

Medical Solutions plc

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Annual Report and Accounts 2005



Innovative solutions in medicine

CORPORATE OVERVIEW

Medical Solutions plc is a focused international healthcare business specialising in diagnostic pathology and cytology services and products.

Pathology Services

Our Pathology Services division comprises our diagnostic pathology operations in Nottingham, UK and Dubai, UAE along with our Drug Development Services business based in Nottingham. This division provides a range of expert pathology services to public and private healthcare providers and to clients in the pharmaceutical and biotechnology industries.

Cytology

Our Cytology division provides the latest cytology screening tools, including SurePath™ Liquid Based Cytology equipment and consumables to healthcare providers in the UK, Ireland and the Middle East.

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HIGHLIGHTS

Financial highlights

- Revenue from continuing operations up 77% to £10.7 million (2004: £6.0 million)
- Gross profit improved to £4.1 million (2004: £1.3 million); gross profit margin up to 39% (2004: 22%)
- Operating expenses (excluding restructuring costs) reduced to £5.9 million (2004: £10.2 million)
- Operating loss from continuing operations (excluding restructuring costs of £0.3 million) of £1.3 million (2004: loss of £8.3 million)
- Loss for the year of £1.8 million (2004: £9.4 million)
- Net cash of £2.3 million (30 June 2005: £2.7 million; 31 December 2004: £0.7 million overdraft)

Operational highlights

- Awarded eight Liquid Based Cytology ("LBC") agreements worth £15.7 million over five years; England and Wales LBC target market share raised from 35% to over 40%
- LBC UK distribution agreement with TriPath Imaging, Inc. renewed until 31 December 2008
- Acquisitions of Dubai Medical Laboratory ("DML") and Specialised Clinical Laboratory ("SCL") formally completed, both earnings enhancing during the year
- Certain intellectual property rights sold to Hamamatsu Photonics KK for initial consideration of £450,000
- Further steps taken to reduce costs including consolidation of UK Diagnostic Pathology in Nottingham, closure of Harley Street facility and significant reduction in UK headcount

Post year end events

- Agreement reached with Welcare Parties to settle outstanding deferred consideration of £2.5 million relating to the acquisition of the Welcare Laboratory in 2003, in exchange for a 16.7% stake in the Group's Dubai business, Medical Solutions FZ LLC. Welcare Parties to repay £0.9 million due to Medical Solutions plc

CHAIRMAN'S STATEMENT

"The Board remains committed to the key task of ensuring that Medical Solutions becomes a profitable, cash generative business."

Sir Gareth Roberts, Non-Executive Chairman

SUMMARY OF CHAIRMAN'S STATEMENT

- Substantial progress made over the last twelve months towards achieving key objectives.
- New format Operating and Financial Review provides a substantial amount of additional information.
- Improved corporate governance policies and procedures.
- Resources being focused on the development of pathology and cytology activities, areas that we believe are capable of scalable, long term growth.
- Planned, phased exit from our operations in Dubai.

INTRODUCTION

The Board remains committed to the key task of ensuring that Medical Solutions becomes a profitable, cash generative business. From such a platform, the Board has the ambition of becoming a significant player in the UK and international diagnostic pathology and cytology markets. During 2005, our main focus has been on achieving the first of these objectives and I am pleased to report that substantial progress has been made over the last twelve months.

BUSINESS OVERVIEW

The Group overall and each of the core components of our business has made significant progress during the year and these achievements are set out in detail later in this Annual Report and Accounts.

BOARD AND MANAGEMENT

At the time of our Interim Report in September 2005, we announced that Mr Charles Green, Chief Executive Officer, intended to concentrate his efforts on the Group's Dubai business with a view to maximising shareholder value. The Board believes that this will continue for the foreseeable future and, in the interim, Dr Neil Johnston has assumed Mr Green's responsibilities in the UK, as well as continuing to act as Chief Financial Officer for the Group.

FINANCIAL REPORTING

For the first time, our annual results have been prepared in accordance with the requirements of International Financial Reporting Standards ("IFRS"). During the year PricewaterhouseCoopers LLP has been appointed auditor to the Company.

In this Annual Report and Accounts, we have included an Operating and Financial Review ("OFR"). This new reporting format provides our shareholders with a substantial amount of additional information about the business and operations of the Group and our strategy for the future. For the first time, we have identified certain Key Performance Indicators ("KPI"), which represent the principal measures used by the Board to report the development, performance and position of the business. We have also identified the key risks faced by individual parts of the business and by the Group as a whole, together with information as to how these risks are being managed.

CORPORATE GOVERNANCE

During the year, we have reviewed and tightened up our corporate governance policies and practices in many areas. The details of progress in this area are set out fully within the corporate governance statement on pages 19 to 24. It is pleasing to note that all of the exceptions that were noted within the 2004 Annual Report and Accounts have been addressed during the year.

STAFF

2005 has been a year of significant change for Medical Solutions. As the Group now looks forward to the achievement of its short and long term objectives, I would particularly like to acknowledge the contributions of our staff whose commitment and dedication have been instrumental to the positive steps the Group have taken during the last twelve months.

PROSPECTS

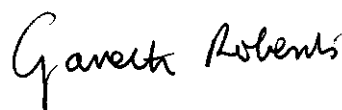
The Group is now focusing its resources on the development of the pathology and cytology based activities, areas that we believe are capable of scalable, long term growth.

Our established infrastructure and strong customer relationships will enable us to benefit from market expansion arising from improved therapeutics and the need for companion diagnostics, the anticipated increased demand for pathology testing from the primary care arena and various UK national screening initiatives.

Our key objectives for 2006 are aimed at growing the business through the introduction of new products and services whilst expanding the market share of our existing offerings. At the same time, we will continue to focus on reducing costs where appropriate, improving our operational efficiency and investing in key research and development projects.

Over the last six months, we have also been exploring potential opportunities to realise value from our operations in Dubai. The agreement announced on 14 March 2006 relating to the settlement of the deferred consideration represents the first step along this path.

The Board is currently considering various strategic options in this respect and has received approaches from a number of private equity groups interested in acquiring further stakes in Medical Solutions FZ LLC. During 2006, we will retain focus on achieving our stated target whilst remaining fully alert to strategic opportunities to maximise shareholder value.



Sir Gareth Roberts
Non-Executive Chairman
24 April 2006

OPERATING AND FINANCIAL REVIEW

"During 2005, the Board was focused on dealing with the turnaround of the business and implementing the plan outlined to shareholders at the time of the fundraising in January 2005. Whilst there remains much to do, the Group is now in a much more stable position than one year ago."

Charles Green, Chief Executive Officer

SUMMARY OF OPERATING AND FINANCIAL REVIEW

- Significant improvement in financial performance.
- Revenue from continuing operations up 77% to £10.7 million (2004: £6.0 million).
- Operating loss from continuing operations (excluding restructuring costs of £0.3 million) of £1.3 million (2004: £8.3 million).
- Three out of four business units now profitable.
- Net cash of £2.3 million at 31 December 2005 (30 June 2005: £2.7 million; 31 December 2004: £0.7 million overdraft).
- Awarded eight LBC agreements worth £15.7 million over five years.

CAUTIONARY STATEMENT

This Operating and Financial Review contains certain forward-looking statements with respect to the financial condition, results, operations and businesses of Medical Solutions plc. These statements and forecasts involve risk and uncertainty because they relate to events and depend upon circumstances that will occur in the future. There are a number of factors that could cause actual results or developments to differ materially from those expressed or implied by these forward-looking statements. Nothing in this Operating and Financial Review should be construed as a profit forecast. This Operating and Financial Review has been prepared in accordance with the principles embodied in the Reporting Statement "Operating and Financial Review" as published by the Accounting Standards Board in January 2006.

OVERVIEW

Medical Solutions plc is a healthcare company with operations based in the UK and the Middle East. During the year, our core activities have been refocused and we have concentrated upon becoming a leading provider of services and products within the pathology and cytology sectors. We believe that these markets provide strong growth opportunities for our business and thus for our shareholders.

The Pathology Services division comprises our diagnostic pathology operations in Nottingham, UK and Dubai, United Arab Emirates ("UAE"). This division provides pathology services to public and private healthcare providers based in the UK and Dubai as well as the pharmaceutical and biotechnology industries. The Pathology Services division also has access to an established bank of normal and diseased, processed human tissue and a UK network of over 60 specialist consultant pathologists. In each of its UK business segments in this area, Medical Solutions operates in a highly competitive market and competes for business against other service based organisations and often against teams from within the customer itself. Regulatory accreditation from relevant authorities is considered to be critical in ensuring the Group can offer its products and services to customers in a trusted manner.

Dr Neil Johnston, Chief Financial Officer

In Dubai, DML, SCL and Histopathology and Speciality Laboratory ("HSL") operate in a similarly competitive business environment. The Group's Welcare business in Dubai is a tied provider of pathology services to the Welcare Hospital. Under an agreement dated 21 May 2003, Medical Solutions is contracted as the sole provider of such pathology services to the Welcare Hospital over a 20 year period.

Our Cytology division distributes and supports the SurePath™ LBC system and consumables for the preparation and analysis of cervical smear samples. SurePath™ is one of only two systems approved by the National Institute for Clinical Excellence ("NICE") for use in England and Wales.

Following the successful Placing and Open Offer to raise approximately £5.7 million (after expenses) in January 2005, the new Board set about the business of reversing the decline seen in 2004 and implemented the business plan which had been outlined to investors at the time of the fundraising, a plan which had made the financial stability of the Group its top priority. The principal components of this plan included refocusing the Group's business, reducing the cost base significantly, selling or closing non-core activities, improving efficiency and strengthening financial controls.

The Group's results for the year ended 31 December 2005 demonstrate that significant progress has been made, although there remains more to do if Medical Solutions is to realise its long term potential. The Board remains committed to the achievement of profitability and cash generation for the Group over the short term.

RESOURCES AVAILABLE TO THE GROUP

We now have a significantly stronger business than was the case twelve months ago. The Board believes that the key resources available to Medical Solutions to help it attain its objectives include a strong market position, an excellent customer base and a good reputation for quality, customer service and cost effectiveness. We have an experienced and flexible workforce. Although we have limited financial resources, we have reduced our cash burn whilst continuing to invest prudently in sales and marketing, key development programmes and business growth initiatives.

Over the medium to long term, the Board believes strongly in the potential for Medical Solutions to become a leading provider of pathology and cytology products and services in a significant and growing market. In this way, the Board believes that Medical Solutions is capable of delivering superior returns to shareholders.

KEY RISKS FACING THE BUSINESS

As with any organisation, the Group faces certain key risks which may adversely affect its business prospects. Many of these are general in nature and can affect all businesses. Examples of such risks include the ability to win business on profitable commercial terms in the face of significant competition; the reliance on key personnel; the ability to successfully integrate acquisitions; the ability to grow the business both organically and through acquisitions; the risk of interruption of operations and the continued ability of the Group to remain a viable and successful business.

The Board operates a system of internal control and risk management to provide reasonable assurance regarding effective and efficient operations, internal financial control and compliance with laws and regulations. The system of internal control is designed to manage rather than eliminate the risk of failure to observe business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

Within this OFR, the key risks facing each area of the Group's business activities, together with the Board's approach to managing and mitigating such risks, are set out on pages 5 to 10. In addition, the Board believes that the Group overall faces certain specific key risks as follows:

The ability of the Group to become cash generative on an ongoing basis and thus not rely on having to raise additional funds and/or sell certain key assets.

The Board of Medical Solutions has this as a clearly stated objective for the Group and has made significant progress towards this objective in 2005. Further progress is expected in 2006.

OPERATING AND FINANCIAL REVIEW

KPI 1: Revenue by business area within Pathology Services

Definition: revenue recognised (under Group accounting policy) in each defined sub-group of its total business.

Purpose: to assist in the ongoing assessment of the performance of each part of the Group's operations.

Source of data: internal Company data/audited financial statements.

Quantified target: not disclosed.

No changes have been made to the source of data or calculation methods used.

KEY RISKS FACING THE BUSINESS (CONTINUED)

Ensuring that sufficient funds are invested in activities, which will generate competitive advantage and thus drive the future success of the Group over the short, medium and long term.

Within its available resources and without increasing the overall financial risk to the Group during its transition phase, Medical Solutions has continued to invest in key projects such as automated cytology screening to ensure that future business prospects are maximised. The Board has also ensured that key intellectual property is suitably protected in support of its business objectives.

The loss of key employees could weaken the Group's management and operational capabilities, adversely affecting its ability to achieve its planned commercial objectives.

The Board endeavours to ensure that key members of its management and staff are suitably incentivised and motivated.

BUSINESS SEGMENT PERFORMANCE REVIEW

Pathology Services

Our Pathology Services division generated revenue of £8.2 million in 2005 compared with £5.8 million in 2004, an increase of 42%. This growth, together with the significant cost reduction measures taken during the year led to a significantly improved operating performance in 2005. The division generated an operating profit of £1.0 million (2004: operating loss of £2.5 million).

UK Diagnostic Pathology

Revenue from our UK Diagnostic Pathology operation grew by 10% to £2.4 million (2004: £2.2 million). This area became profitable in 2005 generating an operating profit of £0.1 million in 2005 compared with an operating loss of £2.2 million in 2004.

The growth in Her-2 testing volumes, the consolidation of operations onto a single site in Nottingham and strong cost control in other areas has led to a significantly improved operating performance for this part of the business.

