Specialist Machine Developments (SMD) Limited

Report and Financial Statements

31 December 2017

Directors

M T Jones
R H Howarth
J Chen
D Zhu
X Li
H Zhang

Secretary

R H Howarth

Independent Auditors

Ernst & Young LLP
Citygate
St James' Boulevard
Newcastle upon Tyne
NE1 4JD

Bankers

Citibank Europe plc, UK Branch
Citigroup Centre
Canada Square
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NE11 0BE

Registered Office

Turbinia Works
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NE28 6UZ

Strategic report

The directors present their strategic report for the year ended 31 December 2017.

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 Group has developed a strategy with a five year horizon which started in 2016, focused on five main business groups covering the following:

- Projects;
- Products;
- Services;
- China; and
- Technology/Central Functions.

SMD's strategy is to achieve a significant growth in annual revenue by 2021, 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. The Group's key financial performance indicators for the year were:

	2017	*2016*
	£000	*£000*
Revenue	53,873	21,053
Gross profit	11,957	1,540
Gross profit %	22%	7%
Operating profit/(loss)	3,212	(9,277)
Operating profit/(loss) margin %	6%	(44%)

2017 saw the start of an upturn in a number of markets although the order book continued to be affected by changes in our operating markets, primarily oil and gas. Trade also continued to be impacted by government policy and sanctions with Russia. Sales effort continues with a pickup in activity throughout 2017 and into Q1 2018.

Major trading events of the year were:

- The ROV Business continues to develop its product range. The order intake continued to be weak with revenue driven from the two contract wins from late 2016. 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 has been secured in Q1 2018 and some pickup in sales activity is being seen.

- The Trenching Business recovered from the tough trading conditions of 2016 and saw the business exceed budgeted revenue. Order book at the end of 2017 was half of that at the start but a number of significant wins in early 2018 means budgeted revenue for this Business is already largely secured.

- Our subsea mining equipment contract with Nautilus Minerals moved into a different phase in 2017 with wet test support taking place throughout the year. Focus continues to support Nautilus through the post-delivery support phase.

- The Deck equipment Business continued to support the equipment businesses through 2017 and worked on its first major direct sale which is due to complete around mid 2018. Sales activity continues in this market.

- The Services business delivered on its traditional revenue streams in 2017. Alongside delivery, the newly formed team set about fine tuning its strategy and offerings to the market. The Business has a challenging budget for 2018 but has a third of its target already secured, a run rate of core sales activity will add another third of the budgeted revenue leaving the final third to be secured.

Principal activities and review of the business (continued)

Capital expenditure

The Group invested £1,055,102 of capital expenditure in 2017 (2016 – £1,465,130) to support business growth, which included capitalised product development costs of £642,190.

Taxation

A tax charge of £322,121 (2016 credit of £2,121,698) was incurred against a pre-tax profit of £444,201 (2016 loss of £11,919,642). The Group is carrying forward these unused losses as a £2,314,455 deferred tax asset, where management expect this to be fully utilised against future taxable profits by 2020.

Outlook

Order backlog at 31 December 2017 was below that of January 2017 however a number of significant business wins in early 2018 mean that approximately 60% of 2018 budgeted revenue is already secured and sales pipeline is strong in most business areas.

Principal risks and uncertainties

The Group's activities expose it to a number of financial 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 Group 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 Group'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 Group'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.

Supplier risk

The Group 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 Group invests surplus cash in floating rate interest bearing deposits so the Group's interest income is affected by changes in interest rates. The Group's funding structure is in the form of fixed rate loan notes and an overdraft. The Group 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 Group's principal financial assets are cash and trade and other receivables.

The Group's credit risk is primarily attributable to its trade receivables and amounts recoverable on contracts. 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.

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.

Principal risks and uncertainties (continued)

Foreign currency risk

The Group's activities expose it to the financial risks of changes in foreign currency exchange rates. The Group'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 Group, 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

Historically, in order to maintain liquidity to ensure that sufficient funds were available for ongoing operations and future developments, the Group carefully managed the cash generated by its operations. Following the acquisition the day to day management of cash and liquidity risk is significantly reduced as SMD has access, if required, to the facilities of its parent company.

Political risk

As a company operating in a range of markets SMD is exposed to political risk from time to time. Such risks are managed through the Group'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 Group'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. A number of strategic actions are in place to reduce the reliance on particular markets in future.

By order of the Board

R H Howarth

Richard Howarth
Secretary
24th September 2018

Registered No. 06533623

Directors' report

The directors present their report and financial statements for the year ended 31 December 2017.

Results and dividends

The total profit for the year after taxation amounted to £122,080 (2016 – loss of £9,797,844). The directors do not recommend a final dividend (2016 – £nil).

Going concern

The directors have prepared the financial statements on a going concern basis on the grounds that the Group expects to meet its liabilities as they fall due. The directors have reached this conclusion after undertaking a detailed review of the Group's trading and cash flow forecasts and the financial facilities expected to be available to the Group from its investors, bankers and other stakeholders. For further detail, please see Note 2.

Research and development

The Group 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 Group'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 Group 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 Group's policy to provide continuing employment wherever practicable in the same or an alternative position and to provide appropriate training to achieve this aim.

Employee involvement

The Group 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 Group has been continued through the newsletter 'ROView' in which employees have also been encouraged to present their suggestions and views on the Group's performance. Regular meetings are held between local management and employees to allow a free flow of information and ideas.

Future developments

The Group will continue to work closely with customers in 2018 providing both technical and financial solutions. Despite the difficult trading environment, the Group has been able to secure a number of large orders in H1 and moves into H2 with a strong pipeline of opportunities. The Group 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.

Directors

The directors who served the Group 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	(appointed 7 July 2017)
D Zhu	
X Li	
H Zheng	(appointed 13 June 2018)
A Hodgson	(resigned 24 October 2017)
J Dong	(resigned 1 July 2017)
W Wang	(resigned 7 July 2017)

Disclosure of information to the auditors

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

Auditors

A resolution to reappoint Ernst & Young LLP as auditors will be put to the members at the Annual General Meeting.

By order of the Board

R H Howarth

Richard Howarth
Secretary
24th September 2018

Statement of directors' responsibilities

The directors are responsible for preparing the Strategic Report, the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs and the profit or loss of the Company and Group for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable International Financial Reporting Standards, as adopted by the European Union, have been followed subject to any material departures disclosed and explained in the financial statements;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of a particular transaction, other events and conditions on the Group's financial position and financial performance.
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company and Group will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's and Group's transactions and disclose with reasonable accuracy at any time the financial position of the Company and Group 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 Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Opinion

In our opinion:

- Specialist Machine Developments (SMD) Limited's group financial statements and parent company financial statements (the "financial statements") give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2017 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of Specialist Machine Developments (SMD) Limited which comprise:

Group	Parent company
Consolidated statement of comprehensive income for the year then ended	
Consolidated balance sheet as at 31 December 2017	Company balance sheet as at 31 December 2017
Consolidated statement of changes in equity for the year then ended	Company statement of changes in equity for the year then ended
Consolidated statement of cash flows for the year then ended	Company statement of cash flows for the year then ended
Related notes 1 to 27 to the financial statements, including a summary of significant accounting policies	Related notes 1 to 27 to the financial statements including a summary of significant accounting policies

The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards (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 below. We are independent of the group and parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed entities, 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 have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the 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 group's or the parent 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.

Overview of our audit approach

Key audit matters	We have identified the following key audit matters, which were of most significance to our audit. Significant risks: • Improper revenue recognition • Accounting for inventory • Impairment of goodwill
Audit scope	• We performed an audit of the complete financial information of Specialist Machine Developments (SMD) Limited (company) • We performed an audit of the complete financial information of 3 components and review procedures on a further 2 components, in relation to the Group financial statements • The components where we performed full audit procedures accounted for 97% of Revenue and 150% of Profit Before Tax
Materiality	• Overall group materiality of £540,000 which represents 1% of revenue.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to the Board of Directors
Improper revenue recognition *Contract revenue* IAS 11 *Construction Contracts* provides requirements on the allocation of contract revenue and contract costs to accounting periods in which construction work is performed. Revenue is recognised on a contract by contract basis using a percentage completion method of contract activity where the outcome of the construction contract can be estimated reliably, otherwise revenue is recognised only to the extent of recoverable contract costs incurred. This percentage completion is based on management's assessment of the stage of completion on the individual contracts. This requires management to calculate costs incurred to date and forecast costs to complete for each contract. Assessing costs to complete is highly judgmental and involves key assumptions over future events to be made. The latest estimated outcome must continually be assessed to ensure that management are constantly predicting what the latest position will be.	We performed a walkthrough of the revenue transactions for both revenue streams and assessed the design and implementation effectiveness of key controls. We have gained an understanding of trading terms and conditions with key customers. We have tested the application of these terms through our sample testing of contracts. For contract revenue, we have revisited contract performance assessments and stage of completion at the year end and compared to post year end outturn. Where there has been a significant change in judgment, this has been reflected back into the financial statements for the year ended 31 December 2017. We held review and challenge meetings with key operational and finance personnel including project managers to discuss a sample of individual contracts.	Based on the procedures performed, we did not identify any evidence of material misstatement in the revenue recognised in the year ended 31 December 2017.

Non contract revenue IAS 18 *Revenue* states that revenue from the sale of goods shall be recognised when there has been a transfer to the buyer of the significant risks and rewards of ownership of the goods. The timing of when revenue is recognised is relevant to the Group performance. There are a number of customer arrangements in place at 31 December 2017, which have different points when the risks and rewards of ownership are transferred to the customer. There is opportunity through management override or error to recognise revenue ahead of transfer of risks and rewards of the goods to the customer and/or misstate allocation of revenue between periods. The timing of revenue recognition, including around year end, is a significant focus area of audit. Consolidated group revenue is £53,872,616 (2016 £21,052,796).	For non-contract revenue, we tested the completeness and accuracy of revenue by performing sample testing from sales orders to sales invoice to ensure revenue recognition is appropriate. To further address the risk of management override in revenue, we examined a sample of manual journal entries that were posted to revenue accounts. These manual adjustments which impact revenue, including the credit note provisions, were substantively tested. We tested a sample of significant receivable balances to cash receipts to confirm recoverability post year end. We performed tests on sales transactions posted near to the year end to ensure that cut off is correctly applied.	We conclude that revenue has been recognised in accordance with the requirements of IAS 18 *Revenue* and there are no material cut off errors or indicators of fraudulent reporting.
Accounting for inventory IAS 2 *Inventories* states that the cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition and that inventory should be carried at the lower of cost or its net realisable value. Given the current poor market trading conditions, the risk is that surplus inventory is held at higher than its ultimate net realisable value. Inventory carrying value of £7,806 647 (2016: £8,818 946).	We attended a stock count at the year end to physically verify a sample of inventory on hand to verify its existence. We have performed cost testing on a sample of inventory held at year end to validate that it is not held at higher than the amounts spent to acquire it. We have reviewed the methodology for calculating the slow moving stock provision, including a review of its clerical accuracy as well as considering the aging on which the provision calculation is applied. We have performed a post year end net realisable value review on a sample of inventory items which have been sold subsequent to the year end. We have challenged management on their forecast utilisation of a sample of inventory items, including expectations for the sale of part built equipment. We have compared forecast sales prices to historic prices achieved on sales of similar items in recent years.	The methodology for accounting for a slow moving stock provision is consistent with the methodology applied in the previous year. Based on the procedures performed, we did not identify any evidence of material misstatement in relation to inventory as at 31 December 2017. We conclude that inventory has been recognised in accordance with the requirements of IAS 2 *Inventories*.

