its historical credit loss experience, adjusted for forward-looking factors specific to the debtors and the economic environment.

Foreign currencies

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions (spot exchange rate). Foreign exchange gains and losses resulting from the settlement of such transactions and from the re-measurement of monetary items denominated in foreign currency at year-end exchange rates are recognised in the income statement.

Foreign currencies (continued)

Non-monetary items are not retranslated at year-end and are measured at historical cost (translated using the exchange rates at the transaction date).

Leases

The determination of whether an arrangement is (or contains) a lease is based on the substance of the arrangement at the inception of the lease.

A contract is, or contains, a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration. A leased asset is capitalised at the commencement of the lease and recognised as a right-of-use asset representing the Company's right to use the underlying leased asset and a lease liability representing its obligation to make lease payments.

The right-of-use asset is initially measured at the amount of the lease liability plus any initial direct costs incurred by the Company. After lease commencement, the right-of-use asset is then measured using a cost model with the following exemptions:

- i) the right-of-use asset is an investment property and the lessee fair values its investment property under IAS 40; or
- ii) the right-of-use asset relates to a class of PPE to which the Company applies IAS 16's revaluation model, in which case all right-of-use assets relating to that class of PPE can be revalued.

Under the cost model the right-of-use asset is measured at cost less accumulated depreciation and accumulated impairment. Depreciation is calculated over the shorter of the lease and useful life of the asset.

The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined. If that rate cannot be readily determined, the Company uses its incremental borrowing rate. Finance charges are recognised in finance costs in the profit and loss and other comprehensive income.

Variable lease payments that are not included in the measurement of the lease liability are recognised in profit or loss in the period in which the event or condition that triggers payment occurs.

The Group has not engaged in operating leases as a lessor in any of the years reported.

Provisions

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

A provision is made for the estimated future cost of meeting warranty and other contractual obligations in respect of sales to customers under construction contracts and sales of spare parts.

Pensions

The Company contributes to individual pension scheme arrangements for employees. The assets of the scheme are held separately from those of the Company. The annual contributions payable are charged to the profit and loss and other comprehensive income.

New standards and interpretations applied

The Company has not applied any new standards or interpretations during the year.

3. Significant accounting judgements, estimates and assumptions

The preparation of the Company's financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, the accompanying disclosures, and the disclosure of the contingent liabilities.

In the process of applying the Company's accounting policies, management has made the following judgements, estimates and assumptions which have the most significant effect on the amounts recognised in the financial statements:

(a) Judgements

Revenue recognised over time

The Company principally operates fixed contracts for the provision of subsea equipment such as seabed trenchers, remotely operated vehicles "ROVs" and deck equipment.

In applying the criteria of IFRS 15 the Company identifies a contract with a customer when:

- the parties to the contract have approved the contract;
- the Company can identify each party's rights regarding the goods or service transferred;
- the Company can identify the payment terms for the goods or services to be transferred;
- the contract has commercial substance; and
- it is probable the Company will collect the consideration to which it will be entitled in exchange for the goods or services transferred to the customer.

In identifying performance obligations, the Company determine on an individual contract basis whether the contract contains a bundle of goods and services (one performance obligation), or if there is a series of separate distinct goods and services (multiple performance obligations). Typically, contracts with customers include not only the supply of a product i.e. a subsea vehicle, but also a suite of ancillary equipment and spare parts. In making the assessment, management consider subsea vehicles and ancillary equipment as one individual performance obligation, on the grounds that both products are interdependent. Spares are considered a separate performance obligation, given their nature, unless their value is deemed immaterial, in which case the entire contract is considered as one performance obligation. However, as the Company ensures contractual arrangements separately disclose the selling price of equipment and spares, the Company does not have to estimate the allocation of contract value to the transaction price should equipment and spares be considered separate performance obligations. When a contract includes the provision of equipment and spares, the Company allocates the transaction price to the performance obligation on the basis of standalone price.

In assessing the satisfaction of performance obligations of contracts, management deem revenue can be recognised over time on the grounds that the equipment the Company manufactures is unique in nature, has no alternative use to the Company and the Company has an enforceable right (as stipulated in the contract) to payment for performance completed to date. In the event the equipment is not unique or the contract lacks the enforceable right to payment for performance to date it may be that revenue will be recognised at point in time, although historically this has never been the case.

Assessments are made on an individual contract basis of the various methods of measurement towards complete satisfaction of a performance obligation; for all contracts in the current and prior year the method applied was to take total contract costs incurred against total forecasted costs on a percentage completion basis. This is on the grounds that cost accurately reflects the efforts towards satisfaction of the performance obligation, as it factors all forms of cost i.e. materials and labour, and cost can be measured reliably on the Company's IT system. Alternative input methods such as total hours done per total forecasted hours do not necessarily reflect the Company's financial commitment on a contract as it does not take into account material costs. In addition, alternative output methods such as surveys of performance completed are deemed speculative and unreliable. In applying the cost input method, management are required to exercise judgement in determining the total forecasted cost of the contract. This is decided as part of periodic contract reviews which include consultation with senior individuals across the business including project management, procurement and quality.