During the first half of 2005, it became clear to the Board that operations in London and Nottingham could not both be sustained given the current and likely short term future levels of revenue. A decision was taken to consolidate operations in Nottingham and to close our site in Harley Street, London. Our full operational capability went live in Nottingham in July 2005 and in addition, we surrendered the lease on the Harley Street premises in November 2005, at no cost.

Our laboratory in Nottingham also offers a number of specialised laboratory tests, including the Her-2 test. This test is designed to establish whether or not a patient suffering with breast cancer will respond to the drug Herceptin™ (manufactured and sold by Roche). During the second half of 2005, research was published which indicated that Herceptin could be applicable to a much wider population of breast cancer sufferers than had originally been believed. This has led to a significant increase in the number of Her-2 tests performed by Medical Solutions during the second half of the year.

Looking forward, the market drivers for this business remain sound. The UK continues to experience a shortfall in the number of pathologists and the Government's focus on modernising UK pathology services is expected to generate long term benefits for our business. We are targeting further organic growth from this area of our business during 2006 and we aim to introduce a number of new products during the course of the year. These targets, if achieved, together with the reduced cost base for this part of our business should provide a sound basis for a further improvement in the profitability of this area of our business in the short to medium term.

The key risks facing the UK Diagnostic Pathology business together with the Board's approach to managing such risks are set out below:

A proportion of the revenues of this part of our business are derived from outsourcing relationships and may cease as and when the customer has sufficient internal resources to deal with the level of demand. The current shortage of consultant pathologists in the UK may reduce over the medium to long term.

KPI 2: Segment result – Pathology Services by business area

Definition: segment result as defined by IAS 14 Segment Reporting (under Group accounting policies) in each defined sub-group of its total business.

Purpose: to assist in the ongoing assessment of the performance of each part of the Group's operations.

Source of data: internal Company data/audited financial statements.

Quantified target: not disclosed.

No changes have been made to the source of data or calculation methods used.

The Board is actively investigating opportunities to enter strategic relationships with healthcare providers that may reduce reliance on irregular work-flows. The Group is also investing in research and development programmes, which will provide continued sources of competitive advantage for the Group and thus are expected to provide superior value added services to its customers over the long term.

At present, this area of the business has a relatively narrow service offering and is exposed to competition for all of its services.

The Board has targeted the expansion of its offering in this part of the business as a key objective for 2006, thus reducing its dependence upon any single revenue stream.

This area of the business is dependent upon its ability to maintain its Clinical Pathology Accreditation ("CPA").

The Group has a strong focus on quality and has implemented clear policies and procedures throughout the business, which are designed to ensure compliance with CPA requirements as well as with certain other quality standards such as Good Laboratory Practice ("GLP"). Whilst responsibility for compliance with such policies and procedures sits with operational management, the Group also has an independent Quality Manager who oversees compliance. The Group is also subject to regular audits from the regulatory bodies responsible for such accreditations.

Dubai Diagnostic Pathology

Medical Solutions is a leading provider of pathology services in Dubai and this part of our business also grew strongly in 2005 generating revenues of £5.0 million compared with £2.8 million in 2004, an increase of 77%. Growth was partly by the existing Welcare Laboratory/HSL business and partly by the acquisitions of DML and SCL, both of which were completed in January 2005. Dubai Diagnostic Pathology generated an operating profit of £1.6 million in 2005 compared with £0.6 million in 2004.

The DML and SCL acquisitions have bedded down well into our existing business. During the year, SCL commenced a significant programme, in conjunction with the UAE Government, to provide pathology services to individuals entering Dubai prior to being granted a work permit.

During the second half of the year, negotiations have continued with representatives of the Varkey Group to find a mutually satisfactory resolution to the payment of the outstanding deferred consideration due from the time of acquisition of the Welcare Laboratory from Welcare Hospital during 2003.

In March 2006, we announced that we have agreed to settle the outstanding liability owed by Medical Solutions, of approximately £2.5 million, in exchange for a 16.7% stake in Medical Solutions FZ LLC. Welcare Hospital has also agreed to repay sums owing to Medical Solutions of approximately £0.9 million.

The Board of Medical Solutions has taken the decision to focus on its UK business and we plan to exit from our operations in Dubai in a phased and structured manner in order to maximise shareholder value.

The key risks that the Board believes are facing the Diagnostic Pathology business in Dubai, together with its approach towards the management of such risks, are set out below:

Income is received in UAE Dirhams and the Group is therefore exposed to the risk of fluctuations in the prevailing Sterling/Dirham exchange rate.

Medical Solutions' policy in respect of foreign exchange is set out in note 1 to the consolidated financial statements. This policy will be kept under review as the income streams of the Group mature over time.

OPERATING AND FINANCIAL REVIEW

BUSINESS SEGMENT PERFORMANCE REVIEW (CONTINUED)

Pathology Services (continued)

Dubai Diagnostic Pathology (continued)

An increasing proportion of the Group's revenues in Dubai are generated as a result of an arrangement to supply medical testing services to individuals entering Dubai for employment. In the event that this work were to cease for any reason, the growth prospects in Dubai could be harmed in the short term.

The volatility of the medical testing work has always been recognised and management in Dubai is actively targeting further investment opportunities to diversify the revenue streams and thus reduce the dependence on single revenue streams.

Drug Development Services

Medical Solutions' Drug Development Services business unit offers diagnostic and therapeutic testing services to support drug discovery and development and assists pharmaceutical and biotechnology companies in identifying the markers most closely linked with response to therapy during clinical trials. We have particular strengths in high throughput quantitative protein expression services and in sophisticated image analysis capabilities.

The Drug Development Services business continued to make good underlying progress in 2005 although revenues of £0.8 million showed only a modest improvement on 2004 (£0.7 million). We completed a significant biomarker study for AstraZeneca during the first half of the year. We have also begun to build a strong relationship with GlaxoSmithKline ("GSK") and completed a number of smaller studies with other pharmaceutical and biotechnology companies.

During the year we restructured our relationships with tissue providers in the UK in order to bring the cost base for this part of our business more into line with its revenue generation. As a result, we have generated annualised cash savings of approximately £0.5 million. Overall, Drug Development Services generated an operating loss of £0.7 million in 2005 compared with an operating loss of £0.9 million in 2004.

KPI 3: Cytology revenue

Definition: revenue recognised (under Group accounting policy) in each defined sub-group of its total business.

Purpose: to assist in the ongoing assessment of the performance of each part of the Group's operations.

Source of data: internal Company data/audited financial statements.

Quantified target: not disclosed.

No changes have been made to the source of data or calculation methods used.

The key risks in this area and the Board's approach to mitigating such risks are:

The Group remains dependent upon a limited number of customers and faces significant competition from other providers of such services and from within the pharmaceutical and biotechnology industries.

During 2005, the Group has successfully targeted the diversification and growth of its customer base. In 2006, the key target is revenue growth from the enlarged customer base and an increase in the average revenue per customer.

The Group's technological platform in this area of its business may be superseded by alternative, superior technologies which may provide higher throughput, greater sensitivity, lower cost or other sources of competitive advantage resulting in a reduction in revenue streams.

The Group is actively investing in research and development activities independently and in collaboration to ensure its technological platform remains competitive.

Cytology

The market in England and Wales for LBC products is estimated to be worth in excess of £10 million annually, comprising approximately four million cervical smear tests each year. Medical Solutions has continued to demonstrate its ability to capitalise on this market opportunity having been awarded a total of eight five-year contracts since 2004 worth a total of £15.7 million. During the year, we have consistently raised our market share target and now aim to achieve over 40% of the LBC market in England and Wales.

KPI 4: Segment result – Cytology

Definition: segment result as defined by IAS 14 Segment Reporting (under Group accounting policies) in each defined sub-group of its total business.

Purpose: to assist in the ongoing assessment of the performance of each part of the Group's operations.

Source of data: internal Company data/audited financial statements.

Quantified target: not disclosed.

No changes have been made to the source of data or calculation methods used.

Revenue in 2005 improved significantly as a consequence of these contract wins, rising to £2.5 million in 2005 from £0.4 million (including inter-segment sales of £0.2 million in 2004), a 490% increase. In addition, we have improved the utilisation of our installed machine stock (i.e. the proportion of machines which are revenue generating) from 50% at the start of 2005 to 95% by the end of the year. The Cytology division also generated an operating profit for the first time of £0.2 million in 2005 compared with an operating loss of £0.7 million in 2004.

During the second half of the year, Medical Solutions co-sponsored a Health Technology Assessment Trial designed to test the potential for automated cytology screening in the UK. It is likely that this trial will run for two to three years and other trials are likely to follow.

The UK distribution agreement for the supply of LBC equipment and consumables with TriPath Imaging, Inc. was renewed and extended until 31 December 2008.

The Board is aiming for further growth in 2006 from the Cytology division as a consequence of further contract wins and the achievement of full run rate for the supply of consumables on existing contracts. Typically there is approximately a six-month period between the contract being signed and full run rate during which time training is being conducted, logistics are being organised and the conversion to LBC is achieved by the customer.

The Board believes the key risks facing this part of its business are set out below together with its approach to managing such risks:

The ongoing distribution of LBC equipment and consumables under contract from TriPath Imaging, Inc. is fundamental to the Group's growth from LBC sales. The current contract is due for renewal on 31 December 2008.

The Board is not aware of any reason why the agreement should not be renewed.

Each of the Group's LBC agreements with NHS Trusts or regions are for a five-year term, the first of which was signed in 2004. Over the medium to long term, this area of the business remains dependent upon the successful renewal of such agreements.

The Board is not aware of any reason why such agreements would not be renewed from 2009 and is confident that this will be achieved.

Over the medium to long term, the Board believes that automated screening will be introduced into the UK, provided that the necessary trials are successful. Failure to invest in this area could severely restrict the Group's long term potential in this area.

The Group is actively investing in this area, including capital expenditure on equipment and staff training.

Central resources

Central resources includes the Medical Solutions plc Board together with certain other personnel whose activities span the divisions or carry out a general support function to the business. Other key costs, which are captured centrally, include facilities and investor relations. Having taken significant actions to reduce such costs in 2005, it is pleasing to note that central costs fell from £5.3 million in 2004 to £3.0 million in 2005, a 44% reduction. We will continue to control such costs tightly.

The key risks in this area are believed to be:

Medical Solutions is subject to an increasing number of regulatory frameworks, such as IFRS and the Combined Code on Corporate Governance, together with an increasing regulatory burden in areas such as employment law. In addition, there is a requirement to invest in information technology to protect and improve the business.

In order to comply with these requirements, Medical Solutions has devoted significant resources to fulfilling these obligations.

OPERATING AND FINANCIAL REVIEW

KPI 5: Central operating costs

Definition: costs which are not allocated to any defined business segment.

Purpose: to assist in the ongoing assessment of the performance of each part of the Group's operations.

Source of data: internal Company data/audited financial statements.

Quantified target: not disclosed.

No changes have been made to the source of data or calculation methods used.

BUSINESS SEGMENT PERFORMANCE REVIEW (CONTINUED)

Central resources (continued)

The Board has determined that it has excess space at its headquarters in Nottingham and is currently looking to sub-let a proportion of the building. To date, no tenant has been found resulting in a less than optimal cost to the Group.

The Board is continuing to market the available space and is looking at a number of different alternatives to generate revenue from this resource.

Geographic performance

Both the UK and Dubai regions showed a 77% growth in revenue in 2005. The UK grew from £3.2 million in 2004 to £5.7 million. Revenue in Dubai grew from £2.8 million to £5.0 million in 2005. The reasons for this growth are described on the previous pages.

FINANCIAL REVIEW

Financial performance

Turnover has increased by 77% to £10.7 million (2004: £6.0 million) primarily driven by growth in both the Cytology business and from the Group's pathology operations in Dubai.

As a consequence of the significant growth in sales, costs of sales rose from £4.7 million in 2004 to £6.5 million in 2005. Gross margins have increased to 39% in 2005 from 22% in 2004. The efficiency of the Group's operations has improved significantly during the year following the consolidation of diagnostic pathology operations in Nottingham and the general reduction in UK headcount.

Our laboratory infrastructure in both the UK and Dubai is capable of handling increased sample volumes. Further staff and capital investment may be required beyond a certain level. Many laboratory staff are highly qualified, experienced and flexible thus providing good operational gearing as revenue grows as well as the ability to deal with fluctuations in workload.

In May 2005, we completed the sale of certain intellectual property assets in the area of virtual microscopy to Hamamatsu Photonics KK for initial consideration of £0.45 million, generating a profit on disposal of £0.4 million. We have retained a non-exclusive licence, at no cost, to continue to utilise the intellectual property concerned within the Pathology Services division.

Selling and distribution costs of £0.8 million were in line with 2004 (£0.9 million). Research and development costs increased to £0.2 million in 2005 from £0.1 million in 2004, primarily due to lower capitalisation of development costs.

Administrative expenses, excluding restructuring costs, share-based compensation costs and impairment, were £4.5 million in 2005 compared with £5.6 million in 2004. This reduction is primarily due to savings realised in the area of personnel and property costs. Administrative expenses for the year include a charge of £0.3 million (2004: £0.3 million) relating to a share option-based compensation charge as required by IFRS 2 Share-based Payment.

Operating losses for the year ended 31 December 2005, excluding restructuring costs were £1.3 million compared with £8.3 million during 2004. This includes a profit on sale of fixed assets of £0.4 million during 2005 (2004: £0.6 million). It is especially pleasing to see that operating losses have continued to narrow during the second half of 2005 compared with the first half. Operating losses for the six months ended 30 June 2005, excluding restructuring costs and the profit on sale of fixed assets, were £1.1 million compared with £0.6 million during the second half of 2005.