Impairment of goodwill IAS 36 *Impairment of Assets* requires that goodwill should be tested annually for impairment, with an impairment arising when the recoverable amount of the cash generating unit (CGU) is less than the carrying value of the CGU. Value in use (VIU) calculations are used to determine the recoverable amount of the CGU. SMD must include various forecasts and judgments into its assessment of the VIU of its group, which if misstated could give rise to an unrecognised impairment. The key assumptions for the VIU calculation include the forecast revenue growth, expected EBITDA margins and the discount rate applied thereon. Goodwill carrying value £44,970,014 (2016: £44,970,014)	The group carries out its annual impairment test as at 31 December each year, concurrent with the financial year end. We considered the group's assessment of its CGU to confirm that testing goodwill for impairment purposes is allocated to the lowest level of CGU at which management monitor goodwill. We reviewed the discount rate used in the goodwill Impairment model and engaged with valuations specialists to benchmark the risk premiums used in the weighted average cost of capital (WACC) to comparables in the same industry. We challenged management's forecast future cash flows used in their impairment review discounted cash flow model by reference to historic results and also our understanding of the latest order pipeline and future strategy of the group. We applied various sensitivity analyses to management's forecasts to stress test the goodwill impairment model.	We confirmed that the entire group is judged to be a single operating segment and whilst revenues are monitored by different divisional activity, the base of assets from which the divisional cash flows are generated are all common and there is no reporting of assets by division. The weighted average cost of capital (WACC) used in the goodwill impairment model is in line with our expected range. We noted that the revenue growth targets and EBITDA margins used in the goodwill impairment model appeared to be at the optimistic end of a reasonable range when compared to past results, albeit the forecasts used in the goodwill impairment model are consistent with management's consideration of the nature of the markets in which it operates, the expected growth of these markets and the ability of the group to exploit the opportunities within those markets, with reference to the current economic climate. No impairment loss arises for the year ended 31 December 2017, using management's base assumptions, although we noted that management's forecasts appeared to be relatively ambitious. Our review of sensitivities noted that the VIU calculation is most sensitive to revenue growth and EBITDA % assumptions. If all key assumptions were to change unfavourably in combination, then this could give rise to a future impairment of goodwill. These sensitivities, along with their impact have been disclosed in Note 14 We are satisfied that there is no impairment of goodwill at 31 December 2017.

An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for each entity within the Group. Taken together, this enables us to form an opinion on the consolidated financial statements. We take into account size, risk profile, the organisation of the group and effectiveness of group-wide controls, changes in the business environment and other factors when assessing the level of work to be performed at each entity.

	2017			2016		
	Number	*% Group PBT*	*% Group Revenue*	*Number*	*% Group PBT*	*% Group Revenue*
Reporting components						
Full scope	3	150%	97%	3	97%	95%
Review scope	2	(50%)	3%	2	3%	5%
Total reporting components	5	100%	100%	5	100%	100%

In assessing the risk of material misstatement to the Group financial statements, and to ensure we had adequate quantitative coverage of significant accounts in the financial statements, of the 5 reporting components of the Group, we selected 3 components entities within the United Kingdom, which represent the principal business units within the Group.

We performed an audit of the complete financial information of all 3 components ("full scope components") which were selected based on their size or risk characteristics. The remaining 2 entities were subject to review scope procedures, which included analytical review procedures based on an assigned testing threshold as a sub-division of our materiality based on relative size and risk profile of each component.

There were no changes in scope from the prior year and all group audit work continued to be performed by the UK audit team.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Group to be £540,000 (2016: £350,000), which is 1% (2016: 2%) of group revenue. We believe that revenue provides us with the best indication of the level of activity and is currently the most relevant performance measure to the stakeholders of the Group.

During the course of our audit, we reassessed initial materiality and have revised this to reflect final audited results, rather than basing on forecasts.

Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 50% (2016: 50%) of our planning materiality, namely £270,000 (2016: £174,000). We have set performance materiality at this percentage which reflects our expectation of the level of audit differences based on the prior year.

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Board of Directors that we would report to them all uncorrected audit differences in excess of £27,000 (2017: £17,000), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

The other information comprises the information included in the strategic report set out on page 2, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this 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 the other information, we are required to report that fact.

We have nothing to report in this regard.

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 directors' report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

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

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

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

Responsibilities of directors

As explained more fully in the statement of directors' responsibilities set out on page 7, the directors are responsible for the preparation of the financial statements and for being satisfied that 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 group and parent 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 group or the parent 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 Financial Reporting Council's website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

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.

Ernst & Young LLP

Sandra Thompson (Senior statutory auditor)

for and on behalf of Ernst & Young LLP, Statutory Auditor

Newcastle upon Tyne

25 September 2018

Notes:

1. The maintenance and integrity of the Specialist Machine Developments (SMD) Limited web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Consolidated statement of comprehensive income

for the year ended 31 December 2017

	Note	*2017* £	*2016* £
Revenue	5	53,872,616	21,052,796
Cost of sales		(41,916,000)	(19,513,093)
Gross profit		11,956,616	1,539,703
Administration expenses		(11,494,757)	(13,016,706)
Other operating income	6	2,750,000	2,200,000
Operating profit/(loss)	6	3,211,859	(9,277,003)
Finance income	9	641	1,627
Finance costs	10	(2,768,299)	(2,644,266)
Profit/(loss) before tax		444,201	(11,919,642)
Tax (charge)/credit	11	(322,121)	2,121,698
Profit/(loss) for the year		122,080	(9,797,944)
Other comprehensive income to be reclassified to profit or loss in subsequent periods (net of tax):			
Cumulative translation differences		(27,381)	73,313
Total comprehensive income/(loss) for the year		94,699	(9,724,631)

All amounts relate to continuing activities.

Consolidated balance sheet

at 31 December 2017

	Note	2017 £	2016 £
Assets			
Non-current assets			
Property, plant and equipment	12	3,927,266	4,173,724
Intangible assets	13	46,768,431	46,283,096
Investments in joint ventures	15	-	103,131
Trade and other receivables	18	50,000	100,000
Deferred tax assets	11	2,315,716	2,246,441
		53,061,413	52,906,392
Current assets			
Inventories	17	7,806,647	8,818,946
Trade and other receivables	18	31,576,333	17,089,285
Cash and cash equivalents	19	2,176,380	1,868,138
		41,559,360	27,776,369
Total assets		94,620,773	80,682,761
Liabilities			
Non-current liabilities			
Borrowings	21	60,000,000	60,034,046
Other financial liabilities	16	-	8,167
Provisions	22	507,024	869,315
		60,507,024	60,911,528
Current liabilities			
Borrowings	21	15,476,740	12,984,570
Other financial liabilities	16	-	286,432
Provisions	22	855,881	95,171
Trade and other payables	20	20,219,277	8,848,244
Current income tax liabilities		245,747	335,211
		36,797,445	22,549,628
Total liabilities		97,304,469	83,461,156
Equity			
Share capital	23	44,048,325	44,048,325
Share premium	23	689	689
Retained earnings		(46,773,644)	(46,895,724)
Foreign translation reserve	23	40,934	68,315
Total shareholders' deficit		(2,683,696)	(2,778,395)
Total equity and liabilities		94,620,773	80,682,761

The financial statements were approved by the Board of Directors on 24th September 2018 and signed on its behalf by

R.H. Howarth

Richard Howarth
Director

Consolidated statement of changes in equity

for the year ended 31 December 2017

	Share capital £	Share premium £	Retained earnings £	Foreign translation reserves £	Total equity £
Balance at 1 January 2016	44,048,325	689	(37,097,780)	(4,998)	6,946,236
Loss for the year	-	-	(9,797,944)	-	(9,797,944)
Other comprehensive income for the year	-	-	-	73,313	73,313
Total comprehensive loss for the year	-	-	(9,797,944)	73,313	(9,724,631)
Balance at 31 December 2016 and 1 January 2017	44,048,325	689	(46,895,724)	68,315	(2,778,395)
Profit for the year	-	-	122,080	-	122,080
Other comprehensive loss for the year	-	-	-	(27,381)	(27,381)
Total comprehensive income for the year	-	-	122,080	(27,381)	94,699
Balance at 31 December 2017	44,048,325	689	(46,773,644)	40,934	(2,683,696)

Company statement of changes in equity

for the year ended 31 December 2017

	Share capital £	Share premium £	Retained earnings £	Total equity £
Balance at 1 January 2016	44,048,325	689	(469,340)	43,579,674
Loss for the year	-	-	(4,739,733)	(4,739,733)
Balance at 31 December 2016 and 1 January 2017	44,048,325	689	(5,209,073)	38,839,941
Profit for the year	-	-	761,616	761,616
Balance at 31 December 2017	44,048,325	689	(4,447,457)	39,601,557

Company balance sheet

at 31 December 2017

	Note	2017 £	2016 £
Assets			
Non-current assets			
Investments in subsidiaries	15	99,500,000	99,500,000
Deferred tax assets		81,457	-
		99,581,457	99,500,000
Current assets			
Trade and other receivables	18	15,462,794	2,354,893
Total assets		115,044,251	101,854,893
Liabilities			
Non-current liabilities			
Borrowings	21	60,000,000	60,000,000
Current liabilities			
Borrowings	21	15,442,694	2,400,000
Trade and other payables	20	-	614,952
		15,442,694	3,014,952
Total liabilities		75,442,694	63,014,952
Equity			
Share capital	23	44,048,325	44,048,325
Share premium	23	689	689
Retained earnings		(4,447,457)	(5,209,073)
Total shareholders' equity		39,601,557	38,839,941
Total equity and liabilities		115,044,251	101,854,893

Permitted by section 408 of the Companies Act 2006, no income statement has been presented for the Company. The profit for the year recognised by the Company was £761,616 (2016 – loss of £4,739,733).