On an individual contract basis management assess costs incurred that are not proportionate to the Company's progress in satisfying performance obligations, as they are not considered when measuring stage of completion. In the current and prior year, the assessment deemed no costs as disproportionate on any contract on the grounds that whilst the vast majority of goods used in the products are procured from third parties, they are custom fabrications based on designs by the Company and specialised in nature. Accordingly, costs reflect progress in satisfying the performance obligation. Parts used on contracts which are not specialised in nature have been deemed immaterial.

Variations to contracts are assessed on a case-by-case basis as to whether they are part of the original contract performance obligation or a distinct performance obligation (and if so, whether the separate performance is priced on a standalone selling price basis). In making this assessment management take into account a number of factors such as the nature and purpose of the variations, the date of delivery of

Revenue recognised over time (continued)

the variation and materiality; the majority of variations are minor adjustments to the equipment supplied and are small in value.

Liquidated damages are not considered by the Company as requiring an adjustment to constrain the transaction price, as they do not occur with such regularity as to represent a highly probable reversal of revenue.

Revenue recognised at point in time

Revenue recognised at point in time includes spare part sales and support services. The vast majority of revenue recognised at point in time falls under the Services business stream. It is standard policy for payment terms to be 30 days.

Spare part sales consist of goods procured by the Company from its supply chain. Once the customer has been notified the goods are available for delivery, revenue is recognised in accordance with Ex works terms. Whilst the goods sold are usually on the Company's premises at the point of sale, the responsibility for the goods and hence the risks and rewards have at this point transferred to the customer.

Support services relates to the provision of personnel, typically offshore, to provide customers with support for their equipment, charged at either an hourly or daily rate. The performance obligation is not deemed to be satisfied until the customer has formally accepted the work is complete, therefore revenue is recognised as and when the service is performed. Expenses incurred chargeable at a marked-up rate.

Short term contracts relate to small commercial contracts which are short term in length i.e. several days or weeks. They include upgrades, repairs and the supply and build of small pieces of equipment.

Management have judged that the most appropriate accounting treatment is to recognise revenue at point in time when the obligation is fulfilled on the basis that the contract length and value is immaterial.

Contingent liabilities

The Company is party to guarantees which include financial penalties should the Company fail to provide goods and services that meet specified performance obligations (performance guarantees) and the return of customer payments made upfront should the Company withdraw from a contract (advance payment guarantees). To secure these obligations, the Company enters into bonding arrangements with its bank as part of the facilities agreement (Note 16), where the bank will settle these guarantees should they materialise and reclaim this back from the Company.

Management made an assessment on the likelihood of circumstances of this nature arising, considering the current and forecasted future performance of its products and the Company's ability to comply with the specific conditions. The assessment found the extent of the guarantees was £6,528,000 (2019 – £12,867,681) and deemed the likelihood of any bonds materialising to be possible, therefore the guarantees have been disclosed as a contingent liability only (see Note 22).

Deferred tax

Deferred tax assets are recognised for unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future tax profits together with tax planning strategies.

The Company has £24,218,774 (2019 - £19,699,956) total tax losses carried forward, which consist of brought forward unused losses from 2016 and the impairment to debtors recognised in 2018. In assessing the recoverability of these losses, management considered performance forecasts and as the Company is expected to increase in profitability in future years, it was determined that £12,819,112 losses can be recognised for future offset. On analysis, management deem it at least probable these tax losses will be fully utilised by 2024 but note that changes in assumptions made could have a material impact on the Company's reported tax charge. Management estimate that most of these losses will be utilised in 2024/2025, which results in a deferred tax asset at the year ended 2020 of £2,435,631 (2019 - £2,179,249).

Tax losses of £11,399,662 have not been recognised on the grounds they are not expected to be utilised until beyond 2024, where there is a reasonable level of uncertainty on recoverability. Had the Company recognised these tax losses at the future rate of 19% it would result in an additional £2,165,936 deferred tax asset. See Note 10 for further details on deferred tax.

(b) Estimates

Warranty provision

The Company offers warranty on its products, typically for one year, covering machine and component part failures. Due to the uncertainty of the timing and extent of such failures management estimate a warranty provision based on 1% of total revenue. In arriving at this assumption management performed a

Warranty provision (continued)

comparison of warranty cost as a proportion of revenue on historical performance and found a consistent relationship of 1%. Management then consider the likelihood of future warranty claims based on customer feedback and will increase or decrease the warranty provision if necessary. Please see Note 19 which includes disclosure of the warranty provision recognised.

Inventory provision

The Group recognises a provision against inventory based on an estimation where the net realisable value is lower than the original cost for ageing inventory, which was estimated to be £2,376,792 at 31 December 2020 (2019 - £2,437,776). In determining this provision, management have made the assumption that all inventory which have not been consumed, either on a contract or sold as a spare, in at least a year incurs a provision of 20% of the original cost, increasing by a further 20% for each year thereafter. Inventory that is five years or older is therefore fully impaired.