Restructuring costs for the year ended 31 December 2005 of £0.3 million (2004: £0.2 million) relate mainly to the closure of the Harley Street facility and certain other redundancy costs incurred during 2005. Restructuring costs in 2004 related mainly to redundancies.

After taking account of tax and interest charges, the loss for the 2005 financial year was £1.8 million compared with a loss of £9.4 million in 2004.

KPI 6: Net cash used in operating activities

Definition: Group cash flows used/generated by operating activities as defined by IAS 7 Cash Flow Statements.

Purpose: to assist in the ongoing assessment the current and future ability of the Group to generate positive cash flows.

Source of data: internal Company data/audited financial statements.

Quantified target: not disclosed.

No changes have been made to the source of data or calculation methods used.

Financial position

As at 31 December 2005, the Group had net assets of £17.2 million compared with £12.0 million as at 31 December 2004. Of this, approximately £14.8 million represents goodwill (2004: £11.1 million). As at 31 December 2005, the Group had net cash of £2.3 million (31 December 2004: £0.7 million overdrawn after excluding £2.0 million restricted cash deposit).

The improvement in the Group's underlying financial position during 2005 is demonstrated by an examination of the movement in net current assets/(liabilities), including the full Welcare deferred consideration during the period. As at 31 December 2004, the Group had a net current liability position of £0.8 million compared with a net current asset position of £0.5 million as at 31 December 2005. Excluding the Welcare deferred consideration (payable in cash or shares), this equates to a net current asset position of £2.9 million at 31 December 2005 compared with £0.3 million at 31 December 2004.

This positive change has been effected through the net proceeds of the fundraising, strong working capital management and the reduction in short term borrowings during the period. During the year, the Group also reached agreements with a number of major creditors who were outstanding as at 31 December 2004. Assuming continued improvements in the trading profile of the business, the Board expects this position to improve further during 2006.

The Group has historically been funded primarily through equity although debt has been raised as and when appropriate for the needs of the business. As at 31 December 2005, the Group's balance sheet included bank and finance lease obligations of approximately £0.6 million, £0.3 million of which is repayable within one year and £0.3 million after more than one year but less than two years. As at 31 December 2005, the Welcare deferred consideration amounted to £2.4 million (net of discounting of £0.1 million), all of which is repayable within one year.

Cash flows and liquidity

A total of £5.7 million (net of expenses) was raised through an equity fundraising completed in January 2005. Net cash used in operating activities during the year ended 31 December 2005 was £2.1 million (2004: £2.9 million).

Capital expenditure of £0.3 million was incurred during the year (2004: £0.8 million) primarily in relation to additional LBC equipment. During 2004, the Group invested cash of £2.2 million in the acquisitions of subsidiaries including majority shareholdings in DML and SCL, although these acquisitions were not formally completed until January 2005.

The Group's treasury policies are focused on the investment of surplus funds in fixed rate deposits with major clearing banks and building societies for up to six months. The primary considerations when placing funds are the security of the financial institution and the rate of return. Given the relative unpredictability of cash flows especially in the early part of 2005, the Group did not engage in hedging foreign currency transactions. The Board is comfortable with this approach given that the UAE Dirham is linked to the US Dollar and the profits from the Group's business in Dubai are naturally hedged with US Dollar denominated payments made to certain suppliers. The Board intends to keep this policy under review as its business matures.

As stated previously, the Board has set the achievement of cash generation for the Group as a key objective. Once achieved on a stable basis, the Board will look to invest further in the business with a view to maximising shareholder value without increasing the risk attached to the business.

International Financial Reporting Standards

The Group has adopted IFRS for the first time in producing consolidated financial statements for the year ended 31 December 2005. The reconciliations of the Group's balance sheet and equity at 1 January 2004 and 31 December 2004 together with reconciled income statements and cash flows for the year ended 31 December 2004 were presented with the Group's Interim Report for the six months ended 30 June 2005.

The Group's key accounting policies under IFRS were also set out in the Interim Report (available on our website www.medical-solutions.co.uk), together with a description of the impact of adopting IFRS on its balance sheets, income statements and cash flows during the period covered. The Board does not believe that there are any material changes to the information presented within the Interim Report.

OPERATING AND FINANCIAL REVIEW

FINANCIAL REVIEW (CONTINUED)

People and work environment

Medical Solutions' people are critical to the Group's success. At the start of 2005, the Board recognised that there was an urgent need to address certain issues in the area of Human Resources ("HR"). Many of the issues raised centred on a lack of consistency in HR practices across the UK business given the Group's growth through acquisition.

In response, a UK HR Review Team was organised with a remit of addressing these issues over a period of time. The initial aims of the HR Review were to establish and deliver a process in which all roles within the business were defined and evaluated according to agreed criteria and to produce a banding structure in which different roles across the organisation could be compared and remunerated. The review was directed by Dr Neil Johnston, Group Chief Financial Officer and led by Carol Knott, Director Pathology Services. Ms Knott was supported by senior management internally and by outside consultants. The review was conducted in the early part of 2005 and the results were reported to staff in May 2005.

During the year, Directors and management have consulted widely with staff with a view to understanding staff concerns and identifying areas for improvement. As a result, a number of actions have been taken to address matters. In particular, communications with staff about the progress of the business and other relevant matters have been improved. The Board aims to continue this progress in 2006 and beyond. In 2006, the Board expects to invest further in the training and development of its staff.

As at 31 December 2005, the Group had a total of 114 employees (31 December 2004: 113). The number of people in the Group averaged 114 during 2005 against 125 in 2004, a decrease of 9%.

The Board believes that its employees require a work environment which is safe, encourages communication and is efficient in terms of the Group's working practices.

The Board also considers that health and safety matters are an essential part of the Group's business success. Medical Solutions is committed to providing a safe environment for its employees and visitors and has a clear Health and Safety Policy. The Board and Executive Management Committee receive regular reports from the Health and Safety Committee and prompt action is taken where appropriate. During the year, Medical Solutions had one accident on site in the UK which was reported to the Health and Safety Executive ("HSE"). Following an internal investigation and a visit from the HSE, no further action has been requested by the HSE.

Key business and corporate relationships

Medical Solutions' business is dependent upon a number of key business relationships with employees and with external organisations and individuals. Medical Solutions strives to operate its business in an ethical manner and this is made clear in its expectations of employees, advisors and other business partners.

Its key customer relationships are with those NHS Trusts or groups of trusts who are LBC customers; AstraZeneca; GSK and the Welcare Hospital in Dubai. Its key suppliers include TriPath Imaging, Inc. and DAKO Cytomation.

The Group's key corporate advisors include Allen & Overy (legal, UAE); Bell Pottinger (financial public relations, UK); Hichins Harrison & Co. plc (broking); Nomura Code Securities Limited (corporate advisors and broking); Deloitte & Touche LLP (tax services, UK); Ernst & Young LLP (audit, UAE); and PricewaterhouseCoopers LLP (audit and related services, UK and Group). In addition, Medical Solutions regularly seeks advice and assistance from a number of legal firms in the UK.

ENVIRONMENT, SOCIAL AND COMMUNITY

The Board believes that the direct impact of Medical Solutions' business upon the environment is relatively low. Medical Solutions remains committed to raising awareness of environmental issues which affect our business and minimising the impact of our activities upon the environment.

Medical Solutions aims to conduct our business activities in a socially responsible manner, maintaining integrity and professionalism in dealing with the requirements of investors, employees, suppliers and the local community.

INFORMATION ON KEY PERFORMANCE INDICATORS

This OFR includes six KPIs which are viewed by the Board as being important factors by which the progress of the Group can be measured. In accordance with the Reporting Statement "Operating and Financial Review" published by the Accounting Standards Board in January 2006, additional information which may be relevant to a full understanding of these KPIs and has been provided in the KPI performance charts.

PROSPECTS

During 2005, the Board was focused on dealing with the turnaround of the business and implementing the plan outlined to shareholders at the time of the fundraising in January 2005. Whilst there remains much to do, the Group is now in a much more stable position than one year ago. The settlement of the outstanding deferred consideration relating to the Welcare Laboratory represents a further step forward. We expect to exit from our Dubai operations during 2006.

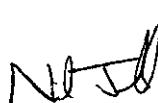
The Board remains focused on becoming a profitable and cash generative business and believes the key target for 2006 to be the continued organic growth of both the Pathology Services and Cytology divisions. We are aiming for revenue growth rates of 20-25% overall in 2006 (including Dubai). Such growth, coupled with close cost control, prudent investment and the introduction of new products will be the basis upon which the Board aims to achieve its short term objectives. At the same time, we must be alert to opportunities to maximise shareholder value in a non-organic manner.

Over the medium to long term, the Board believes the opportunities for growth in our business to be strong. We expect the markets for our products and services to grow significantly. This expectation is a consequence of improved therapeutics which target segmented patient populations and the need for companion diagnostics, the anticipated increased demand for pathology testing from the primary care arena and various UK national screening initiatives. We have an established infrastructure and strong relationships with our customers which we can utilise to benefit from this market expansion.

We also intend to capture greater market share through the introduction of new products and services. Through partnerships, we are also investing in the next generation of automated cytology and image analysis.



Charles Green
Chief Executive Officer
24 April 2006



Dr Neil Johnston
Chief Financial Officer
24 April 2006

DIRECTORS AND ADVISORS

COMPANY SECRETARY
Dr NG Johnston

REGISTERED OFFICE
1 Orchard Place
Nottingham Business Park
Nottingham NG8 6PX

REGISTERED NUMBER
0079136

AUDITOR
PricewaterhouseCoopers LLP
Donington Court
Pegasus Business Park
Castle Donington
East Midlands DE74 2UZ

FINANCIAL ADVISORS AND JOINT BROKERS
Nomura Code Securities Limited
1 Carey Lane
London EC2V 8AE

JOINT BROKERS
Hichins Harrison & Co. plc
11 Bloomfield Street
London EC2M 1LB

SOLICITORS
Hammonds
2 Park Lane
Leeds LS3 1ES

PRINCIPAL BANKERS
The Royal Bank of Scotland plc
1 Spinningfields Square
Manchester M3 3AP

REGISTRARS
Lloyds TSB Registrars
The Causeway
Worthing
West Sussex BN99 6DA

SIR GARETH GWYN ROBERTS (AGE 65) (d)
 Non-Executive Chairman
 Sir Gareth was appointed Non-Executive Chairman in April 2000, having joined the Board as a Non-Executive Director in August 1999. He has an international reputation for his research on semi-conductors and molecular electronics and is the author of numerous publications and patents. He was elected a Fellow of the Royal Society in 1984 and, more recently, to the Fellowship of the Royal Academy of Engineering. He is President of the Science Council and Chairman of several UK Government science and research related committees. He was elected President of Wolfson College, Oxford in January 2001 and serves on the Board of ISIS Ltd, the technology transfer arm of the University of Oxford. He has also held two senior industrial posts, the first as Senior Research Scientist with the Xerox Corporation and the second as Director of Research and Chief Scientist of THORN EMI. He was a member of the Retained Organs Commission and is actively involved with the Royal College of Pathology.

PROFESSOR KAROL SIKORA (AGE 57) (a)
 Scientific Director
 Professor Sikora studied medical science and biochemistry at Cambridge University. He became Clinical Director for Cancer Services at Hammersmith in London where, during the following twelve years, he established a major cancer research laboratory. Following a period as Deputy Director (Clinical Research) of the Imperial Cancer Research Fund, he became Chief of the WHO Cancer Programme. From 1999 to 2001 he was Vice President, Global Clinical Research (Oncology) at Pharmacia Corporation. He is currently a consultant to AstraZeneca and Special Advisor to HCA Healthcare, where his role is to create and develop the largest UK cancer network outside the NHS. He is also Visiting Professor of Cancer Medicine and honorary Consultant Oncologist at Imperial College School of Medicine, Hammersmith Hospital, London.

CHARLES ALEXANDER GREEN (AGE 52) (a)
 Chief Executive Officer
 Mr Green was appointed Chief Executive Officer during 2002. Mr Green has significant experience of corporate acquisitions. In 1993 he was involved in the acquisition of L Gardener Group plc, which was subsequently floated on the London Stock Exchange in November 1995. He was also involved in the purchase of a controlling stake in the holding company of Sheffield United FC where he was Chief Executive until March 1998 and was involved in its flotation in January 1997. He was also involved in the flotation of Medical Solutions plc in 1999 and, subsequently, the flotation of Kingsbridge Holdings PLC and Proactive Sports Group plc.

DR SUSAN FODEN (AGE 52) (b, c, d)
 Senior Non-Executive Director and Chairman of the Remuneration Committee
 Dr Foden is a Non-Executive Director for a number of public and private companies including Innovata plc, Piramed Limited and Biovex Limited. She also sits on the Boards of two seed funds, The Rainbow Seed Fund and the University Challenge Seed Fund, Cascade Limited. She is a Trustee of the Institute of Cancer Research and a Director of Medical Research Council Technology Limited. Prior to 2000, Dr Foden spent time in technology transfer with Cancer Research Campaign Technology Limited (now CRT) and Celtech. Dr Foden holds an MA and DPhil in Biochemistry from the University of Oxford.