The financial statements were approved by the Board of Directors on 24th September 2018 and signed on its behalf by

R.H. Howarth

Richard Howarth
Director

Consolidated statement of cash flows

for the year ended 31 December 2017

	Note	2017 £	2016 £
Operating activities			
Profit/(loss) before tax		444,201	(11,919,642)
Adjustments to reconcile profit/(loss) before tax to net cash flows:			
Depreciation and impairment of property, plant and equipment	12	486,260	476,549
Amortisation and impairment of intangible assets	13	318,568	341,338
Impairment of investments	15	-	96,371
Loss on disposal of property, plant and equipment	6	11,247	125,218
Finance income	9	(641)	(1,627)
Finance costs	10	2,768,299	2,644,266
Movement in other financial liabilities	16	(294,599)	294,599
Movement in provisions		398,219	(308,331)
Working capital adjustments:			
(Increase)/decrease in trade receivables		(14,384,527)	2,881,309
Decrease/(increase) in inventories		1,009,870	(290,076)
Increase/(decrease) in trade payables		11,288,335	(893,372)
		2,045,232	(6,553,398)
Interest received		641	1,627
Interest paid		(2,719,349)	(437,170)
Income tax paid		(459,778)	-
Net cash flows used in operating activities		(1,133,254)	(6,988,941)
Investing activities			
Disposal of investments		103,129	-
Purchase of property, plant and equipment	12	(251,198)	(520,806)
Purchase of intangible assets	13	(803,904)	(944,324)
Net cash flows used in investing activities		(951,973)	(1,465,130)
Financing activities			
Drawdown of bank loan		13,000,000	-
Capital element of hire purchase repayments		(53,575)	(53,575)
Net cash flows used in financing activities		12,946,425	(53,575)
Net increase/(decrease) in cash and cash equivalents		10,861,198	(8,507,646)
Cash and cash equivalents at beginning of year		(8,669,114)	(201,977)
Net foreign exchange difference		(15,704)	40,509
Cash and cash equivalents at end of year	19	2,176,380	(8,669,114)

Cash and cash equivalents at 31 December 2016 includes a bank overdraft of £10,537,252. During the year the overdraft was replaced with a bank loan, which is not included in cash and cash equivalents at 31 December 2017.

Company statement of cash flows

for the year ended 31 December 2017

	Note	2017 £	2016 £
Operating activities			
Profit/(loss) before tax		749,492	(4,739,733)
Adjustments to reconcile profit before tax to net cash flows:			
Impairment of investments		-	1,230,468
Finance costs		2,442,694	2,400,000
Working capital adjustments:			
(Increase)/decrease in trade receivables		(13,177,234)	1,313,101
Decrease in trade payables		(614,952)	-
		(10,600,000)	203,836
Interest paid		(2,400,000)	(203,836)
Net cash flows used in operating activities		(13,000,000)	-
Drawdown of borrowings		13,000,000	-
Net cash flows used in financing activities		13,000,000	-
Net increase in cash and cash equivalents		-	-
Cash and cash equivalents at beginning of year		-	-
Cash and cash equivalents at end of year	19	-	-

Notes to the financial statements

for the year ended 31 December 2017

1. General Information

The consolidated and separate financial statements of Specialist Machine Developments (SMD) Limited (the "Company") and its subsidiaries (collectively, the "Group") for the year ended 31 December 2017 were authorised for issue in accordance with a resolution of the directors on 24th September 2018. Specialist Machine Developments (SMD) Limited is a private company limited by shares, incorporated and domiciled in the United Kingdom with the registered office at Turbinia Works, Davy Bank, Wallsend, Tyne and Wear.

The Group is principally engaged in the development and construction of subsea remote operated vehicles (ROVs) and trenching and mining equipment. Information on the Group's structure is provided in Note 15. Information on other related party relationships of the Group is provided in Note 26.

2. Accounting policies

Basis of preparation and statement of compliance with IFRS

The financial statements of the Specialist Machine Developments (SMD) Limited Company and its Group have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU).

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 2017 as defined below. The presentation currency is GBP Sterling (£), which is also the functional currency of the Company and Group. All policies and measurement bases were in effect throughout all periods presented in the financial statements.

Going concern

The directors have prepared the financial statements on a going concern basis on the grounds that the Company expects to meet its liabilities as they fall due. The directors have reached this conclusion after undertaking a detailed review of the Company's trading and cash flow forecasts and the financial facilities expected to be available to the Company from its investors, bankers and other stakeholders. In making this assessment the directors acknowledge the following:

I. The Group has net liabilities of £2.7m, although is in a net current assets position of £4.6m
II. The Group remains within the limits of the current facilities agreement with Citibank and from cash flow forecasts will continue to fund current operations for at least the next 12 months from the date of approval of these financial statements.
III. Going from a loss of £9.7m in 2016 the Group beat its target of breaking even in 2017 by generating a small profit, indicating the market recovery is well underway.
IV. The closing order book for 2017 is £16m (2016 £17.3m), but is still far higher than the 2015 closing order book of £3.6m.
V. The immediate parent company CRRC Times Electric (Hong Kong) Co. Limited has guaranteed both financial support to the Group and to refrain from recalling the £62.4m loan notes until the Group has enough funds to make the repayment.

Consolidated financial statements

The Group financial statements consolidate the financial statements of Specialist Machine Developments (SMD) Limited and all its subsidiary undertakings, all of which whose issued share capital are owned 100% within the Group. On consolidation, all intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

Entities in which the Group holds an interest on a long-term basis and are jointly controlled by the Group and one or more other ventures under a contractual agreement, are treated as joint ventures in accordance with IFRS 11 and are accounted for using the equity method. The financial statements of the joint ventures are prepared in accordance with IFRS for the same reporting period as the Group. Carrying values are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable.

Separate financial statements

The separate financial statements disclose the financial information of the Specialist Machine Developments (SMD) Limited Company. Investments in subsidiaries are recorded at cost less provision for impairment, where carrying values are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable.

Revenue

Revenue, excluding value added tax, comprises sales to outside customers under construction contracts and non-contract revenue, which includes sales of spares parts and support services.

(a) Contract revenue

The Group principally operates fixed price contracts. If the outcome of such a contract can be reliably measured, revenue associated with the construction contract is recognised by reference to the stage of completion of the contract activity at year end (the percentage of completion method).

The outcome of a construction contract can be estimated reliably when:

(i) the total contract revenue can be measured reliably;
(ii) it is probable that the economic benefits associated with the contract will flow to the entity;
(iii) the costs to complete the contract and the stage of completion can be measured reliably; and
(iv) the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates. When the outcome of a construction contract cannot be estimated reliably (principally during early stages of a contract), contract revenue is recognised only to the extent of costs incurred that are expected to be recoverable.

In applying the percentage of completion method, revenue recognised corresponds to the total contract revenue (as defined below) multiplied by the actual completion rate based on the proportion of total contract costs (as defined below) incurred to date and the estimated costs to complete.

Contract revenue — Contract revenue corresponds to the initial amount of revenue agreed in the contract and any variations in contract work, claims and incentive payments to the extent that it is probable that they will result in revenue, and they are capable of being reliably measured.

Contract costs — Contract costs include costs that relate directly to the specific contract and costs that are attributable to contract activity in general and can be allocated to the contract. Costs that relate directly to a specific contract comprise: site labour costs (including site supervision); costs of materials used in construction; depreciation of equipment used on the contract; costs of design, and technical assistance that is directly related to the contract.

The Group's contracts are typically negotiated for the construction of a single asset or a group of assets which are closely interrelated or interdependent in terms of their design, technology and function. Contracts for services directly related to construction contracts are accounted for as part of the construction contract.

Provided that the outcome of construction contracts can be assessed with reasonable certainty, such contracts are valued at cost plus attributable profit earned to date. Full provision is made for any estimated losses to completion of contracts as soon as they become reasonably foreseeable.

Progress payments received, when greater than recorded revenue, are deducted from amounts recoverable on contracts except to the extent that payments on account exceed the value of any amount recoverable on a contract where the excess is included in deferred income. The amount by which recorded revenue of construction contracts is in excess of payments on account is classified as 'amounts recoverable on contracts'.

(b) Non-contract revenue

Non-contract revenue, which comprises sales of spare parts and support services, is recognised upon the transfer of significant risk and rewards of ownership of the goods to the customer, usually on delivery of goods. Revenue is not recognised to the extent where there are significant uncertainties regarding recovery of the consideration due, associated costs or the possible return of goods.

Other operating income

Other operating income relates to licence fees received from Zhuzhou CRRC Times Electric Co., Ltd to license intellectual property rights of SMD technology to the CRRC Group. Within the terms of the licence agreement, the Group are required to provide training and support when licensing the intellectual property. Income is recognised as a proportion of training and support provided by the Group compared to that required by the agreement of the total licence fees owed for the year.

Current taxation

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the end of the reporting period.

Current income taxes are recognised in profit or loss except to the extent that the tax relates to items recognised outside profit or loss, either in other comprehensive income or directly in equity. Management periodically evaluates positions taken in the tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate.

Deferred taxation

Deferred tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill; deferred tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is undiscounted and determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Inventories

Inventories and work in progress are valued at the lower of cost and net realisable value. Cost includes an attributable proportion of production overheads.

Property, plant and equipment

All property, plant and equipment 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.

Intangibles

(a) Goodwill

Goodwill arises on the acquisition of subsidiaries, associates and joint ventures and represents the excess of the consideration transferred over the Group's interest in net fair value of the net identifiable assets, liabilities and contingent liabilities of the acquiree.

Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. Goodwill is allocated to the cash-generating unit (CGU) expected to benefit from the combination. The Group has determined that it has a single CGU for the purposes of the impairment testing. The carrying value of the CGU to which goodwill is allocated is compared to the recoverable amount, which is the higher of value in use and the fair value less costs of disposal. Any impairment of goodwill is recognised immediately as an expense and is not subsequently reversed.

(b) Computer software

Intangible assets relate to capitalised computer software that is not integral to related 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.

(c) 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) 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.

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.

Financial assets include foreign exchange forward contracts that are classified as fair value through the profit or loss. These are carried in the balance sheet at fair value with net changes in fair value presented as finance costs (negative net changes in fair value) or finance income (positive net changes in fair value) in the statement of comprehensive income. 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. An impairment assessment is performed at each reporting date to determine if there is objective evidence that a financial asset, or group of assets is impaired. An impairment exists if one or more events that has occurred since the initial recognition of the asset (an incurred 'loss event'), has an impact on the estimated future cash flows that can be reliably estimated.