4. Revenue

4.1. Disaggregation of revenue from contracts with customers

The Company provides a variety of goods and services for the subsea and offshore industry, which are provided through four business units as seen in the table below and designated by geographical source. In accordance with the criteria of IFRS 15, these goods and services are recognised either over time or at a point in time as follows:

For year ended 31 December 2020

| Revenue recognised over time | People's Republic of China £ | Japan £ | Netherlands £ | United Kingdom £ | Rest of the World £ | Total £ |
|--|---------------------------------|------------------|------------------|---------------------|------------------------|-------------------|
| Trenching, mining and renewables | 381,941 | 4,508,294 | 970,711 | 6,666,670 | 3,287 | 12,530,903 |
| Services | 481,112 | 708,511 | 329,997 | 306,550 | 2,018,108 | 3,844,278 |
| Remotely operated vehicles, "ROV"s | 4,749,462 | - | 615,295 | 283,356 | 3,576,603 | 9,224,716 |
| Deck equipment and Curvetech | - | - | 2,744,066 | 115,987 | 1,615,051 | 4,475,104 |
| | 5,612,515 | 5,216,805 | 4,660,069 | 7,372,563 | 7,213,049 | 30,075,001 |
| Revenue recognised at a point in time | | | | | | |
| Trenching, mining and renewables | - | - | - | 30,880 | - | 30,880 |
| Services | 262,228 | 1,352,335 | 818,975 | 2,877,677 | 3,085,252 | 8,396,467 |
| Remotely operated vehicles, "ROV"s | - | - | - | - | - | - |
| Deck equipment and Curvetech | 911,428 | - | - | 96,582 | - | 1,008,010 |
| | 1,173,656 | 1,352,335 | 818,975 | 3,005,139 | 3,085,252 | 9,435,357 |
| Total revenue recognised from customers | 6,786,171 | 6,569,140 | 5,479,044 | 10,377,702 | 10,298,301 | 39,510,358 |

Included within the rest of the world is £3,543,708 relating to customers based in the EU. This comprises of sales of deck equipment and Curvetech of £1,615,05, sales of remotely operated vehicles of £375,011 and a further £1,553,646 relating to services. Revenue for each of these business units was recognised at a point in time.

For the year ended 31 December 2019

| Revenue recognised over time | People's Republic of China | Japan | Netherlands | United Kingdom | Rest of the World | Total |
|--|----------------------------|------------------|-------------------|-------------------|-------------------|-------------------|
| Trenching, mining and renewables | 8,719,660 | 2,130,438 | 8,688,506 | 8,248,589 | 1,064,876 | 28,852,069 |
| Services | 57,825 | 106,018 | 509,306 | 1,461,711 | 1,408,970 | 3,543,830 |
| Remotely operated vehicles, "ROV"s | 246,336 | - | 170,058 | 1,894,007 | - | 2,310,401 |
| Deck equipment and Curvetech | - | 821,772 | 373,541 | (105,712) | - | 1,089,601 |
| | 9,023,821 | 3,058,228 | 9,741,411 | 11,498,595 | 2,473,846 | 35,795,901 |
| Revenue recognised at a point in time | | | | | | |
| Trenching, mining and renewables | - | - | - | 85,943 | - | 85,943 |
| Services | 159,765 | 413,758 | 912,717 | 3,827,118 | 3,790,224 | 9,103,582 |
| Remotely operated vehicles, "ROV"s | 111,277 | - | - | 729,070 | 1,882,686 | 2,723,033 |
| Deck equipment and Curvetech | 1,649,503 | - | - | - | - | 1,649,503 |
| | 1,920,545 | 413,758 | 912,717 | 4,642,131 | 5,672,910 | 13,562,061 |
| Total revenue recognised from customers | 10,944,366 | 3,471,986 | 10,654,128 | 16,140,726 | 8,146,756 | 49,357,962 |

4.2. Assets and liabilities related to contracts with customers

The Company has recognised the following assets and liabilities related to contracts with customers:

| | <i>Contracts in trade debtors</i> | <i>Contract assets</i> | <i>Contract liabilities</i> |
|------------------------|---------------------------------------|----------------------------|---------------------------------|
| | £ | £ | £ |
| As at 1 January 2019 | 7,266,926 | 14,030,062 | 826,254 |
| As at 31 December 2019 | 6,042,688 | 5,712,645 | 4,184,382 |
| As at 31 December 2020 | 6,135,328 | 8,004,051 | 1,463,671 |

Movement in contract asset and liability balances in the year are due to:

- timing of progress made in respect of satisfying performance obligations and meeting the contractual milestones for payments;
- new contracts awarded in the year; and
- changes in estimates (see 4.4).

During the year, no gains or losses were recognised in profit or loss in relation to impaired contract assets.

The following table shows how much of the revenue recognised in the current reporting period relates to carried forward contract liabilities from the prior year:

| | 2020 £ | 2019 £ |
|---|-----------|-----------|
| Revenue recognised that was included in the contract liability balance at the beginning of the period | 4,184,382 | 826,254 |

There was no revenue recognised in the current reporting period from performance obligations satisfied in the prior year.

The total value of unsatisfied performance obligations on contracts in existence at the end of the reporting period (which are to be recognised as revenue in future periods) are as follows:

| | 2020 £ | 2019 £ |
|---|-----------|------------|
| Total contract value of unsatisfied performance obligations | 9,550,325 | 13,459,779 |

All unsatisfied contracts at the end of the reporting period are due to have all performance obligations satisfied by at the most 12 months from the year end.