DR NEIL GERARD JOHNSTON (AGE 39) (a)
 Chief Financial Officer and Company Secretary
 Dr Johnston joined the Board of Medical Solutions plc as Chief Financial Officer and Company Secretary in January 2005. Dr Johnston was previously Chief Financial Officer of Pharmagene plc. At Pharmagene he played a key role in its admission to the Official List of the UKLA and flotation on the main market of the London Stock Exchange in July 2000. Prior to this he worked at PricewaterhouseCoopers for nine years, the last five of which were spent in the Corporate Finance practice where he specialised in the biotechnology sector, gaining extensive experience in public listings, private placements, acquisitions and disposals. Dr Johnston holds a PhD in Molecular Biology from Liverpool University and is a Chartered Accountant.

ROBIN SLINGER (AGE 52) (b, c, d)
 Non-Executive Director and Chairman of the Audit Committee
 Mr Slinger joined the Board as a Non-Executive Director in January 2005. Until June 2004 Mr Slinger had worked for 34 years at the Royal Bank of Scotland plc, most recently as a Director of Corporate Banking. Over the last ten years he had specific responsibilities for corporate clients active within the London, New York and Amsterdam exchanges, gaining broad experience in public listings, placements and general corporate activity in acquisitions and disposals. Mr Slinger is an Associate of The Chartered Institute of Bankers and also a Non-Executive Director of CBG Group plc, which is an insurance company quoted on the Alternative Investment Market of the London Stock Exchange.

(a) Member of the Executive Management Committee

(b) Member of the Audit Committee

(c) Member of the Remuneration Committee

(d) Member of the Nomination Committee

DIRECTORS' REPORT

The Directors present their Annual Report and Accounts on the affairs of the Group, together with the financial statements and auditor's report for the year ended 31 December 2005.

PRINCIPAL ACTIVITIES

Medical Solutions is an international healthcare group specialising in diagnostic pathology and cytology products and services.

The Pathology Services division provides pathology services to public and private healthcare providers in the UK and Dubai, UAE as well as to the pharmaceutical and biotechnology industries.

The Cytology division distributes and supports the SurePath™ LBC system and consumables for cervical cancer screening and non-gynaecological applications.

The Board had previously reported its intention to consolidate its UK Diagnostic Pathology operations in Nottingham and close its Harley Street, London facilities. This was completed successfully during the year.

A review of the operations of the Group and future prospects is included in the Operating and Financial Review on pages 4 to 13.

RESULTS AND DIVIDENDS

Turnover for the year from continuing operations was £10.7 million (2004: £6.0 million). The Directors do not propose the payment of a dividend (2004: £nil).

DIRECTORS AND THEIR INTERESTS

The Directors of the Company who held office during the year, and at the year end, are as follows:

Executive Directors

Mr CA Green

Dr NG Johnston (appointed 14 January 2005)

Prof K Sikora

Mr AD Longstaffe (resigned 14 January 2005)

Non-Executive Directors

Sir Gareth Roberts

Dr S Foden

Mr R Slinger (appointed 14 January 2005)

Biographical details of the Directors are given on page 15.

Under the Company's Articles of Association, each Director shall retire from office at the third Annual General Meeting ("AGM") after the AGM at which he or she was last elected. Mr Green and Dr Foden were last elected to office at the 2004 AGM. Sir Gareth Roberts, Dr Johnston, Prof Sikora and Mr Slinger were last elected at the 2005 AGM. On this basis, none of the Directors are required to, or will be, retiring by rotation.

The Board recognises that during 2006, Sir Gareth Roberts will have served for a total of seven years. The Revised Combined Code states that any term beyond six years for a Non-Executive Director should be subject to particularly rigorous review which should take into account the need for progressive refreshing of the Board. The Board has considered this requirement and believes strongly that the Chairman should continue in his current role.

Other than as disclosed in note 35 to the consolidated financial statements, no contract existed during the year, or at the year end, in which any Director of the Company was interested, other than service contracts.

None of the Directors have a service contract with the Company requiring more than twelve months' notice of termination to be given. The details of the Directors' contracts and remuneration are provided in the Directors' Remuneration Report on pages 25 to 28.

DIRECTORS AND THEIR INTERESTS (CONTINUED)

The interests (including the interests of their immediate families and persons connected with the Directors) of the Directors who held office during the year in the ordinary shares of the Company at 20 April 2006, 31 December 2005 (or date of resignation) and 1 January 2005 (or the date of appointment) were:

	Beneficial holding		
	20 April 2006 Number of shares	31 December 2005 or date of resignation Number of shares	1 January 2005 or date of appointment Number of shares
Sir Gareth G Roberts	431,723	431,723	210,223
Mr CA Green	637,722	637,722	342,422
Dr NG Johnston (appointed 14 January 2005)	110,700	110,700	—
Prof K Sikora	624,600	624,600	255,500
Dr S Foden	110,700	110,700	—
Mr R Slinger (appointed 14 January 2005)	25,000	25,000	—
Mr AD Longstaffe (resigned 14 January 2005)	N/A	858,538	755,238

SUBSTANTIAL SHAREHOLDINGS

On 20 April 2006 the Company had been notified, in accordance with sections 198 to 208 of the Companies Act 1985, of the following interests of 3% or more in the Company's ordinary share capital:

	Number of shares	Percentage of ordinary share capital
Aberforth Partners	31,950,000	15.68
Mr S Varkey	17,635,457	8.65
BWD UK Microcap Growth Trust	7,500,000	3.68

SHARE CAPITAL

Details of the movements in share capital are given in note 22 to the consolidated financial statements.

RESEARCH AND DEVELOPMENT

In order to further the Group's business objectives, it engages in research and development projects. In 2005, the nature of this research and development was primarily focused on the development of diagnostic techniques for cancer and other therapeutic areas and the development of software products designed for both internal use and use by third parties.

Prof Sikora, Dr Foden, Sir Gareth Roberts and Professor Ian Ellis (Medical Director, Executive Management Committee) have very strong connections with the medical and health research community.

Total research and development expenditure in the year was £0.2 million (2004: £0.1 million).

EMPLOYEES AND EQUAL OPPORTUNITIES

The Group places considerable value on involving its employees in the evolution of the Group, its policies and procedures and matters affecting them as employees. The Board strives to keep employees informed on such matters. Participation of employees in contributing to the growth of the Group is encouraged through meetings between management and all staff who are invited to discuss progress, plans, performance and any issues affecting them or the Group.

The Group is committed to the principle of equal opportunity in the employment of its employees and applicants for employment, regardless of their age, race, gender, marital status, sexual orientation, religious belief, ethnic origin, nationality, national origin or disability. All applications for employment are treated equally in accordance with the Group's Staff Recruitment and Selection Policy. In the event of members of staff becoming disabled, every effort is made to ensure that their employment with the Group continues and that appropriate training is arranged. It is the policy of the Group that the training, career development and promotion of disabled persons should be, as far as possible, identical with that of other employees.

DIRECTORS' REPORT

CHARITABLE AND POLITICAL DONATIONS

The Group made no charitable or political donations during the year (2004: £nil).

SUPPLIER PAYMENTS

The Group is committed to obtaining the best terms for all types of business. Consequently there is no single policy as to the terms used. The number of days purchases represented by Group trade creditors at 31 December 2005 was 88 days (2004: 137 days).

FINANCIAL RISK MANAGEMENT

Details of the Group's policy for the management of financial risk are given in note 1 to the consolidated financial statements.

ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

From 1 January 2005, the Group has been required to prepare consolidated financial statements, including comparative data, in accordance with IFRS as adopted by the European Union. Accordingly, financial information for the year 2005, and comparative information, has been prepared on the basis of IFRS.

EVENTS AFTER THE BALANCE SHEET DATE

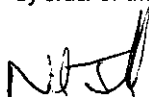
Deferred consideration in respect of the acquisition of the Welcare Laboratory

On 13 March 2006, the Company entered into an agreement with the Welcare Hospital and Welcare World Health Systems Limited ("Welcare Parties") in respect of the deferred consideration outstanding following the acquisition of the Welcare Laboratory from the Welcare Parties in 2003. Under this agreement, the Company will exchange a shareholding of 16.7% in its subsidiary Medical Solutions FZ LLC in satisfaction of the outstanding deferred consideration recognised at 13 March 2006 of £2.5 million. On conclusion of this transaction, Welcare Hospital will release cash to the Company amounting to £0.9 million, which has been withheld pending settlement of the deferred consideration. This transfer of shares in Medical Solutions FZ LLC requires ratification by the Dubai Healthcare City authorities.

AUDITOR

The previous auditor, Deloitte & Touche LLP resigned during the year. PricewaterhouseCoopers LLP was appointed to fill the casual vacancy arising and has indicated its willingness to continue as auditor. A resolution that it be appointed to office will be proposed at the forthcoming AGM.

By order of the Board



Dr Neil Johnston
Company Secretary
1 Orchard Place
Nottingham Business Park
Nottingham NG8 6PX
24 April 2006

CORPORATE GOVERNANCE STATEMENT

PRINCIPLES STATEMENT

The Board of Directors as a whole is collectively accountable to the Company's shareholders for good corporate governance and is committed to achieving compliance with the principles of corporate governance set out in the Revised Combined Code as issued in July 2003 by the Financial Reporting Council ("FRC").

Set out below is a statement of how the principles of the Revised Combined Code were applied.

BOARD OF DIRECTORS

Board responsibilities

The Group is controlled through its Board of Directors. The Board's main responsibilities are to provide leadership of the Company and Group within a framework of controls for managing risk, to approve the strategic objectives and to ensure the necessary financial and other resources are made available to enable the Group to meet those objectives. The Board, which meets approximately twelve times a year, has a schedule of matters reserved for its approval.

Specific responsibilities reserved to the Board include:

- setting Group strategy and approving an annual budget and medium term projections;
- reviewing operational and financial performance;
- approving major acquisitions, divestments and capital expenditure;
- reviewing the Group's systems of financial control and risk management;
- ensuring that appropriate management development and succession plans are in place;
- reviewing the environmental, health and safety performance of the Group;
- approving appointments to the Board, appointment of the Company Secretary, policies relating to Directors' remuneration and the severance of Directors' contracts;
- ensuring that a satisfactory dialogue takes place with shareholders; and
- approval of interim and annual financial statements.

Board composition

The Board of Directors currently comprises three Executive and three Non-Executive Directors. Biographical details of the Board of Directors are set out on page 15.

The roles of Chairman and Chief Executive Officer are separate and written evidence of this was formalised in April 2005 and reviewed in January 2006. The Chairman is responsible for leadership of the Board, ensuring its effectiveness and setting its agenda. It is the Chief Executive Officer's responsibility to ensure delivery of the strategic and financial objectives.

Dr Johnston and Mr Slinger were appointed to the Board on 14 January 2005.

Mr Slinger was appointed in order to complement the existing skills and expertise amongst the Non-Executive Directors. His financial experience and expertise were in line with that which the Board had been seeking and, as a result, Mr Slinger was appointed without open advertising or the use of an external search consultancy.

Between them, the Directors have a considerable breadth of experience and a range of complementary skills. Each brings an independent judgement to bear on matters of strategy, performance, research and development, resources and standards of conduct.

Appropriate training is made available to assist the Directors in the discharge of their duties and each has access to the advice and services of the Company Secretary. All Directors have access to independent professional advice at the expense of the Company, where they deem it necessary to discharge their responsibilities as Directors. Each Director receives a full and tailored induction on joining the Board.

Board papers contain sufficient information to enable the Directors to form a balanced overview of all significant matters to be considered. Such papers are prepared and distributed in advance of the meetings at which these matters are to be discussed.

CORPORATE GOVERNANCE STATEMENT

BOARD OF DIRECTORS (CONTINUED)

Board and Committee meetings

The number of full scheduled Board and Committee meetings and the attendance records of each Director during the year is indicated below.

	Scheduled Board meetings	Audit Committee meetings	Remuneration Committee meetings	Nomination Committee meetings
Number held	12	3	3	1
Number attended				
Sir Gareth G Roberts	11	—	—	1
Mr CA Green	12	—	—	—
Dr NG Johnston	12	—	—	—
Prof K Sikora	11	—	—	—
Dr S Foden	12	3	3	1
Mr R Slinger	12	3	3	1

— indicates not a member of that Committee during 2005.

INDEPENDENCE OF NON-EXECUTIVE DIRECTORS

The Board considers each of the Non-Executive Directors (excluding the Chairman) to be independent in character and judgement. Neither Dr Foden nor Mr Slinger:

- has been an employee of the Group within the last five years;
- has, or has had within the last three years, a material business relationship with the Group, notwithstanding the advice provided to the Board by Manntex Limited, during 2004 (see below);
- receives remuneration other than a Director's fee;
- has close family ties with any of the Group's advisors, Directors or senior employees;
- holds cross-directorships or has significant links with other Directors through involvement in other companies or bodies; and
- represents a significant shareholder.

Manntex Limited, a company of which Mr Slinger is an employee, provided advice on the renewal of the Group's banking facilities during 2004. The Board believes that Mr Slinger remains independent in character and judgement and, along with Dr Foden, continues to make a significant and challenging contribution to the Company. On this basis, the Board does not believe that Mr Slinger's independence or objectivity is compromised.

COMMITMENT OF THE CHAIRMAN

Details of the Chairman's professional commitments are included in his biography. The Board is satisfied that these other commitments are not such as to interfere with the performance of his duties as Chairman of the Company which are based around a commitment of approximately 30 days per annum.

EVALUATION OF THE BOARD AND ITS COMMITTEES

The Board has established a formal process, led by the Chairman, for the annual evaluation of the performance of the Board, its principal Committees and individual Directors. The Senior Non-Executive Director conducts the annual performance evaluation of the Chairman, taking into account the views of all Directors.