Financial liabilities relate to issued loan notes traded on the International Stock Exchange and to finance leases that are initially recognised at fair value net of any directly attributable transaction costs. After initial recognition, they are subsequently measured at amortised cost using the effective interest rate method. Gains and losses are recognised in profit or loss when the liabilities are derecognised as well as through the effective interest rate amortisation process. They are derecognised when the obligation under the liability has either been discharged, cancelled or expired.

Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the effective interest rate. The effective interest rate amortisation is included as finance costs in the statement of profit or loss.

For details of the financial instruments disclosed see Note 16.

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

In the Group's financial statements, all assets, liabilities and transactions of Group entities with a functional currency other than the £ are translated into £ upon consolidation. Assets and liabilities have been translated into £ at the closing rate at the reporting date and income and expenses have been translated at the average rate over the reporting period. Exchange differences are charged/credited to other comprehensive income and recognised in the currency translation reserve in equity.

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. The arrangement is, or contains, a lease if fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset or assets, even if that right is not explicitly specified in an arrangement.

(a) As a lessee

A lease is classified at the inception date as a finance lease or an operating lease. A lease that transfers substantially all the risks and rewards incidental to ownership to the Group is classified as a finance lease.

Finance leases are capitalised at the commencement of the lease at the inception date fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are recognised in finance costs in the consolidated statement of comprehensive income.

A leased asset is depreciated over the useful life of the asset. However, if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the estimated useful life of the asset and the lease term.

Operating lease payments are recognised as an operating expense in the consolidated statement of comprehensive income on a straight-line basis over the lease term.

(b) As a lessor

At commencement of the lease term, the Group records finance leases in the balance sheet as a receivable, at an amount equal to the net investment in the lease. The Group recognises finance income based on a pattern reflecting a constant periodic rate of return on the Group's net investment outstanding in respect of the finance lease. The Group has not engaged in operating leases as a lessor in any of the years reported.

Warranty provisions

Provisions are recognised when the Group 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 Group contributes to individual pension scheme arrangements for employees. The assets of the scheme are held separately from those of the Group. The annual contributions payable are charged to the consolidated statement of comprehensive income.

New standards and interpretations not applied

The International Accounting Standards Board ("IASB") and the International Financial Reporting Interpretations Committee ("IFRIC") have issued the following standards, interpretations and amendments with an effective date after these financial statements:

		Effective date
IFRS 9	Financial instruments	1 January 2018
IFRS 15	Revenue from contracts with customers	1 January 2018
IFRS 16	Leases	1 January 2019

IFRS 9 Financial Instruments will be adopted by the SMD Group for the year ending 31 December 2018. Management are currently reviewing the standard to understand its impact on accounting for financial assets, but do not expect there to be a material impact on the financial statements aside from increased disclosure requirements.

IFRS 15 Revenue from Contracts with Customers will be adopted by SMD for the year ending 31 December 2018. During the year, SMD had undertaken a review of significant contract terms and conditions against the requirements of IFRS 15. As part of the review, management considered alternatives to the current measurement basis of revenue recognition (cost of labour and materials per total forecasted costs), such as number of hours worked per total forecasted hours. In arriving at the best approach, management factored in that materials consumed on contracts are typically bespoke in nature, designed by SMD and are controlled by the customer. Given materials are fundamental to each contract, the current method was therefore deemed more reflective of contract progress and hence revenue and margin recognition. As a result, the review concluded there are no contracts which are expected to require a materially different treatment under IFRS 15 versus current standards. Therefore the introduction of IFRS 15 is currently not expected to impact the financial statements in future periods other than additional disclosure requirements.

Regarding IFRS 16 Leases, management expect the Group will recognise an increase in leased assets and lease liabilities by an amount comparable to the future minimum rentals outlined in Note 25.

3. Significant accounting judgements, estimates and assumptions

The preparation of the Group's consolidated 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 Group's accounting policies, management has made the following judgements, estimates and assumptions which have the most significant effect on the amounts recognised in the consolidated financial statements:

Construction contracts

The group recognises revenue relating to construction contracts on a percentage completion of costs basis. In order to determine the overall contract cost, estimates are used based on a combination of internal and external sources with expert knowledge and experience in their respective areas. The overall contract cost including any estimates, contract risk and current progress against schedule and budget are reviewed by management before any progress is recognised in the financial statements.

Goodwill impairment review

Management were required to make judgements, estimates and assumptions when performing the goodwill impairment review, to support the carrying value recognised in the financial statements. This was based on the criteria that an impairment exists when the carrying value of an asset exceeds its recoverable amount, which is the higher of its fair value less costs of disposal and its value in use.

To determine if an impairment exists management used a discounted cash flow (DCF) model based on forecasted cash flows over a five year period plus the terminal year. The model was sensitive to assumptions based on revenue, EBITDA (earnings before interest, tax, depreciation and amortisation) margin and discount rate, the effects of which are discussed in greater detail in Note 14.

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 £2,028,583 at 31 December 2017 (2016 - £1,561,838). 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.

Receivables provision

As the Group's main source of revenue is derived from various construction contracts, revenue and receivables can fluctuate significantly from year to year depending on market conditions at the time. Impairments to receivables are therefore judged on a case by case basis, as a flat rate percentage provision would not fairly represent the recoverability.

In arriving at the receivables provision, management perform a review of all receivables and assess the likelihood of carrying value recovery, factoring in both feedback from the customer and the ability for the customer to settle the debt. Should the recoverable amount be lower than the carrying value, the Group recognises a specific provision. Please see Note 18 which discloses trade and other receivables balances including recognised impairments.

Warranty provision

The Group 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 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 22 which includes disclosure of the warranty provision recognised.

Contingent liabilities

The Group is party to guarantees which include financial penalties should the Group fail to provide goods and services that meet specified performance obligations (performance guarantees) and the return of customer payments made upfront should the Group withdraw from a contract (advance payment guarantees). To secure these obligations, the Group enters into bonding arrangements with its bank as part of the facilities agreement (Note 19), where the bank will settle these guarantees should they materialise and reclaim this back from the Group.

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 Group's ability to comply with the specific conditions. The assessment found the extent of the guarantees was £4,657,416 (2016 - £9,174,345) and deemed the likelihood of any bonds materialising to be remote, therefore the guarantees have been disclosed as a contingent liability only (see Note 25).

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 Group has £12,459,510 (2016 - £12,251,829) total tax losses carried forward, the vast majority of which consist of unused losses from the prior year. In assessing the recoverability of these losses management considered performance forecasts and as the Group is expected to increase in profitability in future years, it was determined that the entire £12,459,510 tax losses can be recognised for future offset.

On analysis, management deem it at least probable the tax losses will be fully utilised by 2020, but note that changes in assumptions made could have a material impact on the Group's reported tax charge. Management estimate that £8,936,000 losses will be utilised in 2018/19 at the existing rate of 19% and £3,512,075 losses utilised in 2020 at the blended rate of 17.5%, resulting in in a deferred tax asset for the year ended 2017 of £2,314,455 (2016 - £2,287,308).

See Note 11 for deferred tax disclosures.

4. Capital Management

For the purpose of the Group's capital management, capital includes issued share capital, share premium and all other equity reserves attributable to the equity holders of the parent. The primary objective of the Group's capital management is to maximise shareholder value.

The Group does not actively manage its capital structure to a fixed amount or rate and instead makes adjustments in light of changes in economic conditions and requirements of its financial obligations. Prior to April 2015 this included meeting financial covenants imposed by the Group's bank, but subsequent to that date the covenants were removed when the Group was acquired by the CRRC Group. Since acquisition, the capital structure is now determined by CRRC and may change depending on profitability and cash flow. The Group monitors capital using the gearing ratio, which is net debt divided by total capital plus net debt; within net debt the Group includes interest-bearing loans and borrowings and trade and other payables, less cash and short-term deposits.

	2017 £	2016 £
Interest-bearing loans and borrowings	75,476,740	73,018,616
Trade and other payables	20,219,277	8,848,244
Less: cash and short-term deposits	(2,176,380)	(1,868,138)
Net debt	93,519,637	79,998,722
Total equity	(2,683,696)	(2,778,395)
Capital and net debt	90,835,941	77,220,327
Gearing ratio	103%	104%

In order to achieve the primary objective, the Group's capital management, amongst other things, aims to ensure that it meets the financial obligations attached to the interest-bearing loans and borrowings that define capital structure requirements. A cash flow reconciliation of the Group's borrowings is shown below.

	Borrowings £	Finance leases £	*Total* £
At 1 January 2017	72,937,252	81,364	73,018,616
Cash flows:			
- Capital element of hire purchase payments	-	(53,575)	(53,575)
- Drawdown of bank loan	13,000,000	-	13,000,000
- Interest paid	(2,513,600)	-	(2,513,600)
- Borrowings repaid	(10,537,252)	-	(10,537,252)
Non-cash flows:			
- Interest expense	2,556,294	6,257	2,562,551
At 31 December 2017	75,442,694	34,046	75,476,740

Interest paid and interest expense include interest associated with borrowings only. Noted with the statement of cash flows, the Group repaid its overdraft facility of £10,537,252.

5. Revenue

The group applies IFRS 8 Operating Segments which provides segmental information for the group on the basis of information reported internally to the chief operating decision maker for decision-making purposes. The Group considers that the role of chief operating decision maker is performed by the Board of Directors. Analysis of revenue is prepared and monitored on a divisional basis, however, resource allocation decisions are made on a group basis and, as a result, the Directors consider that there is one operating segment as defined under IFRS 8, being the whole group.

An analysis of revenue by geographical market is given below:

	2017 £	2016 £
United Kingdom	8,057,630	5,903,506
People's Republic of China	18,741,905	4,435,124
Netherlands	10,846,702	385,107
Rest of the world	16,226,379	10,329,059
	53,872,616	21,052,796

An analysis of revenue is given below:

	2017 £	2016 £
Contract revenue	39,321,949	11,802,472
Non-contract revenue	14,550,667	9,250,324
	53,872,616	21,052,796

	2017 £	2016 £
Aggregate amount of costs incurred and recognised profits (less recognised losses) to date	122,938,707	84,400,840
Amount of retentions	3,198,501	3,147,501

	2017 £	2016 £
Amounts recoverable on contracts (Note 18)	14,030,062	3,638,754
Payments received on account (Note 20)	826,254	3,817,398

6. Operating profit/(loss)

This is stated after charging/(crediting):

	2017 £	2016 £
Amount of inventories recognised as an expense	28,723,882	7,300,770
Auditor's remuneration – as auditor	90,000	90,000
Auditor's remuneration – non audit	5,000	-
Depreciation of owned property, plant and equipment (Note 12)	486,260	476,549
Loss on disposal of property, plant and equipment	11,246	125,218
Amortisation of owned intangible assets (Note 13)	318,568	341,338
Research and development costs	294,920	656,432
R&D above the line tax credit	(847,976)	(180,417)
Integration costs	-	1,400,000
Recharge of integration costs	-	(1,400,000)
Licence fee income	(2,750,000)	(2,200,000)
Net gain on foreign currency translation	(212,457)	(80,868)
Operating lease rentals – land and buildings	583,655	543,542

7. Directors' remuneration

	2017 £	2016 £
Aggregate remuneration in respect of qualifying services	874,282	733,396
Value of company pension contributions to money purchase schemes	18,917	27,800
	893,199	761,196

	No.	No.
Members of money purchase pension schemes	2	2

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

	2017 £	2016 £
Remuneration in respect of qualifying services	302,300	329,342
Value of company pension contributions to money purchase schemes	-	13,851
	302,300	343,193

8. Staff costs

8.1. Group

	2017 £	2016 £
Wages and salaries	12,994,358	11,587,595
Social security costs	1,356,219	1,185,762
Other pension costs	598,801	584,965
	14,949,378	13,358,322

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

	No.	No.
Administration	66	69
Production	193	176
	259	245

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

8.2. Company

There were no individuals employed by the Company during the year (2016: nil).