The Company recognised no assets in relation to costs to fulfil contracts with customers at the year ended 31 December 2020.

4.3. Other operating income

| | 2020 £ | 2019 £ |
|--------------------|------------------|------------------|
| Licence fee income | 1,464,388 | 2,255,336 |
| Government grants | 103,703 | - |
| | <u>1,568,091</u> | <u>2,255,336</u> |

In addition to revenue, the Company recognised licence fee income of £1,464,388 (2019: £2,255,336) that also falls under the scope of IFRS 15. This income relates to licence fees received from Zhuzhou CRRC Times Electric Co., Ltd, "Zhuzhou", (the parent of the Group's parent company and based in China) to transfer intellectual property rights of SMD technology to the CRRC Group. It is recognised over time, by reference to the costs incurred in delivering training required to SMD Shanghai, to effect the transfer of the license.

4.3. Other operating income (continued)

The Company also received government grants of £103,703 (2019 - £nil) under the Coronavirus Job Retention Scheme. As this scheme involves a transfer of resources from government to the entity, it meets the definition of a government grant.

The scheme is designed to compensate for staff costs of certain employees who were asked to stop working, but who were being kept on the payroll. The amounts received by the Company were recognised in the statement of profit and loss and other comprehensive income over the same period as the costs to which they relate.

At the time of this report, there were no employees who were "furloughed". However, it is possible that the Company will apply for further grants before this scheme ends on 30 September 2021. The Company did not benefit directly from any other forms of government assistance.

There are no unfulfilled conditions or other contingencies attaching to this grant.

5. Operating profit

This is stated after charging/(crediting):

| | 2020 | 2019 |
|--|-------------|-------------|
| | £ | £ |
| Amount of inventories recognised as an expense | 21,111,072 | 26,521,158 |
| Write down of inventories in the year | 390,775 | 117,133 |
| Auditor's remuneration – audit of the financial statements | 112,000 | 120,000 |
| Auditor's remuneration – non-audit | - | - |
| Depreciation of owned tangible assets (Note 11) | 374,669 | 437,324 |
| Depreciation of right-of-use assets (Note 112) | 235,176 | 290,997 |
| Amortisation of owned intangible assets (Note 13) | 30,904 | 29,353 |
| Loss on disposal of tangible assets | - | 588 |
| Research and development costs | 1,164,926 | 1,061,457 |
| R&D above the line tax credit | (656,543) | (601,564) |
| Licence fee income – other operating income (Note 4.3) | (1,464,388) | (2,255,336) |
| Government grants – other operating income (Note 4.3) | (103,703) | - |
| Dilapidation provision | 100,539 | 910 |
| Net loss on foreign currency translation | 269,210 | 272,870 |
| Staff costs | 12,487,346 | 12,917,236 |

6. Directors' remuneration

| | 2020 | 2019 |
|--|----------------|----------------|
| | £ | £ |
| Aggregate remuneration in respect of qualifying services | 656,059 | 661,061 |
| Value of company pension contributions to money purchase schemes | 16,342 | 17,319 |
| | <u>672,401</u> | <u>678,380</u> |

| | No. | No. |
|---|----------|----------|
| Members of money purchase pension schemes | <u>2</u> | <u>3</u> |

The amounts in respect of the highest paid director are as follows:

| | 2020 | 2019 |
|--|----------------|----------------|
| | £ | £ |
| Remuneration in respect of qualifying services | 199,946 | 198,976 |
| Value of company pension contributions to money purchase schemes | - | 977 |
| | <u>199,946</u> | <u>199,953</u> |

7. Staff costs

| | 2020 £ | 2019 £ |
|-----------------------|-------------------|-------------------|
| Wages and salaries | 10,786,541 | 11,144,470 |
| Social security costs | 1,080,964 | 1,156,176 |
| Other pension costs | 619,841 | 616,590 |
| | <u>12,487,346</u> | <u>12,917,236</u> |

The average monthly number of employees during the year was made up as follows:

| | No. | No. |
|----------------|------------|------------|
| Administration | 65 | 69 |
| Production | 163 | 168 |
| | <u>228</u> | <u>237</u> |

In addition, the Company utilises the service of temporary contractors engaged through agencies.

8. Finance income

| | 2020 £ | 2019 £ |
|---------------------------|-----------|--------------|
| Other interest receivable | - | 1,392 |
| | <u>-</u> | <u>1,392</u> |

9. Finance costs

| | 2020 £ | 2019 £ |
|-----------------------------|----------------|----------------|
| Bank interest payable | 318,500 | 204,517 |
| Right-of-use asset interest | 74,237 | 84,718 |
| Other interest payable | 2,525 | 100,857 |
| Bonding charges | 134,136 | 290,967 |
| | <u>529,398</u> | <u>681,059</u> |

10. Tax

The major components of income tax expense for 2020 and 2019 are as follows:

(a) Income Statement

| | 2020 £ | 2019 £ |
|--|----------------|----------------|
| Current income tax: | | |
| Current income tax credit | 124,743 | 13,138 |
| Adjustments in respect of prior years | - | 56,551 |
| Foreign tax suffered | - | 225,534 |
| | <u>124,743</u> | <u>295,223</u> |
| Deferred tax: | | |
| Origination and reversal of timing differences | 266,346 | 651,914 |
| Adjustments in respect of prior years | 19,426 | (383,522) |
| Effect of tax rate change on opening balance | (175,051) | 250,597 |
| | <u>110,721</u> | <u>518,989</u> |
| Total income tax charge in the income statement | <u>235,464</u> | <u>814,213</u> |

10. Tax (continued)

(b) Reconciliation of tax charge to loss before tax

Tax expense for the year is higher (2019: higher) than the standard rate of corporation tax in the UK for the year ended 31 December 2020 of 19% (2019: 19%). The differences are explained below:

| | 2020 £ | 2019 £ |
|---|----------------|----------------|
| Loss/(profit) before tax | (2,813,880) | 1,229,783 |
| Tax on (loss)/profit at standard UK tax rate of 19% (2019: 19%) | (534,637) | 233,659 |
| Effects of: | | |
| Adjustments in respect of prior years | 19,426 | (326,971) |
| Expenses not deductible for tax purposes | 9,764 | 3,000 |
| Deferred tax not recognised | 746,125 | 561,647 |
| Tax rate changes | (175,051) | 250,597 |
| Effects of foreign tax suffered | - | 182,683 |
| Exempt amounts | - | 9,080 |
| Change in basis | - | (122) |
| Effects of group relief/other reliefs | 169,837 | (54,886) |
| Income not taxable | - | (44,474) |
| Total income tax charge in the income statement | 235,464 | 814,213 |

The tax rate for the current year is the same as the prior year

(c) Deferred tax

| | <i>Balance sheet</i> | | <i>Income Statement</i> | |
|---|----------------------|------------------|-------------------------|----------------|
| | 2020 £ | 2019 £ | 2020 £ | 2019 £ |
| Accelerated depreciation for tax purposes | (1,079,571) | (731,571) | 348,000 | 261,981 |
| Temporary differences – trading | 40,455 | 59,558 | 19,103 | (3,763) |
| Trading losses | 2,435,631 | 2,179,249 | (256,382) | 260,771 |
| Restricted RDEC | 263,857 | 263,857 | | |
| Deferred tax income | | | 110,721 | 518,989 |
| Net deferred tax asset | 1,660,372 | 1,771,093 | | |

The Company offsets tax assets and liabilities if and only if it has a legally enforceable right to set off current tax assets and current tax liabilities and the deferred tax assets and deferred tax liabilities relate to income taxes levied by the same tax authority.

At the year ended 2020 the Company recognised total tax losses of £12,819,112 (2019: losses of £12,819,112) as recoverable resulting in a deferred tax asset of £2,435,631 (2019: deferred tax asset of £2,179,249). For further information on the recognition of deferred tax losses please see Note 3.

The Company has a non-refundable R&D expenditure credit (RDEC) carried forward of £263,857 (2019: 263,857) which can be offset against future corporation tax liability.

In the Spring Budget 2021, the UK Government announced that from 1 April 2023 the corporation tax rate would increase from 19% to 25%. In addition, the 19% rate will continue to apply to companies with profits of not more than £50,000, with marginal relief for profits of up to £250,000. We expect the rate to be substantively enacted over the coming months via the Finance Bill being passed by the House of Commons.

As the proposal to increase the rate to 25% had not been substantively enacted at the balance sheet date, its effects are not included in these financial statements. However, it is likely that the overall effect of the change, had it been substantively enacted by the balance sheet date, would be to increase the deferred tax asset by £441,005.

11. Property, plant and equipment

| | <i>Freehold property</i> | <i>Leasehold properties and improvement</i> | <i>Fixtures and fittings</i> | <i>Motor vehicles</i> | <i>Computer equipment</i> | <i>Total</i> |
|------------------------|------------------------------|---|----------------------------------|---------------------------|-------------------------------|--------------|
| | £ | £ | £ | £ | £ | £ |
| Cost: | | | | | | |
| At 1 January 2020 | 3,450,443 | 5,803,221 | 1,858,723 | 22,230 | 849,203 | 11,983,820 |
| Additions | 13,364 | 218,835 | 8,476 | - | 31,590 | 272,265 |
| Disposals | - | (1,686,669) | (257,313) | - | - | (1,943,982) |
| At 31 December 2020 | 3,463,807 | 4,335,387 | 1,609,886 | 22,230 | 880,793 | 10,312,103 |
| Depreciation: | | | | | | |
| At 1 January 2020 | (1,413,541) | (3,316,781) | (1,567,070) | (22,230) | (693,506) | (7,013,128) |
| Disposals | - | 1,686,669 | 257,313 | - | - | 1,943,982 |
| Charge for the year | (66,308) | (332,516) | (129,725) | - | (81,296) | (609,845) |
| At 31 December 2020 | (1,479,849) | (1,962,628) | (1,439,482) | (22,230) | (774,802) | (5,678,991) |
| Net book value: | | | | | | |
| At 31 December 2020 | 1,983,958 | 2,372,759 | 170,404 | - | 105,991 | 4,633,112 |
| At 1 January 2020 | 2,036,902 | 2,486,440 | 291,653 | - | 155,697 | 4,970,692 |

Included in property, plant and equipment, the Company held right-of-use assets with a net book value of £1,359,067 at the end of the reporting period (2019 - £1,397,098). On these assets the Company incurred a depreciation charge of £235,176 during the year (2019 - £290,997). Amounts relating to right-of-use assets are disclosed in Note 12.