DIALOGUE WITH KEY SHAREHOLDERS

The Directors seek to build on a mutual understanding of objectives between the Group and its key shareholders, in particular by communicating regularly throughout the year and encouraging them to participate in the AGM, which all the Directors normally attend. Each Non-Executive Director is available to meet with shareholders should this be desired.

The Board has significantly increased the level of disclosure regarding the Group's strategy, objectives, resources, risks and financial performance and position within the Operating and Financial Review as set out on pages 4 to 13.

COMMITTEES OF THE BOARD

Certain Board responsibilities are delegated to Committees of the Board.

EXECUTIVE MANAGEMENT COMMITTEE

The Executive Management Committee comprises the Executive Directors together with the divisional and functional heads. The UK Executive Management Committee is chaired by Dr Johnston and normally meets every two weeks to discuss the performance of the Group's business units and other issues as they arise in the course of the Group's activities. The Group's activities in Dubai are directed by Mr Green.

The Board has delegated the following responsibilities to the Executive Management Committee:

- implementation of the strategies and policies of the Company as determined by the Board;
- development and recommendation of strategic plans for consideration by the Board that reflect the longer term objectives and priorities established by the Board;
- monitoring of the operational and financial results against plans and budgets;
- prioritising the allocation of financial, technical and human resources; and
- developing and implementing risk management systems.

AUDIT COMMITTEE

Role of the Audit Committee

Under the terms of reference, the Audit Committee monitors the integrity of the Group's financial statements including its Annual and Interim Reports, preliminary results announcements and any other formal announcement relating to financial performance, reviewing significant financial reporting issues and judgements which they contain. It is responsible for ensuring that an appropriate relationship between the Group and the external auditor is maintained, including reviewing non-audit services and fees. It also reviews the Group's systems of internal control (including financial controls) and risk management.

In 2005, the Audit Committee discharged its responsibilities by:

- reviewing the Group's draft 2004 Annual Report and Accounts and 2005 Interim Report (including the preliminary announcement relating to each) prior to Board approval and reviewing the external auditor's detailed reports thereon;
- reviewing the appropriateness of the Group's accounting policies;
- reviewing regularly the potential impact on the Group's financial statements of certain matters such as impairments of fixed asset values and changes in the financial reporting environment;
- reviewing and approving the 2005 audit fee and reviewing non-audit fees payable to the Group's external auditor in 2005;
- reviewing the external auditor's plan for the audit of the Group's 2005 Annual Report and Accounts, which included key areas of extended scope work, key risks on the accounts, confirmations of auditor independence and the proposed audit fee, and approving the terms of engagement for the audit;
- reviewing and approving the UK and Dubai internal financial control frameworks; and
- reviewing the Group's internal control and risk management systems.

CORPORATE GOVERNANCE STATEMENT

AUDIT COMMITTEE (CONTINUED)

Role of the Audit Committee (continued)

The Audit Committee meets at least three times each year, including meetings before the announcement of the Group's annual and interim results. The Audit Committee meets with Executive Directors and management as well as privately with the external auditor. The Audit Committee's terms of reference are available from the Company Secretary.

Composition of the Audit Committee

The Audit Committee comprises Mr Slinger (Chairman) and Dr Foden. Dr Johnston acts as Secretary to the Audit Committee.

INTERNAL CONTROL AND RISK MANAGEMENT SYSTEMS

In applying Principle C.2 of the Revised Combined Code, which states that the Board should maintain a sound system of internal control to safeguard shareholders' investment and the Group's assets, the Directors recognise that they have overall responsibility for ensuring that the Group maintains a system of internal control and risk management to provide them with reasonable assurance regarding effective and efficient operations, internal control and compliance with laws and regulations. The system of internal control and risk management is designed to manage rather than eliminate the risk of failure to observe business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

The Company views the careful management of risk as a key management activity. Managing business risk to deliver opportunities is a key element of all activities.

The Directors have continued to review the effectiveness of the Group's system of internal controls, including strategic, commercial, operational, compliance and financial controls and risk management systems. These reviews have included an assessment of internal controls, and in particular internal financial controls, management assurance of the maintenance of control and reports from the external auditor on matters identified in the course of its statutory audit work. The Directors believe that the Company maintains an effective embedded system of internal controls and complies with the Turnbull Report guidance.

There is a clearly defined organisational structure. The Group operates a comprehensive annual planning and budgeting process. Corporate objectives are defined at the start of each year and cascaded throughout the organisation. The performance of each part of the business is reviewed by the Executive Management Committee and the Board. Corrective actions are taken where performance does not meet internal expectations.

The Company does not have an independent internal audit department. However, it is felt that the financial record keeping is robust and capable of highlighting significant departures from procedures. Other areas of risk review and management that may normally be conducted by an internal audit department are covered by the Board and its Committees as highlighted in this Corporate Governance Statement.

EXTERNAL AUDITOR

The Audit Committee monitors the integrity and effectiveness of the external audit process and oversees the relationship with the external auditor.

The Audit Committee has the specific task of keeping under review the nature and extent of non-audit services provided by the external auditor in order to ensure that objectivity and independence are maintained.

The external auditor has in place processes to ensure its independence is maintained including safeguards to ensure that where it does provide non-audit services, its independence is not threatened. The external auditor has written to the Audit Committee confirming that, in its opinion, it is independent.

Following a competitive tender process during 2005 for the external audit engagement, the Audit Committee accepted the resignation of Deloitte & Touche LLP and appointed PricewaterhouseCoopers LLP to fill the casual vacancy arising. A resolution that PricewaterhouseCoopers LLP be appointed to office will be proposed at the forthcoming AGM.

REMUNERATION COMMITTEE

Role of the Remuneration Committee

The Remuneration Committee meets at least twice each year to review the Group's policy on Directors' remuneration and advise the Board on the salaries and benefits of Executive Directors and senior management. Non-Executive Directors' remuneration is a matter for the Board as a whole.

The terms of reference of the Remuneration Committee have been documented and agreed by the Board of Directors and are available from the Company Secretary. The key terms are as follows:

- determine and agree the policy for the remuneration of the Company's Chairman, Chief Executive Officer, the Executive Directors, the Company Secretary and such other members of senior management as it is designated to consider. Currently, this includes all individuals with a remuneration package which could, subject to bonuses, exceed £60,000 per annum. The Remuneration Committee shall also review the ongoing appropriateness and relevance of the remuneration policy;
- the Committee shall review the size of the annual cash bonus to be awarded to staff as a whole and the specific amounts of any bonus (whether in cash or any other form) to Executive Directors and designated senior management;
- review annually the remuneration trends across the Company or Group;
- approve all proposals for allocations of share options or share-based payment;
- ensure that all provisions regarding disclosure of remuneration including pensions, as set out in the Directors' Remuneration Report Regulations 2002 and the Revised Combined Code, are fulfilled;
- the Committee Chairman shall report formally to the Board on its proceedings after each meeting on all matters within its duties and responsibilities; and
- the Committee shall, at least once a year, review its own performance, constitution and terms of reference to ensure it is operating at maximum effectiveness and recommend any changes it considers necessary to the Board for approval.

The Board has discussed the composition of the Remuneration Committee and is satisfied that the Directors who are members of this Committee are those who are best able to contribute to the Committee's objectives.

The Directors' Remuneration Report, which includes details of the Group's remuneration policy is set out on pages 25 to 28 of the Annual Report and Accounts.

Composition of the Remuneration Committee

In February 2005, Dr Foden was appointed Chairman of the Remuneration Committee and Mr Slinger was appointed to the Committee. In line with the Revised Combined Code, Sir Gareth Roberts stepped down from the Remuneration Committee in February 2005 but continues to attend such meetings by invitation. Dr Johnston acts as Secretary to the Remuneration Committee.

NOMINATION COMMITTEE

Role of the Nomination Committee

During 2005, a Nomination Committee was established to recommend the appointment of new Directors to the Board and to make recommendations on Board composition and balance.

The terms of reference of the Nomination Committee have been documented and agreed by the Board of Directors and are available from the Company Secretary. The key terms are as follows:

- to review and evaluate the Board structure, size, balance of skills and composition and to make recommendations to the Board with regard to adjustments that are deemed necessary;
- consider succession planning for Directors, in particular the Chairman and Chief Executive Officer, other senior management and membership of Audit and Remuneration Committees; and
- prepare a description of the roles and capabilities required for a particular appointment, be responsible for identifying and nominating candidates for approval of the Board to fill Board vacancies.

CORPORATE GOVERNANCE STATEMENT

NOMINATION COMMITTEE (CONTINUED)

Composition of the Nomination Committee

At 31 December 2005, the Nomination Committee comprised Sir Gareth Roberts (Chairman), Dr Foden and Mr Slinger. Dr Johnston acts as Secretary to the Nomination Committee.

STATEMENT OF COMPLIANCE WITH THE REVISED COMBINED CODE

The Board remains committed to high standards of corporate governance. During the early part of 2005, the Board identified a number of areas of non-compliance with the Revised Combined Code as set out below:

- the Group did not formalise written evidence of the roles of the Chairman and Chief Executive Officer until April 2005 (A.2.1);
- the Group did not formalise written terms of reference for its Audit and Remuneration Committees until February 2005;
- the Group did not have a Nomination Committee until July 2005;
- the Group did not formalise written terms of reference for its Nomination Committee until July 2005;
- prior to the appointment of Mr Slinger in January 2005, the Company did not have two independent, Non-Executive Directors (A.3.2). As a result, neither the Audit Committee, nor Remuneration Committee included at least two independent Non-Executive Directors (C.3.1; B.2.1) for the whole of the year. Sir Gareth Roberts was Chairman of both the Audit and Remuneration Committees until February 2005;
- Dr Foden was appointed as the Senior Non-Executive Director in 2005 (A.3.3; D.1.1);
- from July 2005, letters of appointment for Non-Executive Directors specify fixed terms of three years (A.7.2);
- the performance of the Board and its Committees and individual Directors, including the Chairman, were evaluated formally for the first time during 2005 (A.6.1; A.7.2); and
- as a matter of Company policy employees of Group companies may, in confidence, raise concerns about financial reporting or other matters through the Group's grievance procedures (C.3.4).

Each of the exceptions identified has been addressed during 2005 and the Board aims to report full compliance with the Revised Combined Code for the year ending 31 December 2006.

GOING CONCERN

In accordance with the guidance for Directors of listed companies "Going Concern and Financial Reporting" and, after making appropriate enquiries, the Directors have concluded at the time of approving the financial statements that it is appropriate to continue to adopt the going concern basis in preparing these financial statements. This is based on the Directors' opinion that the Group has adequate financial resources to continue in operational existence for the foreseeable future.

Approved by the Board of Directors and signed on behalf of the Board



Sir Gareth Roberts
Non-Executive Chairman
24 April 2006

DIRECTORS' REMUNERATION REPORT

INTRODUCTION

This report is made by the Board and prepared on its behalf, and for its approval, by the Remuneration Committee. It provides the Company's statement of how it has applied the principles of good governance as set out in the Revised Combined Code and those required by the Companies Act 1985 and Directors' Remuneration Report Regulations.

Further, the Directors' Remuneration Report Regulations require the Company's auditor to report to the Company's members on the "auditable part" of the Directors' Remuneration Report and to state whether in their opinion that part of the Report has been properly prepared in accordance with the Companies Act 1985 (as amended by the Regulations). This Report has therefore been divided into sections for audited and unaudited information.

UNAUDITED INFORMATION

Remuneration Committee

None of the Remuneration Committee has any personal financial interest (other than as shareholders), conflicts of interests arising from cross-directorships or day-to-day involvement in running the business. The Remuneration Committee is responsible for setting Group policy on remuneration for Executive Directors and other members of senior management in the UK and Dubai whose total remuneration package exceeds £60,000 per annum. Fees paid to Non-Executive Directors are determined by the Board as a whole. No Director is involved in discussions about his or her own remuneration. In determining the Directors' remuneration for the year, the Committee consulted Mr Green and Dr Johnston about its proposals, except those concerning their own remuneration and obtained benchmarking information from internal and external sources. The Remuneration Committee seeks to give full consideration to the Revised Combined Code including the provisions set out in Schedule A to the Code.

Remuneration policy

Executive remuneration packages are prudently designed to attract, motivate and retain Directors of the high calibre needed to improve the Group's position and to reward them for enhancing value to shareholders. There are four main elements of the remuneration package for Executive Directors and senior management:

- basic annual salary;
- annual discretionary bonus payments;
- other customary benefits such as pension contributions, private health insurance, life assurance and, in certain situations, company car benefits; and
- long term incentive arrangements in the form of share options.

The Company's policy is that a substantial proportion of the remuneration of the Executive Directors should be performance related. Executive Directors may earn annual incentive payments at the discretion of the Remuneration Committee together with the benefits of participation in share option schemes.

Executive Directors are entitled to accept appointments outside the Company providing that the Chairman's permission is sought.

Basic salary

An Executive Director's basic salary is determined by the Committee at the beginning of each year and when an individual changes position or responsibility. In deciding appropriate levels, the Committee considers performance and aims to ensure that remuneration remains competitive with similar companies in terms of size and complexity.

Annual bonus payments

Each Executive Director is eligible for a discretionary annual bonus in recognition of their personal and collective contribution to the success of the Group and the achievement of specified performance targets. As a matter of current policy, the maximum cash bonus for Executive Directors is 50% of basic salary. In addition, the Company operates a matching bonus scheme whereby cash bonuses invested in the Company's shares are matched by the issue of the Company's shares to the Director.