9. Finance income

	2017 £	2016 £
Bank interest receivable	-	3
Other interest receivable	641	1,624
	641	1,627

10. Finance costs

	2017 £	2016 £
On bank loans and overdrafts	156,294	155,454
On loan notes	2,400,000	2,400,000
Finance lease interest	6,257	10,932
Other interest	875	8,585
Bonding charges	204,873	69,295
	2,768,299	2,644,266

11. Income Tax

11.1. Group

The major components of income tax expense for 2017 and 2016 are as follows:

(a) Income Statement

	2017 £	2016 £
Current income tax:		
Current income tax	92,450	-
Adjustments in respect of prior years	-	89,154
Foreign tax suffered	280,268	200,000
	372,718	289,154
Deferred tax:		
Current year	(106,745)	(2,455,171)
Adjustments in respect of prior years	977	(74,036)
Effect of tax rate change on opening balance	55,171	118,355
	(50,597)	(2,410,852)
Total income tax charge/(credit) in the statement of comprehensive income	322,121	(2,121,698)

(b) Reconciliation of tax charge/(credit) to profit/(loss) before tax

	2017 £	2016 £
Profit/(loss) before tax	444,201	(11,919,642)
Tax on profit/(loss) at standard UK tax rate of 19.25% (2016: 20%)	85,501	(2,383,928)
Effects of:		
Adjustments in respect of prior years	977	15,118
Expenses not deductible for tax purposes	20,845	45,558
Income not taxable for tax purposes	(6,046)	(77,284)
Tax rate changes	55,171	118,355
Effects of foreign tax suffered	178,854	160,000
Corporate interest restriction	(13,181)	-
Total income tax charge/(credit) in the statement of comprehensive income	322,121	(2,121,698)

(c) Deferred tax

	Balance sheet 2017 £	Balance sheet 2016 £	Statement of comprehensive income 2017 £	Statement of comprehensive income 2016 £
Accelerated depreciation for tax purposes	(17,597)	(55,840)	(38,816)	(69,861)
Temporary differences – trading	18,858	14,973	32,310	20,353
Adjustments in respect of prior years	-	-	1,462	(74,036)
Trading losses	2,314,455	2,287,308	(45,553)	(2,287,308)
Deferred tax income			(50,597)	(2,410,852)
Net deferred asset	2,315,716	2,246,441		

The Group 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 2017 the Company had total tax losses of £12,459,510 and on the basis they will be utilised in full by 2020 have been recognised as a £2,314,455 deferred tax asset.

(d) Change in corporation tax rate

The UK government has announced its intention to reduce the UK corporation tax rate to 17% by 1 April 2020 and has now been substantively enacted.

11.2. Company

The Company manages its tax assets and liabilities in accordance with the Group policy per Note 11.1. At the year ended 2017 the Company had total tax losses of £428,719 of which £81,457 have been recognised as a deferred tax asset. This is on the basis that the carried forward trading losses are forecasted to be utilised in full by 2020.

12. Property, plant and equipment

Group	*Freehold property*	*Leasehold properties and improvement*	*Fixtures and fittings*	*Motor vehicles*	*Computer equipment*	*Total*
	£	£	£	£	£	£
Cost:						
At 1 January 2016	2,268,875	2,492,223	1,680,674	31,535	880,294	7,353,601
Additions	172,500	-	194,801	-	153,505	520,806
Disposals	-	(249,246)	(4,999)	(20,000)	(142,859)	(417,104)
Transfers to current assets	-	-	(93,191)	-	-	(93,191)
Foreign exchange differences	-	-	13,875	-	11,622	25,497
At 31 December 2016 and 1 January 2017	2,441,375	2,242,977	1,791,160	11,535	902,562	7,389,609
Additions	41,404	-	45,453	-	164,341	251,198
Disposals	-	(47,853)	(11,805)	-	(3,215)	(62,873)
Reclassifications	(246,849)	180,592	35,666	10,695	19,896	-
Foreign exchange differences	-	-	(1,363)	-	(5,558)	(6,921)
At 31 December 2017	2,235,930	2,375,716	1,859,111	22,230	1,078,026	7,571,013
Depreciation:						
At 1 January 2016	(345,362)	(930,764)	(1,124,231)	(20,421)	(637,208)	(3,057,986)
Disposals	-	128,918	4,999	20,000	142,363	296,280
Transfers to current assets	-	-	45,855	-	-	45,855
Charge for the year	(45,747)	(103,868)	(186,460)	(5,558)	(134,916)	(476,549)
Foreign exchange differences	-	-	(12,823)	-	(10,662)	(23,485)
At 31 December 2016 and 1 January 2017	(391,109)	(905,714)	(1,272,660)	(5,979)	(640,423)	(3,215,885)
Disposals	-	39,045	10,587	-	1,995	51,627
Reclassifications	189,695	(123,438)	(48,226)	(10,694)	(7,337)	-
Charge for the year	(47,759)	(122,689)	(179,717)	(5,557)	(130,538)	(486,260)
Foreign exchange differences	-	-	1,363	-	5,408	6,771
At 31 December 2017	(249,173)	(1,112,798)	(1,488,653)	(22,230)	(770,895)	(3,643,747)
Net book value:						
At 31 December 2017	1,986,757	1,262,920	370,458	-	307,131	3,927,266
At 31 December 2016 and 1 January 2017	2,050,266	1,337,263	518,500	5,556	262,139	4,173,724
At 1 January 2016	1,923,513	1,561,459	556,443	11,114	243,086	4,295,615

13. Intangible assets

Group	*Computer software*	*Product Development*	*Intellectual Property*	*Goodwill*	*Total*
	£	£	£	£	£
Cost:					
At 1 January 2016	2,747,112	-	-	44,970,014	47,717,126
Additions	58,323	886,001	-	-	944,324
Disposals	(1,057,852)	-	-	-	(1,057,852)
At 31 December 2016 and 1 January 2017	1,747,583	886,001	-	44,970,014	47,603,598
Additions	37,128	642,190	124,586	-	803,904
Disposals	(639)	-	-	-	(639)
At 31 December 2017	1,784,072	1,528,191	124,586	44,970,014	48,406,863
Amortisation:					
At 1 January 2016	(2,032,622)	-	-	-	(2,032,622)
Disposals	1,053,458	-	-	-	1,053,458
Charge for the year	(341,338)	-	-	-	(341,338)
At 31 December 2016 and 1 January 2017	(1,320,502)	-	-	-	(1,320,502)
Disposals	638	-	-	-	638
Charge for the year	(314,415)	-	(4,153)	-	(318,568)
At 31 December 2017	(1,634,279)	-	(4,153)	-	(1,638,432)
Net book value:					
At 31 December 2017	149,793	1,528,191	120,433	44,970,014	46,768,431
At 31 December 2016 and 1 January 2017	427,081	886,001	-	44,970,014	46,283,096
At 1 January 2016	714,490	-	-	44,970,014	45,684,504

14. Goodwill impairment review

The Board monitor the business at a Group level and goodwill is allocated to a single CGU, being the entirety of the Group and was tested for impairment at this overall Group level.

14.1. Carrying value of goodwill

	2017	*2016*
	£	£
Goodwill carrying value	44,970,014	44,970,014

At the end of the year the Specialist Machine Developments (SMD) Group had net liabilities of £2,683,696, compared to net liabilities of £2,778,395 at the end of 2016. The decline of the oil and gas industry in recent years had previously led to a decrease in revenue for the Group, but from diversifying its product range and expanding into new geographical markets the Group has since increased its revenue to £53,872,616 (up from £21,052,796 in 2016). In accordance with IAS 36 management performed a goodwill impairment assessment based on a value in use calculation using cash flow projections from financial budgets. The assessment concluded no goodwill impairment was to be recognised which reflects the Group's return to profit, the continuingly strong order book and meeting the targets set by management.

14.2. Value in use

Value in use was calculated using discounted free cash flows covering a five year period plus terminal year. The model uses a pre-tax discount rate of 14.32%, as discussed below, (comparable to 12.5% post tax rate) on cash flow projections with revenue growth and EBITDA margin as follows:

	2018	*2019*	*2020*	*2021*	*2022*	*Terminal year*
Revenue growth	24%	29%	17%	15%	17%	2%
EBITDA margin	10%	14%	14%	15%	17%	17%

In comparison with the prior year projection revenue targets are now lower but EBITDA margins are higher, which highlights the Group's shift in focus to profitability. Whilst it narrowly missed its 2017 revenue target of £55m, the Group significantly exceeded its EBITDA target of £3.3m by achieving £4.0m in the year, increasing management's confidence in its ability to forecast Group performance and that future forecasts are realistic.

Management also emphasise that whilst forecasted average revenue growth exceeds 18% and appears to be optimistic, prior to the decline in the oil and gas industry from 2011 to 2014 the Group generated average revenues of £96m. Long-term revenue growth is therefore reflective of market recovery as opposed to brand new business. As a result of the analysis and management's expectations for the business, the value in use was found to comfortably exceed the carrying amount of the Group's CGU. The key assumptions that are most sensitive on the value in use calculation are revenue, EBITDA margin and discount rate.

14.3. Revenue and EBITDA margin

Historically, the vast majority of the Group's operations were centred on the oil and gas industry and as such the suppression in the market has had a direct impact on the Group's performance in recent years. In an effort to reduce its dependency on oil and gas and thereby reduce the impact of another decline, the business has focused heavily on diversifying its product range and offerings to alternative markets. This was the main source of growth in 2017 and will continue for the next few years with only long-term growth being supported by oil and gas market recovery. In conjunction with a closing order book of £16m (up from a low point of £3.6m in 2015) and support from its parent company to establish SMD's presence in the Far-East, management are confident forecasted revenue and EBITDA margins are realistic and sustainable.