All assets included in leasehold properties and improvement relate to short leasehold.

12. Leases

The Company has lease contracts for various offices and warehouses. The amounts recognised in the financial statements in relation to the leases is presented below.

| | 2020 £ | 2019 £ |
|---|------------------|------------------|
| Property, plant and equipment owned (Note 11) | 3,274,045 | 3,573,594 |
| Right-of-use assets | 1,359,067 | 1,397,098 |
| | <u>4,633,112</u> | <u>4,970,692</u> |

Additions to the right-of-use assets during the 2020 financial year were £197,145 (2019 - £nil).

Lease liabilities

| | 2020 £ | 2019 £ |
|---|------------------|------------------|
| Maturity analysis – contractual undiscounted cash flows | | |
| Less than one year | 242,132 | 300,804 |
| One to five years | 984,105 | 984,105 |
| More than five years | 658,192 | 688,874 |
| Total undiscounted lease liabilities at 31 December | <u>1,884,429</u> | <u>1,973,783</u> |

12. Leases (continued)

| | 2020 £ | 2019 £ |
|---|------------------|------------------|
| Lease liabilities included in the statement of financial position as at 31 December | | |
| Current | 169,983 | 229,779 |
| Non-current | 1,392,117 | 1,373,070 |
| | <u>1,562,100</u> | <u>1,602,849</u> |

Amounts recognised in profit or loss

| | 2020 £ | 2019 £ |
|----------------------------------|----------------|----------------|
| Interest on lease liabilities | 74,237 | 84,718 |
| Depreciation charge for the year | 235,176 | 290,997 |
| | <u>309,413</u> | <u>375,715</u> |

The average incremental borrowing rate applied to lease liabilities recognised under IFRS 16 is 5%.

The total cash outflow for leases was £411,212 (2019 - £402,730). Included within this balance is an overpayment of £79,962 in respect of rent for a lease that expired in July 2020. Management expect to recover this balance in full in early 2021.

Termination option is included in one property lease. This is used to maximise operational flexibility in terms of managing the assets used in the Company's operations. The option is exercisable only by the Company and not by the respective lessor.

13. Intangible assets

| | Computer software £ | Product Development £ | Total £ |
|--------------------------|---------------------------|-----------------------------|--------------------|
| Cost: | | | |
| At 1 January 2020 | 1,816,736 | 4,643,528 | 6,460,264 |
| Additions | - | 1,706,891 | 1,706,891 |
| At 31 December 2020 | <u>1,816,736</u> | <u>6,350,419</u> | <u>8,167,155</u> |
| Amortisation: | | | |
| At 1 January 2020 | (1,745,312) | - | (1,745,312) |
| Provided during the year | (30,904) | - | (30,904) |
| At 31 December 2020 | <u>(1,776,216)</u> | <u>-</u> | <u>(1,776,216)</u> |
| Net book value: | | | |
| At 31 December 2020 | <u>40,520</u> | <u>6,350,419</u> | <u>6,390,939</u> |
| At 31 December 2019 | <u>71,424</u> | <u>4,643,528</u> | <u>4,714,952</u> |

Intangible assets amortisation is recorded in administrative expenses in the profit and loss and other comprehensive income.

14. Inventories

| | 2020 £ | 2019 £ |
|------------------|------------------|------------------|
| Raw materials | 2,741,853 | 1,777,134 |
| Work in progress | 224,066 | 240,699 |
| Finished goods | - | 1,544,158 |
| | <u>2,965,919</u> | <u>3,561,991</u> |

Included in the figures above the Company holds a provision against stock as follows:

| | 2020 £ | 2019 £ |
|-----------------------------|------------------|------------------|
| Opening inventory provision | 2,437,776 | 2,225,067 |
| Increase in provision | 327,059 | 849,592 |
| Utilised | (388,043) | (636,883) |
| Closing inventory provision | <u>2,376,792</u> | <u>2,437,776</u> |

15. Trade and other receivables

| <i>Amounts falling due within one year</i> | 2020 £ | 2019 £ |
|--|-------------------|------------------|
| Trade receivables | 6,721,458 | 5,844,685 |
| Amounts owed by group undertakings | 629,307 | 622,162 |
| Prepayments | 798,342 | 714,140 |
| Accrued income | 519,823 | 355,012 |
| Other receivables | 1,540,555 | 1,867,677 |
| | <u>10,209,485</u> | <u>9,403,676</u> |

Management perform an assessment on a case by case basis of the expected credit losses on outstanding debt factoring in the length of overdue debt, customer feedback and market intelligence. The assessment in both 2020 and 2019 did not identify any significant impairment indicators and therefore management have not recognised a loss allowance within trade debtors.