Share options

Share options are granted to Executive Directors and senior employees (and other staff) to encourage them to identify with shareholder interests. Share options are granted and exercised under the rules of the Inland Revenue approved executive share option scheme and the unapproved executive share option scheme.

The Company's policy is to grant options at the discretion of the Remuneration Committee taking into account individual performance up to a maximum of four times salary over a three year period. It is the Company's policy to phase the granting of share options rather than to award them in a single large block to any individual, except where specific circumstances exist.

DIRECTORS' REMUNERATION REPORT

INTRODUCTION

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DIRECTORS' REMUNERATION REPORT

UNAUDITED INFORMATION (CONTINUED)

Share options (continued)

The exercise of options granted may be subject to performance conditions, at the discretion of the Remuneration Committee. Historic and recent share option grants have been made in order to motivate staff and as such there are no performance criteria applicable to grants made to date. The Remuneration Committee expects to review the issue at the time of any future share option grants and is mindful of ABI guidelines in this area.

The exercise price of the options granted under the above schemes is equal to the closing mid-market value of the Company's ordinary shares on the day prior to grant and vest with the individual after three years.

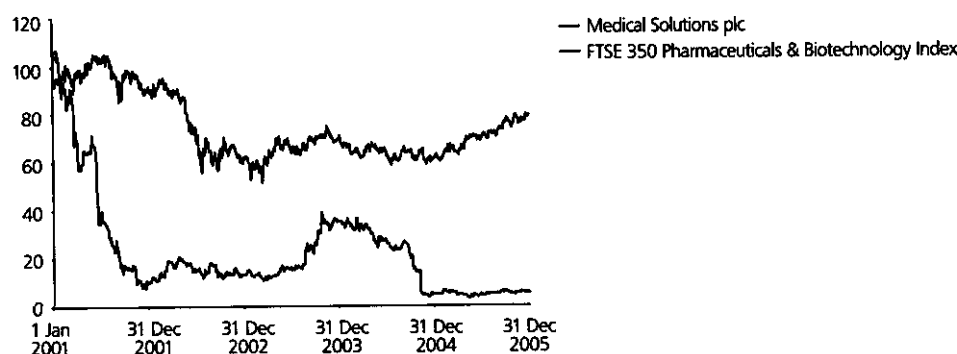
The Company also operates an Inland Revenue approved savings related scheme which was open to all employees and full-time Directors of the Company and its subsidiaries, who were UK income tax resident and ordinarily resident. This scheme was closed to new entrants during 2004.

Pension and other benefits

Executive Directors along with all employees are eligible to be members of the Company's defined contribution pension scheme. The Group contributes a sum equal to a fixed percentage of basic salary, currently between 3% and 12%. Members' dependents are eligible for dependents' pensions and the payment of a lump sum in the event of death in service. Members of the pension fund are also covered by Permanent Health Insurance, providing 50% of salary after six months' absence from work due to a permanent disability. The Group funds the provision of private medical insurance cover for Executive Directors and their immediate families and life assurance cover. Certain Executive Directors are provided with a company car or car allowance and are provided with a mobile phone for business and personal use.

Performance graph

The following graph shows the Company's performance, measured by total shareholder return, compared with the performance of the FTSE 350 Pharmaceuticals & Biotechnology Index also measured by total shareholder return. The Directors are of the opinion that the FTSE 350 Pharmaceuticals & Biotechnology Index provides the most appropriate comparative based on the Group's operations.



Directors' contracts

It is the Company's policy that Executive Directors should have contracts with an indefinite term providing for a maximum of one year's notice.

All Non-Executive Directors have specific terms of engagement and their remuneration is determined by the Board within the limits set by the Articles of Association and based on independent surveys of fees paid to Non-Executive Directors of similar companies. Non-Executive Directors cannot participate in any of the Company's share option schemes and are not eligible to join the Company's pension scheme.

The details of the service contracts or letters of appointment for all Directors who served during the year are shown in the table below:

	Original date of contract/ letter of appointment	Notice period
Sir Gareth G Roberts	27 July 1999*	6 months
Mr CA Green	1 April 2005	12 months
Dr NG Johnston	14 January 2005	12 months
Prof K Sikora	1 September 2003	12 months
Dr S Foden	2 December 2004*	6 months
Mr R Slinger	14 January 2005*	6 months
Mr AD Longstaffe (resigned 14 January 2005)	28 March 1997	12 months

* Updated 25 July 2005.

AUDITED INFORMATION

Directors' emoluments and compensation

	Fees/basic salary £'000	Bonus £'000	Taxable benefits in kind £'000	Total 2005 £'000	Total 2004 £'000	Pension 2005 £'000	Pension 2004 £'000
Executive Directors							
Mr CA Green	167	20	—	187	210	13	—
Dr NG Johnston	134	50	1	185	—	16	—
Prof K Sikora	73	7	—	80	80	3	—
Mr AD Longstaffe ¹ (resigned 14 January 2005)	5	—	—	5	112	2	6
Non-Executive Directors							
Sir Gareth G Roberts	50	—	20	70	72	—	—
Dr S Foden	27	—	—	27	30	—	—
Mr R Slinger	28	—	—	28	—	—	—
				582	504	34	6
Money purchase pension contributions				34	6		
Aggregate remuneration				616	510		

¹ Mr Longstaffe resigned from the Group on 14 January 2005 and his contract was terminated. Mr Longstaffe was paid £117,000 in respect of his contractual notice period and his company car and computer were transferred to him at nil cost.

The Directors who held office during the year held options under the Company's share option schemes as follows:

Director and date of grant	Note	First exercisable date	Last exercisable date	Option price	1 January 2005	Granted	Lapsed	31 December 2005
Sir Gareth G Roberts								
13 Jan 2003	2	13 Jan 2006	12 Jan 2013	22.00p	706,000	—	—	706,000
					706,000	—	—	706,000
Mr CA Green								
28 Sept 1999	1	28 Sept 2002	27 Sept 2009	48.00p	416,667	—	—	416,667
28 Sept 2003	2	22 Sept 2006	21 Sept 2013	32.50p	500,000	—	—	500,000
3 May 2005	1	3 May 2008	2 May 2015	6.25p	—	25,000	—	25,000
					916,667	25,000	—	941,667
Dr NG Johnston								
19 Jan 2005	1	19 Jan 2008	18 Jan 2015	6.75p	—	4,000,000	—	4,000,000
3 May 2005	2	3 May 2008	2 May 2015	6.25p	—	25,000	—	25,000
					—	4,025,000	—	4,025,000
Prof K Sikora								
22 Sept 2003	2	22 Sept 2006	21 Sept 2013	32.50p	250,000	—	—	250,000
16 Oct 2004	3	16 Oct 2011	15 Apr 2012	34.25p	52,189	—	—	52,189
3 May 2005	1	3 May 2008	2 May 2015	6.25p	—	25,000	—	25,000
					302,189	25,000	—	327,189
Mr AD Longstaffe								
13 Jan 2003	2	13 Jan 2006	12 Jan 2013	22.00p	250,000	—	250,000	—
22 Sept 2003	2	22 Sept 2006	21 Sept 2013	32.50p	150,000	—	150,000	—
					400,000	—	400,000	—

Note 1: granted under the 1999 unapproved share option scheme.

Note 2: granted under the 2001 approved share option scheme.

Note 3: granted under the Inland Revenue approved savings related scheme.

DIRECTORS' REMUNERATION REPORT

AUDITED INFORMATION (CONTINUED)

Directors' emoluments and compensation (continued)

No Directors exercised share options during the year.

There have been no variations to the terms and conditions or performance criteria for share options during the financial year. As described in this Remuneration Report there are no performance criteria attached to the options granted to date.

The market price of the Company's ordinary shares at 31 December 2005 was 7.75p and the range during the year was 4.38p to 9.50p.

On behalf of the Board



Dr Sue Foden
Chairman of the Remuneration Committee
24 April 2006

STATEMENT OF DIRECTORS' RESPONSIBILITIES

UK Company Law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the Group and of the profit or loss for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state that the financial statements comply with IFRS; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The Directors confirm that they have complied with the above statements in preparing the financial statements. The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and Group and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and Group and hence for taking reasonable steps to prevent and to detect fraud and other irregularities.

NOTES

The maintenance and integrity of the Medical Solutions plc website is the responsibility of the Directors, the work carried out by the auditor does not involve consideration of these matters and, accordingly, the auditor accepts no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MEDICAL SOLUTIONS PLC

We have audited the Group and Parent Company financial statements (the "financial statements") of Medical Solutions plc for the year ended 31 December 2005 which comprise the Consolidated Income Statement, Consolidated and Parent Company Statement of Changes in Shareholders' Equity, the Consolidated and Parent Company Balance Sheets, the Consolidated and Parent Company Cash Flow Statements and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITOR

The Directors' responsibilities for preparing the Annual Report and Accounts, the Directors' Remuneration Report and the financial statements in accordance with applicable law and International Financial Reporting Standards as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

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

BASIS OF AUDIT OPINION

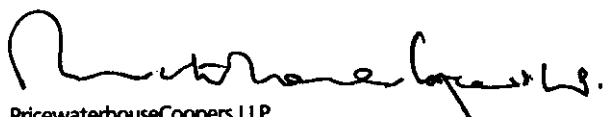
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration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

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

OPINION

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union, of the state of the Group's affairs as at 31 December 2005 and of its loss and cash flows for the year then ended;
- the Parent Company financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the Parent Company's affairs as at 31 December 2005 and cash flows for the year then ended; and
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation.



PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
East Midlands
24 April 2006

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2005

	Note	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
Continuing operations			
Revenue from continuing operations	2	10,672	6,026
Cost of sales		(6,536)	(4,710)
Gross profit		4,136	1,316
Selling and distribution expenses		(833)	(866)
Administrative expenses:			
– normal		(4,460)	(5,609)
– share-based compensation		(304)	(320)
– restructuring costs	3	(347)	(181)
– impairment of goodwill and development costs	3	(64)	(3,049)
– aborted acquisition		–	(240)
Administrative expenses		(5,175)	(9,399)
Research and development		(207)	(103)
Gain on sale of fixed assets	4	383	607
Operating loss from continuing operations	2	(1,696)	(8,445)
Interest receivable	6	108	–
Interest payable and similar charges	6	(251)	(264)
Loss before tax from continuing operations		(1,839)	(8,709)
Taxation	9	–	(90)
Loss after tax but before loss from discontinued operations		(1,839)	(8,799)
Discontinued operations			
Loss from discontinued operations	8	–	(636)
Loss for the year		(1,839)	(9,435)
Attributable to:			
Equity holders of the Parent Company		(1,890)	(9,435)
Minority interest		51	–
Loss for the year		(1,839)	(9,435)
Basic and diluted loss per ordinary share from continuing operations	10	(0.96)p	(9.50)p
Basic and diluted total loss per ordinary share	10	(0.96)p	(10.19)p

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the year ended 31 December 2005

Group	Attributable to equity holders of the Parent Company						Total equity £'000
	Share capital £'000	Share premium £'000	Merger and other reserves £'000	Translation reserve £'000	Profit and loss reserve £'000	Minority interest £'000	
Balance at 1 January 2004	1,788	25,059	4,558	(136)	(13,157)	—	18,112
Currency translation adjustments	—	—	—	(54)	—	—	(54)
Net expense recognised directly to equity	—	—	—	(54)	—	—	(54)
Loss for the year	—	—	—	—	(9,435)	—	(9,435)
Total recognised expense for the year	—	—	—	—	(9,435)	—	(9,435)
Shares issued	177	2,853	—	—	—	—	3,030
Shares in EBT	(5)	—	50	—	(45)	—	—
Employee share option scheme: – value of services provided	—	—	—	—	320	—	320
Balance at 31 December 2004	1,960	27,912	4,608	(190)	(22,317)	—	11,973
Balance at 1 January 2005	1,960	27,912	4,608	(190)	(22,317)	—	11,973
Currency translation adjustments	—	—	—	307	—	1	308
Net income recognised directly to equity	—	—	—	307	—	1	308
(Loss)/profit for the year	—	—	—	—	(1,890)	51	(1,839)
Total recognised (expense)/income for the year	—	—	—	307	(1,890)	52	(1,531)
Shares issued	2,115	4,372	—	—	—	—	6,487
Employee share option scheme: – value of services provided	—	—	—	—	304	—	304
Balance at 31 December 2005	4,075	32,284	4,608	117	(23,903)	52	17,233

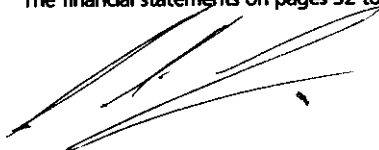
Company	Attributable to equity holders of the Company					Total equity £'000
	Share capital £'000	Share premium £'000	Merger and other reserves £'000	Profit and loss reserve £'000		
Balance at 1 January 2004	1,788	25,059	4,558	(13,754)		17,651
Loss for the year	—	—	—	(12,196)		(12,196)
Total recognised expense for the year	—	—	—	(12,196)		(12,196)
Shares issued	177	2,853	—	—		3,030
Shares in EBT	(5)	—	50	—		45
Employee share option scheme: – value of services provided	—	—	—	320		320
Balance at 31 December 2004	1,960	27,912	4,608	(25,630)		8,850
Balance at 1 January 2005	1,960	27,912	4,608	(25,630)		8,850
Loss for the year	—	—	—	(1,528)		(1,528)
Total recognised expense for the year	—	—	—	(1,528)		(1,528)
Shares issued	2,115	4,372	—	—		6,487
Employee share option scheme: – value of services provided	—	—	—	304		304
Balance at 31 December 2005	4,075	32,284	4,608	(26,854)		14,113