In order to test the sensitivity of revenue and EBITDA projections used in the model, management considered a 'base-case' scenario where the Group would achieve basic expectations (8% lower revenue and 14% lower EBITDA). In this scenario value in use was 38% higher than net assets excluding interest bearing debt, compared to 64% used in the original cash flow model. Management are therefore confident that even if performance was worse than expected there is more than enough margin of error for the goodwill carrying value to be supported.

14.4. Discount rate

The pre-tax discount rate of 14.32% used in the model includes internal and external risks on the Group, such as cash flow and borrowing facilities available as well as market risk of the oil and gas industry. When considering external interesting bear debt (being the facilities agreement discussed in Note 19) is only 1.8% above LIBOR and the continuing support from the CRRC Group, management deem the discount rate to be reflective of the Group's risk profile.

On review of the value in use sensitivity to the discount rate it was found that should it be as high as 17% when all other assumptions remain static, the value in use is still 22% greater than the net assets excluding interest bearing debt.

14.5. Considering a reasonably possible change in all assumptions

Further scrutinising the cash flow model, management have considered the cumulative impact of reduced revenue and EBITDA margin and increased discount rate when calculating the value in use. It is deemed reasonably possible that each key assumption could change to that in the table below:

	2018	*2019*	*2020*	*2021*	*2022*	*Terminal year*
Revenue growth	15%	36%	13%	15%	14%	2%
EBITDA margin	11%	14%	14%	15%	16%	16%
Discount rate	17%	17%	17%	17%	17%	17%

This scenario results in a headroom above impairment of only 1% and whilst this still supports the carrying value of goodwill held by the Group, management note that should these assumptions further change unfavourably, it could result in an impairment that would have a material impact on the Group's financial statements. However, on balance of the risk of goodwill impairment to the assumptions used in the value in use model, management are very confident the goodwill carrying value is still supported and that no impairment exists at the year end.

15. Investments

(a) Joint ventures

Group	*SMD Energy Ltd*	*SMD Closeco Ltd*	*Total*
	£	£	£
At 1 January 2017	2	103,129	103,131
Disposals	(2)	-	(2)
Return of capital	-	(103,129)	(103,129)
At 31 December 2017	-	-	-

The brought forward investment in the Group balance sheet represents its joint venture holdings in SMD Energy Ltd and SMD Closeco Ltd (formerly SMD-BORD Ltd). During the year an agreement was reached between the SMD Group and the other joint party to SMD Energy Ltd to wind up the affairs of the company. On 7 November 2017 SMD Energy Ltd was officially dissolved.

In April 2017 the Group acquired the remaining issued share capital of SMD Closeco Ltd, making it a consolidated member of the SMD Group for the year ended 2017. As part of the acquisition, SMD Closeco Ltd issued dividends of £103,127 to its new parent, Specialist Machine Developments (SMD) Ltd, such that the value of investment in SMD Closeco Ltd recognised at acquisition was nil. This was with the overall purpose of winding up the affairs of the company and on 16 January 2018 SMD Closeco Ltd was officially dissolved. The Group held no other joint ventures and hence no investments by the year ended 2017.

(b) Subsidiaries

Company	£
At 1 January 2017 and 31 December 2017	99,500,000

During the year there was a reorganisation within the SMD Group resulting in the Company acquiring the entire shareholding of Soil Machine Dynamics USA LLC and Soil Machine Dynamics Singapore Pte Ltd as well as 99% of the shareholding in SMD do Brasil Ltda (the remaining 1% is owned by a subsidiary) at book value, £nil.

As part of the reorganisation a decision was made to wind up the holding companies Specialist Machine Developments (Investment) Ltd and Bywell Holdings Ltd in addition to the joint ventures noted further above. As the value of investment in the holding companies and joint ventures were nil, the carrying value of investments held by the company remained unchanged by the year end. By January 2018 both the holding companies and joint ventures were dissolved.

Details of investments in which the Company holds 20% or more of the nominal value of any class of share capital, including indirect investments, at the year ended 31 December 2017 are as follows:

Name of company	*Country of incorporation*	*Holding*	*Proportion of rights held*	*Nature of business*
Soil Machine Dynamics Limited	United Kingdom	Ordinary	100%	Subsea Engineering
SMD Offshore Support Limited	United Kingdom	Ordinary	100%	Subsea Engineering
SMD Robotics Limited	United Kingdom	Ordinary	100%	Subsea Engineering
Soil Machine Dynamics USA LLC	USA	Ordinary	100%	Subsea Engineering
Soil Machine Dynamics Singapore Pte Limited	Singapore	Ordinary	100%	Subsea Engineering
SMD do Brasil Ltda	Brazil	Ordinary	99%	Subsea Engineering
Specialist Machine Developments (Investment) Limited	United Kingdom	Ordinary	100%	Dissolved in 2018
*Bywell Holdings Limited	United Kingdom	Ordinary	100%	Dissolved in 2018
*SMD Closeco Limited	United Kingdom	Ordinary	100%	Dissolved in 2018
*SMD do Brasil Ltda	Brazil	Ordinary	1%	Subsea Engineering

* held by subsidiary

All entities have the registered office of Turbinia Works, Davy Bank, Wallsend, Tyne and Wear other than the following;

- Soil Machine Dynamics USA LLC at 21811 Katy Freeway Suite U111, Katy, Texas, 77450, USA;
- Soil Machine Dynamics Singapore Pte Limited at 33 Ubi Avenue 3, #01-59 Vertex, Singapore; and
- SMD do Brasil Ltda at Rua da Quitanda n.86 – 2nd floor, Centro, Rio de Janeiro, Brazil

16. Financial assets and financial liabilities

16.1. Financial assets

The Company and Group have recognised no financial assets at the year's ending 31 December 2017 and 2016 other than cash and cash equivalents and trade and other receivables.

16.2. Financial liabilities

(a) Financial liabilities: interest-bearing loans and borrowings

Group	*Interest rate*	*Maturity*	*2017*	*2016*
			£	£
Current interest-bearing loans and borrowings				
Obligations under finance leases	11.1%	Aug 2018	34,046	47,318
Series 'A' unsecured loan notes	4.0%	Dec 2023	2,400,000	2,400,000
Bank overdraft	BoE base rate + 1.4%	On demand	-	10,537,252
Bank loan and accumulated interest	LIBOR + 1.8%	Feb 2018	13,042,694	-
			15,476,740	12,984,570
Non-current interest-bearing loans and borrowings				
Obligations under finance leases	11.1%	Aug 2018	-	34,046
Series 'A' unsecured loan notes	4.0%	Dec 2023	60,000,000	60,000,000
Total non-current interest-bearing loans and borrowings			60,000,000	60,034,046
Total interest-bearing loans and borrowings			75,476,740	73,018,616

Bank overdraft

The bank overdraft was secured alongside the bonding facility over its assets. In November 2017 the Group ended its previous facilities agreement which resulted in the bank overdraft being repaid in full.

Bank loan

The Group entered into a new facilities agreement which included a revolving credit facility of £13,000,000, replacing the previous overdraft facility. This facility expired in February 2018 where the Group has opted to continue under the same borrowing arrangements with Citibank Europe plc renewing on a monthly basis.

Obligations under finance leases

The Group acquired £139,818 fixed asset additions under finance leases in 2015 (2016/2017 – £nil) where the present value of minimum lease payments as at 31 December 2017 was £34,046 (2016 - £81,364) (see Note 21). The finance leases are recognised at initial cost and subsequently measured at amortised cost using the effective interest rate method.

Series 'A' unsecured loan notes

On 1 December 2015 series 'A' unsecured loan notes of £60,000,000 were issued by Specialist Machine Developments (SMD) Limited and listed on the International Stock Exchange. The loan notes were issued to CRRC Times Electric (Hong Kong) Co., Ltd, the Group's immediate parent, and will mature on 20 November 2023, redeemable at par value. The notes are interest bearing at a rate of 4 per cent, payable annually in arrears on 31 December; the first payment was due on 31 December 2016 and each year thereafter until maturity. The loan notes were recognised at initial cost and subsequently measured at amortised cost using the effective interest rate method.

(b) Other financial liabilities

Group	*2017*	*2016*
	£	£
Financial liabilities at fair value through profit or loss		
Foreign exchange forward contracts	-	294,599
Total current	-	286,432
Total non-current	-	8,167

Financial instruments through profit or loss reflect the negative change in fair value of foreign exchange forward contracts that are not designated in hedge relationships, but are, nevertheless, intended to reduce the level of foreign currency risk for expected sales and purchases. There were no foreign exchange forward contracts in existence at the year ended 2017.

16.3. Fair value

Management assessed that cash and short-term deposits, trade receivables, trade payables, bank overdrafts and other current liabilities approximate their carrying amounts largely due to the short-term maturities of these instruments.

The Group held no other financial instruments which could be assessed on a different basis at the year ended 2017.

16.4. Market risk

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: interest rate risk, foreign currency risk and price risks.

16.4.1. Interest rate risk

The Group considers cash flow interest rate risk to be insignificant for all the long-term interest-bearing debt obligations as they consist of a fixed rate of interest only.

The Group also owes short-term interest-bearing debt relating to a bank loan of £13,000,000 plus accumulated interest, which is borrowed at a floating rate of LIBOR plus 1.8%. However, as this represents only 17% of total debt and it is unlikely interest rates will substantially increase in the immediate future, the Group has deemed interest rate risk on short-term interest-bearing debt to be insignificant.

16.4.2. Foreign currency risk

The Group has foreign currency obligations amongst its trade receivables and trade payables balances and is exposed to changes in exchange rates. To manage this the Group engages in foreign currency forward contracts over short-term periods, usually with a contract length of one month. To minimise the Group's exposure to fluctuations in foreign currency exchange rates the forward contracts are taken out at the time the obligation arises, where multiple one month contracts are engaged on a rolling basis should the obligation exceed the forward contract length. However, due to timing circumstances there were no forward contracts in existence by the year ended 2017. The following table demonstrates the sensitivity to a reasonably possible change in exchange rates of foreign currency net receivables and payables that were not hedged.