Deferred tax assets relate to losses generated in the year that are available for offset against future taxes. As these are not deemed to be recoverable in the next 12 months, the asset recognised as at 31 December 2020 has been classified as non-current.

Amounts owed by group undertakings as at 31 December 2020 and 2019 wholly relate to amounts owed by related parties and are disclosed in more detail in Note 23. The balances are payable on demand, are unsecured in nature and bear no interest. No provisions are held against these amounts.

Included within other debtors is £1m (2019 - £1m) relating to Research and Development Expenditure Credits (RDEC) which is refundable in cash. The remaining balance mainly relates to other taxation and social security costs.

| <i>Amounts falling due after more than one year</i> | 2020 £ | 2019 £ |
|---|------------------|------------------|
| Deferred tax assets (Note 10) | <u>1,660,372</u> | <u>1,771,093</u> |

16. Cash and cash equivalents

| | 2020 £ | 2019 £ |
|---------------------------|---------------------|--------------------|
| Cash at bank and on hand | 336,102 | 281,417 |
| Bank overdrafts (Note 17) | (14,660,510) | (4,927,517) |
| | <u>(14,324,408)</u> | <u>(4,646,100)</u> |

16. Cash and cash equivalents (continued)

Cash at banks earns interest at floating rates based on daily bank deposit rates. The latest facilities agreement with Barclays Bank Plc was signed by the SMD Group on 8 January 2021 and includes a bank overdraft of up to £17,000,000, a separate credit facility of up to £8,000,000 for the issue of letters of credit, including bonds and foreign exchange agreements.

There is also flexibility between facility limits of the agreement so long as the total facility of £25,000,000 is not exceeded. At 31 December 2020 the Group had an overdraft facility of £15,250,000 and a separate credit facility of £9,750,000.

17. Creditors

| <i>Amounts falling due within one year</i> | 2020 £ | 2019 £ |
|--|-------------------|-------------------|
| Trade creditors | 5,651,813 | 3,144,210 |
| Amounts owed to group undertakings | 2,757,884 | 2,897,210 |
| Accruals | 6,548,541 | 6,376,806 |
| Other taxes and social security costs | 370,428 | 390,555 |
| Bank overdraft (Note 16) | 14,660,510 | 4,927,517 |
| Right-of-use asset obligations (Note12) | 169,983 | 229,779 |
| Other creditors | 120,669 | 121,495 |
| | <u>30,179,828</u> | <u>18,087,572</u> |

Amounts owed to group undertakings include £4,359,182 (2019: 4,642,033) with fellow subsidiaries of the Specialist Machine Developments (SMD) Group. Included within this balance is £1,601,298 (2019: £4,251,973) which has been classified as non-current (Note 18) on the basis that it is not expected to be settled in the next 12 months. The remaining £2,757,884 (2019: 390,059) is recognised in amounts due within one year. Both balances are payable on demand, they are unsecured in nature and bear no interest. No provisions are held against amounts owed by group undertakings.

Amounts owed to related parties (Note 23) are disclosed in amounts owed by group undertakings.

18. Creditors

| <i>Amounts falling due within more than one year</i> | 2020 £ | 2019 £ |
|--|------------------|------------------|
| Right-of-use asset obligations (Note12) | 1,392,117 | 1,373,070 |
| Amounts owed to group undertakings | 1,601,298 | 4,251,973 |
| | <u>2,993,415</u> | <u>5,625,043</u> |

19. Provisions for liabilities

| | <i>Warranty provision</i> £ | <i>Supplier provision</i> £ | <i>Dilapidations provision</i> £ | <i>Total</i> £ |
|--------------------------|------------------------------------|------------------------------------|---|-------------------|
| At 1 January 2020 | 530,001 | 182,000 | 46,416 | 758,417 |
| Charge for the year | 925,768 | - | 100,539 | 1,026,307 |
| Utilised during the year | (933,366) | - | - | (933,366) |
| At 31 December 2020 | <u>522,403</u> | <u>182,000</u> | <u>146,955</u> | <u>851,358</u> |

Warranty cover is typically provided for one to two years and covers machine and component failure where the major uncertainty is the timing and extent of such failures. The provision is calculated on the assumption of 1% of total revenue based on historical figures, which includes contracts still in progress. The utilised provision is recognised at a value of the cost of the replacement part and services when the customer makes a successful warranty claim and is expected to be spent in line with the warranty terms provided. The Company has no obligation to provide warranty cover for claims that have been logged after the end of the warranty period.

19. Provisions for liabilities (continued)

The supplier provision relates to a specific provision to provide replacement parts owed on a contract with a customer, which were returned when they did not meet the customer's specifications and failed factory acceptance testing. At the year ended 2020 the parts have been replaced and accepted by the customer, however management have recognised a provision in respect of liquidated damages which may become payable under the contract.

The dilapidations provision relates to the present value obligation to restore leased premises to its original condition at the end of the lease term (July 2020). The restoration cost is estimated to be £47,000. At the time of this report negotiations with the landlord are still ongoing. Management expect that the restoration cost will be payable in 2021.