BALANCE SHEETS

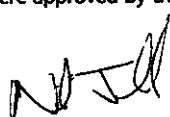
As at 31 December 2005

	Note	Group		Company	
		As at 31 December 2005 £'000	As at 31 December 2004 £'000	As at 31 December 2005 £'000	As at 31 December 2004 £'000
Non-current assets					
Goodwill	11	14,808	11,131	—	—
Other intangible assets	12	181	339	—	—
Property, plant and equipment	13	2,041	2,679	628	760
Investments	14	—	—	22,867	22,275
		17,030	14,149	23,495	23,035
Current assets					
Inventories	15	773	878	—	—
Trade and other receivables	16	3,212	4,348	3,196	2,490
Financial assets – cash and cash equivalents	17	2,313	1,990	2,568	1,888
		6,298	7,216	5,764	4,378
Current liabilities					
Trade and other payables	18	3,058	3,790	12,718	14,633
Financial liabilities – borrowings	19	301	3,039	—	2,013
Provisions	20	2,443	1,197	2,428	1,091
		5,802	8,026	15,146	17,737
Net current assets/(liabilities)		496	(810)	(9,382)	(13,359)
Total assets less current liabilities		17,526	13,339	14,113	9,676
Non-current liabilities					
Financial liabilities – borrowings	19	293	540	—	—
Provisions	20	—	826	—	826
		293	1,366	—	826
Net assets		17,233	11,973	14,113	8,850
Equity					
Issued share capital	22	4,075	1,960	4,075	1,960
Share premium	24	32,284	27,912	32,284	27,912
Other reserves	25	4,725	4,418	4,608	4,608
Profit and loss reserve	26	(23,903)	(22,317)	(26,854)	(25,630)
Total equity attributable to equity holders of the Parent Company		17,181	11,973	14,113	8,850
Minority interest		52	—	—	—
Total equity		17,233	11,973	14,113	8,850

The financial statements on pages 32 to 69 were approved by the Board on 24 April 2006 and signed on its behalf by:



Charles Green
Chief Executive Officer
24 April 2006



Dr Neil Johnston
Chief Financial Officer
24 April 2006

CASH FLOW STATEMENTS

For the year ended 31 December 2005

		Group		Company	
		Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
	Note				
Cash flows from operating activities					
Cash used in operations	28	(2,064)	(2,836)	(3,084)	(7,205)
Interest paid		(78)	(20)	(9)	(20)
Tax paid		—	(61)	—	—
Net cash used in operating activities		(2,142)	(2,917)	(3,093)	(7,225)
Cash flows from investing activities					
Acquisition of subsidiaries, net of cash acquired	5	(491)	(2,230)	—	—
Purchases of property, plant and equipment		(262)	(789)	—	(151)
Purchases of intangible assets		(30)	(248)	—	—
Proceeds from sale of property, plant and equipment		29	4,600	18	4,600
Proceeds from sale of intangible assets		405	—	—	—
Proceeds from sale of discontinued operations		—	555	—	555
Interest received		108	—	98	—
Net cash (used in)/generated from investing activities		(241)	1,888	116	5,004
Cash flows from financing activities					
Proceeds from the issue of share capital	22, 27	6,365	3,030	6,365	3,030
Repayment of borrowings		(2,937)	(1,494)	(1,986)	(1,914)
Payment of transaction costs		(695)	—	(695)	—
Finance lease principal repayments		(48)	(26)	(27)	(14)
Net cash generated from financing activities		2,685	1,510	3,657	1,102
Net increase/(decrease) in cash and cash equivalents		302	481	680	(1,119)
Cash and cash equivalents at beginning of year		1,990*	1,509	1,888*	3,007
Exchange gains on cash and cash equivalents		21	—	—	—
Cash and cash equivalents at end of year		2,313	1,990*	2,568	1,888*

* including a £2 million restricted cash deposit.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2005

1. ACCOUNTING POLICIES

Accounting policies for the year ended 31 December 2005

The principal accounting policies adopted in the preparation of these consolidated financial statements are set out below. These policies have been applied consistently to all the years presented, unless otherwise stated.

Basis of preparation

For all periods, up to and including the year ended 31 December 2004, Medical Solutions plc prepared its financial statements in accordance with UK Generally Accepted Accounting Practice ("UK GAAP"). From 1 January 2005, Medical Solutions plc is required to prepare consolidated financial statements, including comparative data, in accordance with those International Financial Reporting Standards adopted by the European Union.

Accordingly, these consolidated financial statements and the financial statements of the Company have been prepared in accordance with IFRS and International Financial Reporting Interpretation Committee ("IFRIC") interpretations and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS. The financial statements have been prepared under the historical cost convention.

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the balance sheet date of the financial statements and the reported amount of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates.

Forthcoming accounting standards

At the date of approval of these financial statements the following standards and interpretations which have not been applied in these financial statements were in issue but not yet effective: an amendment to IAS 1 Presentation of Financial Statements requiring new disclosures about entities' management of their capital resources (effective from 1 January 2007); amendments to IAS 39 Financial Instruments: Recognition and Measurement (effective from 1 January 2006); and a new accounting standard IFRS 7 Financial Instruments: Disclosures (effective from 1 January 2007). The latter standard replaces the disclosure requirements of IAS 32 Financial Instruments Disclosure and Presentation and locates in one place all disclosures relating to financial instruments. The new requirements incorporate many of IAS 32's disclosures as well as additional qualitative and quantitative disclosures on the risks arising from financial instruments.

The impact of adopting these standards and interpretations on the consolidated financial statements in future periods is not yet known.

Consolidation

The Group's consolidated financial statements include the results of the Parent Company and all its subsidiaries up to the relevant balance sheet date. A subsidiary is an entity controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of the entity so as to derive benefits from its activities. The results of subsidiaries acquired or sold are included in the financial statements for the periods from or to the date on which the transaction became unconditional. Intra-group sales, profits and balances are eliminated fully on consolidation.

Intangible assets

Goodwill

Goodwill represents the excess of fair value of the purchase consideration over the Group's share of the fair value of the identifiable net assets acquired. Goodwill is recognised as an asset and reviewed for impairment at least annually and whenever there is an indicator of impairment. Goodwill is carried at cost less accumulated impairment losses. Any impairment is recognised in the period in which it is identified. On disposal, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Development costs and acquired computer software

Development costs are written off as incurred except where the Directors are satisfied as to the technical, commercial and financial viability of individual projects. In such cases, the identifiable expenditure is deferred and amortised from the point of sale or use of the product on a straight-line basis over the period during which the Group is expected to benefit, usually four years. Development costs on projects in progress are not amortised. Provision is made for any impairment in the carrying value of such development costs. Acquired computer software is capitalised on the basis of the costs incurred to acquire and bring into use the specific software and is amortised over its operational life.

Tangible assets

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. Depreciation is provided on all tangible fixed assets at rates calculated to write off the cost less estimated residual value of each asset evenly over its expected operational life as follows:

Leasehold improvements: lower of 10 years and remaining lease term

Plant and machinery: 5–15 years

Fixtures, fittings and computer software: 3–10 years

Motor vehicles: 4 years

1. ACCOUNTING POLICIES (CONTINUED)

Impairment of assets

Assets that have an indefinite useful economic life are not subject to amortisation and are tested at least annually or whenever there is an indicator of impairment. Assets that are subject to amortisation or depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit and then to reduce the carrying amount of the other assets in the unit on a pro rata basis. Impairment losses are recognised in the income statement.

Government grants

Government grants of a capital nature are released to the income statement by equal annual instalments over the expected useful economic lives of the relevant assets.

Leasing and hire purchase commitments

As lessee

Assets obtained under finance leases and hire purchase contracts that transfer substantially all the risks and rewards of ownership to the Group are capitalised in the balance sheet and depreciated over the shorter of the lease term and their useful economic lives. The interest element of the rental obligation is charged to the income statement over the period of the lease and represents a constant proportion of the balance of the capital repayments outstanding.

Costs in respect of operating leases are charged to the income statement on a straight-line basis over the period of the lease.

As lessor

Amounts receivable under operating leases are included in revenue on a straight-line basis.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined on a first-in-first-out basis and includes transport and handling costs. In the case of manufactured products cost includes all direct expenditure and production overheads based on a normal level of activity. Net realisable value is the price at which inventory can be sold in the normal course of business after allowing for the cost of realisation and, where appropriate, the cost of conversion from their existing state to a finished condition. The Group capitalises certain external costs in relation to processed human tissue. Such costs are averaged over the number of samples acquired and written off to the income statement as the samples are utilised within the business or after a period of three years from acquisition if not used during that period. Provision is made where necessary for obsolete, slow-moving and defective inventory.

Interest

Interest receivable/payable is credited/charged to the income statement using the effective interest method.

Taxation

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

Deferred tax is accounted for using the balance sheet liability method in respect of temporary timing differences arising from differences between the carrying value of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Their carrying amount is reviewed at each balance sheet date on the same basis.

Deferred tax is calculated at the tax rates that are expected to apply in the period in which the liability is settled or the asset is realised, on a non-discounted basis, and is charged in the income statement, except where it relates to items charged or credited in the statement of recognised income and expense, in which case the deferred tax is also dealt with in equity and is shown in the income statement.

Revenue recognition

Turnover (excluding VAT) comprises the value of sales of contract pathology services, processed human tissue, the sale of telepathology hardware systems and associated software, support services and the sales of Liquid Based Cytology ("LBC") systems and testing kits. Amounts received or receivable for services provided under contract pathology services are recognised as revenue when obligations are fulfilled. Revenue from sales of processed human tissue, LBC systems and telepathology hardware systems is recognised when goods are delivered and accepted by the customer.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2005

1. ACCOUNTING POLICIES (CONTINUED)

LBC testing kits

The price charged by the Group for the LBC testing kits is specified in the Supply Agreements negotiated with each customer. The price is determined by the expected demand for testing kits over the term of the Supply Agreement, which is typically five years.

The price for the testing kits comprises an amount for laboratory consumables and reagents required to perform the tests and, where the LBC systems are supplied on a rental basis, an equipment premium, which is equivalent to a rental charge, and an amount for maintenance of the systems during the term of the Supply Agreement.

Revenue from the laboratory consumables and reagents is recognised when the testing kits are delivered and accepted by the customer. Revenue from the equipment premium and maintenance element is recognised on a straight-line basis over the period in which the customer is expected to benefit from the provisions of these elements of the supply.

Employee benefits

Defined contribution pension plans

Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

Share-based compensation

The Group operates a number of share option and share save schemes. For all grants of share options and awards, the fair value as at the date of grant is calculated using the Black-Scholes option pricing model and the corresponding expense is recognised over the vesting period.

Foreign currency

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange ruling at the balance sheet date. All differences are taken to the income statement.

The results of overseas operations are translated at the monthly average rate of exchange and their balance sheets at the rate ruling at the balance sheet date. Exchange differences arising on the translation of opening net assets and results of overseas operations are reported in the foreign currency translation reserve. Similarly, exchange differences arising on the translation of intercompany balances with overseas subsidiaries are reported in the foreign currency translation reserve to the extent that such balances are considered to form part of the net investment in that overseas subsidiary.

Business combinations

The Group accounts for business combinations by applying the purchase method of accounting as required by IFRS 3 Business Combinations.

Discontinued operations

In accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, the Group classified cash-generating units or groups of cash-generating units, as discontinued where they have been disposed of and represent a separate major line of business or geographical area of operations.

Segmental reporting

In accordance with IAS 14 Segment Reporting, a breakdown of certain data in the financial statements is given by segment and geographical region. The segments and regions are the same as those used for internal reporting. The aim is to provide users of the financial statements with information regarding the profitability and future prospects of the Group's various activities.

Medical Solutions is organised into two primary business segments: Pathology Services and Cytology. The Group's reportable segments are strategic business units that offer different services and products for which monthly financial information is provided to the Board and senior management.

Medical Solutions Pathology Services provides a variety of histopathology based services to public and private healthcare providers in the UK and Dubai, UAE. The division also provides specialised laboratory testing to the pharmaceutical and biotechnology industries.

Medical Solutions Cytology distributes and supports the SurePath™ LBC system and related consumables under licence from TriPath Imaging, Inc., USA.

All directly attributable costs are charged to the business segments. These predominantly represent costs of sales and establishment costs. Costs relating to central activities and shared services are not allocated to the business units but are controlled centrally and reported separately.

1. ACCOUNTING POLICIES (CONTINUED)

Cash and cash equivalents

Cash and cash equivalents comprises cash balances and call deposits with an original maturity of three months or less.

Provisions

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, when appropriate, the risks specific to the liability.

Post employment benefits

Employees of Medical Solutions' subsidiaries in Dubai, UAE are entitled to employee leaving indemnities, payable as a one-off sum, generally based on each employee's length of service, employment category and remuneration. The cost of providing these benefits is accrued over the employee's service period.

Restructuring

A provision for restructuring is recognised when the Group has approved a detailed, and formal, restructuring plan and the restructuring either has commenced or has been announced publicly. Future operating costs are not provided for.