		2017		*2016*	
Currency	*Change in currency rate*	*Effect on profit before tax*	*Effect on pre-tax equity)*	*Effect on profit before tax)*	*Effect on pre-tax equity)*
		£	£	£	£
AUD	5%	3,006	3,006	(1,382)	(1,382)
CAD	5%	(1,789)	(1,789)	-	-
EUR	5%	189,963	189,963	211,566	211,566
NOK	5%	(1,216)	(1,216)	(898)	(898)
SGD	5%	(5,462)	(5,462)	(762)	(762)
USD	5%	(684)	(684)	61,558	61,558
		183,818	183,818	270,082	270,082

		Effect on profit before tax	*Effect on pre-tax equity)*	*Effect on profit before tax)*	*Effect on pre-tax equity)*
		£	£	£	£
AUD	(5%)	(3,006)	(3,006)	1,382	1,382
CAD	(5%)	1,789	1,789	-	-
EUR	(5%)	(189,963)	(189,963)	(211,566)	(211,566)
NOK	(5%)	1,216	1,216	898	898
SGD	(5%)	5,462	5,462	762	762
USD	(5%)	684	684	(61,558)	(61,558)
		(183,818)	(183,818)	(270,082)	(270,082)

Overall, should GBP strengthen against other currencies the Group expects to make an exchange loss; conversely the Group expects to make an exchange gain should GBP weaken. Management have considered the potential impact of unfavourable exchange rates when considering cash flow forecasts and have ensured there is sufficient working capital available.

16.4.3. Price risk

Whilst the Group does not own commodity or equity securities it is exposed to price risk on contracts agreed with customers when a commitment is made to provide goods and services at a fixed price, the costs of which are subject to change depending on market prices. However, the Group mitigates this risk by fixing costs with suppliers in advance, using contract clauses to use fixed foreign exchange rates and using tender bonds (tender bonds are covered in the Group's facilities agreement where the provider, Citibank, will pay for costs associated from withdrawing a tender application when a commitment has been made).

16.5. Credit risk

Credit risk is the risk that a counterparty will not meet its obligations under a financial instrument or customer contract, leading to a financial loss. The Group is exposed to credit risk from its operating activities (primarily trade receivables) and from financing activities, including deposits with banks and financial institutions.

At 31 December 2017 the Group had receivables (including trade, amounts recoverable on contracts and accrued income) of £18,753,861 from its three largest customers, which accounts for 59% of total receivables at the end of the year. Management have specifically reviewed the credit quality of these customers and are satisfied no impairment exists on the basis that prior to filing the accounts £11,823,799 had been paid post year end and the remaining balances are expected to be paid on schedule.

To ensure credit control on all receivables, management chase all overdue customer payments each week and perform a monthly impairment review on an individual customer basis. The maximum exposure to credit risk on receivables at 31 December 2017 is the carrying value of the trade and other receivables figures in Note 18. The Group also considers credit risk to be negligible for its cash deposits with Barclays Bank plc, as it is a large blue chip organisation that complies with regulatory capital requirements. The maximum exposure to credit risk on cash at 31 December 2017 is the carrying value of the cash and cash equivalents figure in Note 19.

16.6. Liquidity risk

Group

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

The Group manages its risk of shortage of funds through cash flow forecasting and reliance on a revolving credit facility with Citibank Europe plc. The facilities agreement at the year ended 2017 expired in February 2018 where the Group opted to continue under the same borrowing arrangements with Citibank Europe plc for a further 3 months. As the Group can decide the length of renewal (between 1 and 12 months), it can flexibly manage its debt with cash flow requirements. Management are confident this flexibility, along with its current assets, provides the Group with enough funds to pay all debt maturing within 12 months. In the event the facilities agreement is breached, the Group have been provided assurance via a letter of support from its parent, the CRRC Group, it has access to cash reserves to meet working capital requirements if necessary.

The maturity profile of the Group's financial liabilities based on contractual undiscounted payments is as outlined below:

2017	*On demand*	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Greater than 5 years*	*Total*
	£	£	£	£	£	£
Bank loans	-	13,042,694	-	-	-	13,042,694
Obligations under finance leases	-	-	35,383	-	-	35,383
Interest-bearing loan notes	2,400,000	-	2,400,000	9,600,000	62,125,694	76,525,694
Trade and other payables	-	19,794,847	-	-	-	19,794,847
	2,400,000	32,837,541	2,435,383	9,600,000	62,125,694	109,398,618

2016	On demand £	Less than 3 months £	3 to 12 months £	1 to 5 years £	Greater than 5 years £	Total £
Bank overdraft	10,537,252	-	-	-	-	10,537,252
Obligations under finance leases	-	-	53,575	35,383	-	88,958
Interest-bearing loan notes	2,400,000	-	2,400,000	9,600,000	64,531,506	78,931,506
Trade and other payables	-	8,536,297	-	-	-	8,536,297
Forward contracts	-	5,277,505	10,388,647	509,100	-	16,175,252
	12,937,252	13,813,802	12,842,222	10,144,483	64,531,506	114,269,205

Company

The liquidity risk to the Company is comparatively similar to the Group as it is the holder of all interest-bearing loan notes at 31 December 2017. Whilst the Company does not directly have the cash and cash equivalents to cover this debt, as owner of the entire SMD Group the Company indirectly has access from its subsidiary undertakings. The Company is therefore liable to all obligations from its subsidiaries and would therefore be open to the same liquidity risk.

17. Inventories

Group	2017 £	2016 £
Raw materials	3,796,855	4,377,318
Work in progress	237,076	1,136,178
Finished goods	3,772,716	3,305,450
	7,806,647	8,818,946

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

	2017 £	2016 £
Opening stock provision	1,561,838	1,124,752
Written down	786,904	696,948
Utilised	(320,179)	(259,862)
Closing stock provision	2,028,563	1,561,838

18. Trade and other receivables

(a) Current and non-current receivables

Current	Group 2017 £	Group 2016 £	Company 2017 £	Company 2016 £
Trade receivables	9,926,030	11,401,341	-	-
Amounts recoverable on contracts	14,030,062	3,638,754	-	-
Amounts owed by group undertakings	4,221,457	-	15,462,794	2,354,893
Prepayments	487,603	1,168,604	-	-
Accrued income	177,612	570,200	-	-
Other receivables	2,733,569	310,386	-	-
	31,576,333	17,089,285	15,462,794	2,354,893

Amounts owed by related parties (Note 26) are disclosed in amounts owed by group undertakings.

Included in trade receivables is a retention of £3.2m owed by one of the Group's customers, which for the year ended 2017 is more than 90 days overdue (as seen in the past due not impaired table further below). The customer has notified the Group it has had to manage its cash flow carefully and will require a further cash injection from its investors in order to settle this obligation; at the time of signing the accounts in September 2018 this balance is still unsettled. However, management have assessed this debt to be entirely recoverable on the grounds the customer has reassured the Group it will settle this debt in full, historically it has always been successful in raising finance from its investors and after many years of planning and investment their business is in the final phase prior to launch of operations. See Note 16 on credit risk of trade receivables, which explains how the Group manages and measures credit quality of trade receivables that are past due not impaired.

Non-current	Group 2017 £	Group 2016 £	Company 2017 £	Company 2016 £
Hire purchase receivable	50,000	100,000	-	-

(b) Impairments on receivables

All amounts owed to the Company are from fully owned subsidiaries in the SMD Group. Management have assessed the recoverability of Group debt and are fully confident this can be settled.

Group	£
At 1 January 2017	203,084
Written off during the year	(203,084)
At 31 December 2017	-

All impairments relate to receivables that were individually determined to be impaired. In arriving at the receivables provision, management perform a review of all receivables and assessed the likelihood the carrying value can be recovered, factoring in both feedback from the customer and the ability for the customer to settle the debt. During the year the Group wrote off all bad debt brought forward, totalling £203,084 and recognised no new bad debt.

The ageing analysis of each class of financial asset is as follows:

Trade receivables (excluding retentions)	Total £	Neither past due nor impaired £	Past due but not impaired: <30 days £	31-60 days £	61-90 days £	>90 days £
2017	9,926,030	1,333,230	3,666,999	1,336,704	183,987	3,405,110
2016	11,401,341	3,112,207	4,290,494	437,956	77,249	3,483,435

19. Cash and cash equivalents

	Group 2017 £	Group 2016 £
Cash at bank and on hand	2,176,380	1,868,138
Bank overdrafts	-	(10,537,252)
	2,176,380	(8,669,114)

Cash at banks earns interest at floating rates based on daily bank deposit rates. On 10th November 2017 the overdraft and separate credit facility with HSBC Bank plc was terminated. On the same date the Group entered into a new facilities agreement with Citibank Europe plc which included a revolving credit facility of £13,000,000, a separate credit facility of up to £10,000,000 for the issue of letters of credit, including bonds, with any part of the facility not drawn in this form available to be utilised for cash and £2,000,000 for foreign exchange agreements. The facilities agreement expired in February 2018 where the Group has opted to continue under the same borrowing arrangements with Citibank Europe plc renewing on a monthly basis, enabling the Group to flexibly manage its debt with cash flow requirements.

20. Trade and other payables

	Group 2017 £	Group 2016 £	Company 2017 £	Company 2016 £
Trade payables	9,588,532	1,010,207	-	-
Payments received on account	826,254	3,617,398	-	-
Amounts owed to group undertakings	-	-	-	614,952
Accruals	8,198,036	3,252,126	-	-
Other taxes and social security costs	424,430	311,947	-	-
Other payables	1,182,025	656,566	-	-
	20,219,277	8,848,244	-	614,952

Amounts owed to related parties (Note 26) are disclosed in amounts owed by group undertakings.

21. Borrowings

Current	Group 2017 £	Group 2016 £	Company 2017 £	Company 2016 £
Bank overdrafts	-	10,537,252	-	-
Bank loans	13,042,694	-	13,042,694	-
Accrued interest on loan notes	2,400,000	2,400,000	2,400,000	2,400,000
Finance leases	34,046	47,318	-	-
	15,476,740	12,984,570	15,442,694	2,400,000

Non-current	Group 2017 £	Group 2016 £	Company 2017 £	Company 2016 £
Loan notes	60,000,000	60,000,000	60,000,000	60,000,000
Finance leases	-	34,046	-	-
	60,000,000	60,034,046	60,000,000	60,000,000

(a) Bank loan

	2017 £	2016 £
Revolving short-term credit facility	13,000,000	-
Accrued interest	42,694	-
	13,042,694	-

For further information relating to the bank loan please see Note 19.

(b) Loan notes

	2017 £	2016 £
Series 'A' loan unsecured notes	60,000,000	60,000,000
Accrued interest on loan notes	2,400,000	2,400,000
	62,400,000	62,400,000

On 1 December 2015 series 'A' unsecured loan notes of £60,000,000 were issued by Specialist Machine Developments (SMD) Limited and listed on the International Stock Exchange. The loan notes were issued to CRRC and will mature on 20 November 2023, redeemable at par value. The notes are interest bearing at a rate of 4 per cent, payable annually in arrears on 31 December and conducted at arms' length. The notes are unsecured obligations of the SMD Group and are payable solely from the assets, whether present or future from the Group.