20. Issued share capital

| <i>Authorised, allotted, called up and fully paid</i> | <i>No.</i> | 2020 | <i>No.</i> | 2019 |
|---|------------|----------------|------------|----------------|
| | | £ | | £ |
| Ordinary shares of £1 each | 938,950 | <u>938,950</u> | 938,950 | <u>938,950</u> |

21. Pensions

The Company operates an individual pension scheme under which the Company contributes a fixed percentage of salary provided the employee contributes a matching amount. As at 31 December 2020 the Company had a pension liability of £124,519 (2019 – £105,375).

22. Commitments and contingencies

| <i>Contingent liabilities</i> | 2020 | 2019 |
|-------------------------------|------------------|-------------------|
| | £ | £ |
| Guarantees (bonding) | <u>6,528,000</u> | <u>12,867,681</u> |

The Company had nil capital expenditure commitments at the year ended 31 December 2020 (2019 - £nil).

At the year ended 2020 the Company was party to guarantees which included clawback provisions should the Company fail to provide goods and services that meet specified performance obligations (performance guarantees) and the return of customer payments made upfront should the Company withdraw from a contract (advance payment guarantees). To secure these obligations, the Company entered into bonding arrangements with its bank as part of the facilities agreement (Note 16), where the bank will settle these guarantees should they materialise before reclaiming this back from the Company. Management made an assessment on the likelihood of these obligations arising, considering the current and forecasted future performance of its products and the Company's ability to comply with the specific conditions. The assessment deemed this possible. However, as the settlement is not probable, the guarantees are disclosed as a contingent liability only.

23. Related party transactions

The Company has taken advantage of the exemption available under FRS 101 from disclosing transactions between fully-owned members of the Specialist Machine Developments (SMD) Ltd Group. The following disclosures provide the total amount of other transactions that have been entered into with related parties.

| Trading | <i>Sale of goods/services</i> | | <i>Balance owed (to)/from</i> | |
|--|-------------------------------|-----------|-------------------------------|-------------|
| | 2020 | 2019 | 2020 | 2019 |
| | £ | £ | £ | £ |
| CRRC SMD (Shanghai) Ltd | | | | |
| Recharged costs | 392,745 | - | 392,745 | 491,108 |
| Goods sold | 6,587,648 | 1,896,811 | 308,661 | 108,808 |
| Zhuzhou CRRC Times Electric Co., Ltd | | | | |
| Goods purchased | - | 28,500 | - | - |
| Non-Trading | <i>Transaction amount</i> | | <i>Balance owed (to)/from</i> | |
| | 2020 | 2019 | 2020 | 2019 |
| | £ | £ | £ | £ |
| Zhuzhou CRRC Times Electric Co., Ltd | | | | |
| Licence fee income | 1,464,388 | 2,255,336 | - | (1,464,388) |
| Recharged costs | - | 17,141 | - | - |
| CRRC Times Electric (Hong Kong) Co., Ltd (CRRC) | | | | |
| Loan notes, interest and payments | - | 2,507,151 | - | (2,507,151) |

CRRC SMD (Shanghai) Ltd (SMD Shanghai)

During the year the Company sold goods of £6,587,648 (2019 - £1,896,811) to SMD Shanghai, whose shareholding is owned by the SMD Group's parent company CRRC Times Electric (Hong Kong) Co, Ltd. In the current year the Company also purchased goods and software totalling £392,745. These costs were reclaimed back from SMD Shanghai. The vast majority of these transactions were settled by the year ended 2020 and are disclosed in Notes 15 and 17 as amounts owed by/to group undertakings respectively. All transactions were conducted at arms' length.

Zhuzhou CRRC Times Electric Co., Ltd (Zhuzhou)

On 15 December 2015 the Company entered into an agreement to license intellectual property to Zhuzhou, the shareholder of the SMD Group's parent company. Licence fee income of £1,464,388 (2019 – £2,255,336) was recognised in the year. All licence income has now been recognised and the Company will not recognise any further income in future reporting periods.

CRRC Times Electric (Hong Kong) Co., Ltd (CRRC)

On 25 November 2019 the Company entered into an agreement with CRRC, the SMD's Group parent company. A loan of £2,500,000 was advanced to the Company with interest payable at 2.9% annually. The loan was repaid in full on 9 January 2020.

24. Ultimate parent undertaking and controlling party

The immediate parent undertaking is Specialist Machine Developments (SMD) Limited with registered office Turbinia Works, Davy Bank, Wallsend, Tyne and Wear, NE28 6UZ, United Kingdom which also holds the consolidated financial statements of the Specialist Machine Developments (SMD) Group. These statements are the smallest Group to consolidate the financial statements of the Company.

The ultimate parent undertaking and controlling party is the CRRC Corporation Limited, incorporated in China with registered office at No. 16 West 4th Ring Road, Haidan District, Beijing, 100036, China. The CRRC Corporation Limited is the parent of the largest group to consolidate these financial statements of which the State-owned Assets Supervision and Administration Commission of the State Council (the Chinese State) owns the majority shareholding. The financial statements are publicly available on the CRRC Corporation Limited website at www.crrcgc.cc.