(c) Finance leases

	2017 Minimum payments £	2017 Present value of payments £	2016 Minimum payments £	2016 Present value of payments £
Within one year	35,383	34,046	53,575	47,318
After one year but not more than five years	-	-	35,383	34,046
Total minimum lease payments	35,383	34,046	88,958	81,364
Less amounts representing finance charges	(1,337)	-	(7,594)	-
Present value of minimum lease payments	34,046	34,046	81,364	81,364

22. Provisions

Group	*Warranty provision* £	*Supplier provision* £	*Dilapidations provision* £	*Total* £
At 1 January 2017	848,477	72,270	43,739	964,486
Charge for the year	487,851	800,000	874	1,288,725
Utilised during the year	(366,237)	(35,000)	-	(401,237)
Released in the year	(489,269)	-	-	(489,269)
At 31 December 2017	480,822	837,270	44,613	1,382,705
At 31 December 2017				
Current	18,411	837,270	-	855,681
Non-current	462,411	-	44,613	507,024
At 1 January 2017				
Current	22,901	72,270	-	95,171
Non-current	825,576	-	43,739	869,315

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 Group has no obligation to provide warranty cover for claims that have been logged after the end of the warranty period.

The supplier provision relates to a specific provision to provide replacement parts on a contract owed to a customer, the costs of which are in the process of being reclaimed by the Company from the supplier. As actual figures were not available, management have prudently estimated the costs to be the original value of the replacement parts on the expectation it is unlikely they will exceed this amount.

The dilapidations provision relates to the present value obligation to restore leased premises to its original condition at the end of the lease term. The restoration cost is estimated to be £47,000 and will be payable when the lease expires on July 2020.

23. Issued capital and reserves

Share capital

Group and Company *Allotted, called up and fully paid*	No.	*2017* £	No.	*2016* £
Ordinary shares of £0.01 each	4,404,832,485	44,048,325	4,404,832,485	44,048,325

Share premium

Group and Company	*2017* £	*2016* £
Share premium	689	689

Nature and purpose of reserves

The retained earnings reserve is the accumulated profit or loss generated by the company less any dividends that have been issued to the shareholders of the Group. The foreign translation reserve relates to exchange differences arising from restating the Group's net investment in its overseas subsidiary undertakings using the closing rate method.

24. Pensions

The Group operates a defined contribution stakeholder pension scheme under which the group contributes a fixed percentage of salary provided the employee contributes a matching amount. As at 31 December 2017 the Group had a pensions liability of £110,927 (2016 - £90,933). A previous defined contribution pension scheme to which the Bywell Holdings Limited group acted as trustee was wound up during the year.

25. Commitments and contingencies

Operating leases

Future minimum rentals under non-cancellable operating leases are as follows:

Group	*2017* £	*2016* £
Operating leases which expire:		
Within one year	508,198	503,350
After one year but not more than five years	1,014,051	1,241,857
Over five years	1,267,855	1,464,676
	2,790,104	3,209,883

Finance leases

The Group has financial lease obligations of £34,046 as at 31 December 2017 (2016 - £81,364). See Note 21 for further disclosures.

Capital expenditure commitments

Group	*2017* £	*2016* £
Capital expenditure commitments	-	232,578

Contingent liabilities

Group	*2017* £	*2016* £
Guarantees (bonding)	4,657,416	9,174,345

At the year ended 2017 the Group was party to guarantees which include financial penalties should the Group fail to provide goods and services that meet specified performance obligations (performance guarantees) and the return of customer payments made upfront should the Group withdraw from a contract (advance payment guarantees). To secure these obligations, the Group entered into bonding arrangements with its bank as part of the facilities agreement (Note 19), where the bank will settle these guarantees should they materialise before reclaiming this back from the Group.

Management made an assessment on the likelihood of these obligations arising, considering the current and forecasted future performance of its products and the Group's ability to comply with the specific conditions. The assessment deemed this to be remote, therefore the guarantees are disclosed as a contingent liability only.

26. Related party transactions

The following disclosures provide the total amount of transactions that have been entered into with related parties, separated for the Group and Company. The transactions have been classified as either trading, non-trading or compensation of key management personnel.

26.1. Group

Trading	*Sale of goods/services* *2017* £	*2016* £	*Balance owed (to)/from* *2017* £	*2016* £
CRRC SMD (Shanghai) Ltd				
Recharged costs	446,720	-	446,720	-
Goods sold	851,937	-	851,937	-
Zhuzhou CRRC Times Electric Co., Ltd				
Goods purchased	19,000	-	(19,000)	-

Non-trading	*Transaction amount* *2017* £	*2016* £	*Balance owed (to)/from* *2017* £	*2016* £
Zhuzhou CRRC Times Electric Co., Ltd				
Licence fee income	2,750,000	2,200,000	2,750,000	2,200,000
Other contributions	172,800	-	172,800	-
CRRC Times Electric (Hong Kong) Co., Ltd				
Loan notes, interest and payments	2,400,000	203,836	(62,400,000)	(62,400,000)
Integration cost reimbursement	-	1,050,000	-	350,000

Compensation of key management personnel	*2017* £	*2016* £
Short-term employee benefits	984,266	826,099
Post-employment pension and medical benefits	18,917	27,800
Total compensation paid to key management personnel	1,003,183	853,899

CRRC SMD (Shanghai) Ltd (SMD Shanghai)

During the year the Group sold goods of £851,937 and provided business setup support totalling £446,720 to SMD Shanghai, whose shareholding is owned by the SMD Group's parent company CRRC Times Electric (Hong Kong) Co, Ltd. The setup costs included fixed asset purchases, consultancy and travel costs reclaimed back from SMD Shanghai. All transactions remain unsettled by the year ended 2017, disclosed in Note 18 receivables, amounts owed by group undertakings and were conducted at arms' length.

Zhuzhou CRRC Times Electric Co., Ltd (Zhuzhou)

On 15 December 2015 the Group entered into an agreement to license intellectual property to Zhuzhou, the shareholder of the SMD Group's parent company. Licence fee income relating to 2017 of £2,750,000 (2016 – £2,200,000) was recognised in Note 18, receivables, amounts owed by group undertakings, which has since been paid in 2018. Under the arrangement, one further payment of £2,500,000 (net of withholding tax) will be paid to the Group in relation to 2018 licence fees.

During the year the Group also acquired goods of £19,000 from Zhuzhou as well as receiving £172,800 (settled in 2018) to support the Group dedicating resources towards an engineering contest, "the X-Prize competition". All transactions conducted with Zhuzhou were conducted at arms' length.

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

On 1 December 2015 Specialist Machine Developments (SMD) Limited issued unsecured loan notes of £60,000,000 to CRRC, the Group's parent company, with interest payable at 4 per cent annually, redeemable at par value. For further information please see Note 21.

In 2016, the Company recharged £1,400,000 to CRRC for recovery of integration costs incurred. At 31 December 2016 £350,000 was still owed by CRRC and recovered in 2017.

26.2. Company

Non-trading	*Transaction amount* *2017* £	*2016* £	*Balance (owed to)/from* *2017* £	*2016* £
CRRC Times Electric (Hong Kong) Co., Ltd				
Loan notes, interest and payments	2,400,000	203,836	(62,400,000)	(62,400,000)
Soil Machine Dynamics Limited				
Capital contribution	1,921,523	-	-	-
Interest charges paid on behalf	2,442,694	203,836	-	(203,836)
Management charges	2,442,694	-	-	-
Specialist Machine Developments (Investment) Limited				
Capital contribution	-	3,509,265	-	-
Dividends received	134,540	-	-	-
Distribution received	614,952	-	-	-

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

On 1 December 2015 series 'A' unsecured loan notes of £60,000,000 were issued by Specialist Machine Developments (SMD) Limited and listed on the International Stock Exchange. The loan notes were issued to CRRC and will mature on 20 November 2023, redeemable at par value. The notes are interest bearing at a rate of 4 per cent, payable annually in arrears on 31 December. Interest of £2,400,000 relating to 2016 was paid in February 2017 with 2017 interest of £2,400,000 paid in February 2018. All transactions were conducted at arms' length.

Soil Machine Dynamics Limited (SMD)

During the year the Company wrote off debt owed by SMD of £1,921,523 recognised on a formal deed of waiver. As the transaction was between two fully owned companies of the Group, the debt waiver had no impact on the consolidated financial statements of the Group.

In addition, SMD paid £2,400,000 interest to CRRC and £42,694 to Citibank Europe plc on behalf of the Company during the year. The Company then charged SMD management fees of £2,442,694 in respect of management of the Group financing costs that netted off against the interest paid on the Company's behalf. All transactions with SMD were conducted at arm's length.

Specialist Machine Developments (Investment) Limited

During the year Specialist Machine Developments (Investment) Limited wrote off debt owed by the Company of £614,952 recognised on a formal deed of waiver. Coinciding with this, the Company also received a final dividend payment in 2017 from Specialist Machine Developments (Investment) Limited of £134,540 in relation to its wind up in January 2018.

As these transactions were between two fully owned companies of the Group, the debt waiver and dividend had no impact on the consolidated financial statements of the Group. Both transactions were conducted at arms' length.

27. Ultimate parent undertaking and controlling party

The immediate parent undertaking is CRRC Times Electric (Hong Kong) Co., Ltd with registered office at Room 1106, 11th Floor, Jubilee Centre, 18 Fenwick Street, Wanchai, Hong Kong, China. The ultimate parent undertaking and controlling party is the CRRC Corporation Limited 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 consolidated financial statements of the Specialist Machine Developments (SMD) Group are held at the registered office, Turbinia Works, Davy Bank, Wallsend, Tyne and Wear.

Company statement of comprehensive income

for the year ended 31 December 2017

	2017 £	2016 £
Administration expenses:		
Before exceptional items	2,442,694	2,400,000
Intercompany debt waiver	-	(3,509,265)
Impairment of investments	-	(1,230,468)
	2,442,694	(2,339,733)
Other operating income	749,492	-
Operating profit/(loss)	3,192,186	(2,339,733)
Finance costs	(2,442,694)	(2,400,000)
Profit/(loss) before tax	749,492	(4,739,733)
Tax	12,124	-
Profit/(loss) for the year	761,616	(4,739,733)

All amounts relate to continuing activities.

During the year, the Company recognised interest costs of £2,442,694 in the year (2016 - £2,400,000) the vast majority of which relate to the loan notes borrowed from CRRC Times Electric (Hong Kong), Ltd. In relation to this, the Company placed a management charge on Soil Machine Dynamics Limited of £2,442,694 as a finance levy.

In addition, the Company recognised other income of £749,492 in respect of dividends received of £134,540 and a waiver of £614,952 debt owed by the Company, both with Specialist Machine Developments (Investment) Limited.