Financial risk management

Financial risk factors

The Group's multinational operations expose it to a variety of financial risks that include foreign currency exchange rates, credit risks and interest rates. The Group has in place a risk management programme that continually assesses the potential adverse effects of these risks on the financial performance of the Group. Appropriate action is taken to mitigate the impact of such risks as necessary.

Foreign exchange risk

The Group has operations in the UK and Dubai, UAE. There is immaterial Group trading between the UK and Dubai. The foreign exchange risk is predominantly translational, arising on the conversion of the Dubai financial statements into Sterling on consolidation.

The Group is exposed to foreign exchange risk on US Dollar and Euro purchases although this exposure has not been assessed as significant enough for the Group to enter into forward foreign exchange contracts at the year end to hedge any risk. This position is continually reviewed and appropriate hedging transactions will be entered into where deemed appropriate.

Interest rate risk

The Group has both interest bearing assets and liabilities. Surplus cash is invested in a combination of overnight and weekly treasury deposits and *advantage is taken of the best interest rates available. At the year end, 100% of interest bearing assets and 71% of interest bearing liabilities were at fixed rates.*

Credit risk

The Group has no significant concentrations of credit risk. The Group has implemented policies that require appropriate credit checks on potential customers before sales commence which is augmented with standard contractual terms and conditions where appropriate.

Liquidity risk

The Group actively maintains a mixture of cash balances and short term treasury deposits designed to ensure that the Group has sufficient available funds for operations and planned capital expenditure. In addition, there is an overdraft facility of £300,000.

Price risk

The Group does not have any exposure to equity securities nor commodities price risk.

Accounting for derivative financial instruments and hedging activities

Borrowings are measured at amortised cost, except where they are hedged by an effective fair value hedge, in which case the carrying value is adjusted to reflect the fair value movements associated with the hedged risk.

Trade and other receivables are measured at amortised cost less any provision for impairment. Trade and other receivables are discounted when the time value of money is considered material.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2005

2. SEGMENTAL REPORTING

Primary reporting format – operating divisions

At 31 December 2005, the Group's trading operations were organised into two main operating divisions:

- Pathology Services
- Cytology

Pathology Services comprises the business units of UK Diagnostic Pathology, Dubai Diagnostic Pathology and Drug Development Services.

During 2005 there were immaterial sales between business segments (2004: £0.2 million), and where these do occur they are at arm's length pricing.

Unallocated costs represent corporate expenses and common operating costs. Segment assets include plant and equipment, stocks and debtors. Unallocated assets include property, central debtors and prepayments and operating cash.

Segment liabilities comprise operating liabilities and exclude borrowings. Segment capital expenditure comprises additions to plant and equipment.

Year ended 31 December 2005	Pathology Services			Cytology £'000	Unallocated £'000	Group £'000
	UK Diagnostic Pathology £'000	Dubai Diagnostic Pathology £'000	Drug Development Services £'000			
Continuing operations						
Revenue	2,415	5,017	773	2,467	—	10,672
Segment result	121	1,617	(740)	183	(2,877)	(1,696)
Interest expense					(251)	(251)
Interest income					108	108
Loss before tax					(3,020)	(1,839)
Taxation					—	—
Loss for the year from continuing operations					(3,020)	(1,839)
Profit attributable to minority interests		(51)			—	(51)
Net loss attributable to equity shareholders					(3,020)	(1,890)
Segment assets	1,392	16,399	719	1,678	—	20,188
Unallocated assets						
– property, plant and equipment					737	737
– debtors and prepayments					322	322
– cash and cash equivalents					2,081	2,081
Total assets	1,392	16,399	719	1,678	3,140	23,328
Segment liabilities	240	2,839	420	603	—	4,102
Unallocated liabilities						
– corporate borrowings					490	490
– creditors and accruals					1,503	1,503
Total liabilities	240	2,839	420	603	1,993	6,095
Other segment items						
Capital expenditure	2	3	2	169	86	262
Acquisition of subsidiaries	—	3,761	—	—	—	3,761
Depreciation	115	54	80	254	197	700
Amortisation of intangible assets	58	—	3	—	—	61
Impairment of development costs	64	—	—	—	—	64
Other non-cash expenses						
– share option scheme	—	—	—	—	304	304

2. SEGMENTAL REPORTING (CONTINUED)

Year ended 31 December 2004	Pathology Services			Cytology £'000	Unallocated £'000	Group £'000
	UK Diagnostic Pathology £'000	Dubai Diagnostic Pathology £'000	Drug Development Services £'000			
Continuing operations						
Sales to external customers	2,244	2,832	692	258	—	6,026
Sales to other segments	—	—	—	160	(160)	—
Revenue	2,244	2,832	692	418	(160)	6,026
Segment result	(2,178)	602	(888)	(672)	(5,309)	(8,445)
Interest expense					(264)	(264)
Loss before tax					(5,573)	(8,709)
Taxation					(90)	(90)
Loss for the year from continuing operations					(5,663)	(8,799)
Discontinued operations						
Revenue	560					560
Segment result	(167)					(167)
Loss on disposal of operation	(469)					(469)
Loss before tax	(636)					(636)
Taxation	—					—
Loss for the year from discontinued operations	(636)					(636)
Net loss attributable to equity shareholders					(5,663)	(9,435)
Segment assets	1,968	13,608	1,535	1,229	—	18,340
Unallocated assets						
– property, plant and equipment					931	931
– debtors and prepayments					146	146
– cash and cash equivalents					1,948	1,948
Total assets	1,968	13,608	1,535	1,229	3,025	21,365
Segment liabilities	408	2,404	258	459	—	3,529
Unallocated liabilities						
– corporate borrowings					3,427	3,427
– creditors and accruals					2,436	2,436
Total liabilities	408	2,404	258	459	5,863	9,392
Other segment items						
Capital expenditure	264	163	6	344	185	962
Depreciation	87	40	116	217	435	895
Amortisation of intangible assets	145	—	80	—	—	225
Impairment of intangible assets	1,120	—	106	—	—	1,226
Impairment of goodwill	—	—	—	—	1,823	1,823
Other non-cash expenses						
– share option scheme	—	—	—	—	320	320

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2005

2. SEGMENTAL REPORTING (CONTINUED)

Secondary format – geographical segments

The Group manages its business segments on a global basis. The operations are based in two main geographical regions. The UK is the home country of the Parent Company. The main operations in the principal territories are as follows:

Region	Activity
UK	Diagnostic pathology, cytology and drug development services
Middle East	Diagnostic pathology and cytology

The Middle East segment operations are based in Dubai, UAE.

The sales analysis in the table below is based on the location of the customer, which is not materially different from the location where the order is received and where the assets are located.

	Revenue		Segment assets		Capital expenditure	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000	2005 £'000	2004 £'000
Continuing operations						
UK	5,607	3,094	6,929	7,757	256	799
Middle East	5,017	2,832	16,399	13,608	3,764	163
European (non-UK)	40	258	—	—	—	—
North America	8	2	—	—	—	—
	10,672	6,186	23,328	21,365	4,020	962
Discontinued operations						
UK	—	315	—	—	—	—
North America	—	245	—	—	—	—
	—	560	—	—	—	—
Internal sales	—	(160)	—	—	—	—
Total	10,672	6,586	23,328	21,365	4,020	962

Analysis of revenue by category

The Group's revenue from continuing operations is analysed as follows:

	2005 £'000	2004 £'000
Revenue from the provision of services	7,796	5,411
Revenue from sales of goods	2,617	566
Revenue from operating lease rentals	259	49
Total	10,672	6,026

For discontinued operations see note 8.

3. EXCEPTIONAL ADMINISTRATIVE EXPENSES

Consolidation of UK Diagnostic Pathology operations and other restructuring costs

As set out in the Chairman's Statement, the Board took the decision during the year to consolidate its UK Diagnostic Pathology operations in Nottingham and close its facility in Harley Street, London. The decision to transfer operations and make a number of staff redundant was implemented during July 2005 and the Group has incurred costs of £255,000 during the year in connection with the closure. In addition, the Group has incurred costs of a further £92,000 in respect of redundancies made at its Nottingham operations during the year (2004: £181,000 Nottingham and Harley Street, London operations).

Impairment of capitalised development costs

Following a review conducted by the Directors, including the commercial and operational prospects of the various projects, the carrying values of certain capitalised development costs have been impaired by £64,000 to fully write off those capitalised costs considered as impaired (2004: £1,226,000) (note 12). In 2004 an additional cost of £1,823,000 was also incurred in respect of the impairment of goodwill (note 11).

4. PROFIT ON SALE OF FIXED ASSETS

In line with the Group's previously stated intention to exit the virtual microscopy equipment activity of the business, the sale of certain intellectual property assets, along with microscopy equipment, to Hamamatsu Photonics KK was completed in May 2005. Consideration for the assets was £450,000, which generated a profit on disposal of £387,000. Of the consideration, £405,000 was received in cash with the balance subject to withholding tax.

5. ACQUISITIONS OF SUBSIDIARIES

On 14 January 2005, the Group completed the acquisitions of Dubai Medical Laboratory ("DML") and Specialised Clinical Laboratory ("SCL"). The acquisitions were made by two newly established 100% subsidiaries of Medical Solutions FZ LLC, DML FZ LLC and SCL FZ LLC respectively. These subsidiaries entered into civil partnership agreements with the existing laboratory owners to effectively acquire 80% (DML) and 100% (SCL) of the existing laboratory businesses. Medical Solutions FZ LLC is a 100% owned subsidiary of the Company. Each of the acquisitions was deemed unconditional on 14 January 2005.

Dubai Medical Laboratory

DML FZ LLC acquired an 80% shareholding in DML, a clinical analytical and diagnostic services laboratory which operates as a civil partnership registered in the Emirate of Dubai. DML FZ LLC acquired the 80% holding in DML for total consideration of approximately £1.8 million. The total purchase consideration can be broken down into cash of £1.2 million and 3,887,853 new ordinary shares in Medical Solutions plc, with a fair value of £267,000 (based on the Company's share price at the date of acquisition). The Group incurred legal and professional costs of £261,000 in connection with the acquisition of DML. At the date of acquisition, DML had net assets of £77,000.

In the period between 14 January 2005 and 31 December 2005, DML contributed net profits of £244,000 to the consolidated net loss for the year.

Specialised Clinical Laboratory

SCL FZ LLC acquired 100% of SCL, a provider of clinical laboratory services. SCL operates as a civil partnership registered in the Emirate of Dubai. SCL FZ LLC acquired the 100% holding in SCL for total consideration of approximately £1.2 million. The total purchase consideration can be broken down into cash of £0.9 million and 3,575,730 new ordinary shares in Medical Solutions plc, with a fair value of £246,000 (based on the Company's share price at the date of acquisition). The Group incurred legal and professional costs of £52,000 in connection with the acquisition of SCL. At the date of acquisition SCL had net assets of £18,000.

In the period between 14 January 2005 and 31 December 2005, SCL contributed net profits of £265,000 to the consolidated net loss for the year.

Had the acquisitions of DML and SCL occurred on 1 January 2005, Group revenues would have been £29,000 higher and the net loss reduced by £9,000.

The acquisitions had the following effect on the Group's assets and liabilities:

	Recognised value and carrying amount	
	DML £'000	SCL £'000
Acquiree's net assets at date of acquisition:		
Property, plant and equipment	22	12
Inventories	55	6
Net identifiable assets and liabilities	77	18
Goodwill on acquisition	1,693	1,161
Satisfied by:		
Satisfied in cash*	1,503	933
Satisfied in shares	267	246
Consideration paid	1,770	1,179

* Includes legal fees and costs amounting to £261,000 and £52,000 in respect of DML and SCL respectively.

Of the consideration satisfied in cash, £2,030,000 was prepaid during 2004 and the balance of £406,000 was settled during 2005, along with £85,000 of deferred consideration and associated legal costs relating to the acquisition of HSL.

In accordance with IFRS 3 Business Combinations and IAS 38 Intangible Assets, the acquiring party is required to recognise separately an intangible asset of the acquiree if it meets the definition of an intangible asset and its fair value can be measured reliably. The Board has not identified any exchange transactions in respect of the same or similar non-contractual customer relationships that might otherwise have provided evidence of fair value or separability. As such, the Board does not believe it would be appropriate to recognise any intangible assets separately from goodwill at the date of acquisition.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2005

6. FINANCE COSTS – NET

	Group		Company	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000
Interest expense:				
Interest payable on bank borrowings	7	16	7	16
Interest payable on other loans	55	—	—	—
Interest payable on finance leases	15	4	1	4
Unwinding of discounts in provisions (note 20)	174	244	174	214
Interest and similar charges payable	251	264	182	234
Interest income:				
Interest receivable	108	—	98	—
Finance costs – net	143	264	84	234

7. LOSS BEFORE TAXATION

	Group		Company	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000
The following items have been included in arriving at operating profit:				
Staff costs (note 30)	4,449	4,020	1,051	1,037
Depreciation of property, plant and equipment				
– owned assets	501	615	103	102
– under finance leases	199	280	7	6
Amortisation of intangibles (included in administrative expenses)	61	225	—	—
Impairment of goodwill (included in administrative expenses)	—	1,823	—	—
Impairment of development costs (included in administrative expenses)	64	1,226	—	—
(Profit)/loss on disposal of fixed assets	(383)	(607)	4	(945)
Other operating lease rentals payable				
– property	602	452	—	—
– motor vehicles	16	13	12	13
– fixtures and fittings	77	28	—	—
Repairs and maintenance expenditure on property, plant and equipment	37	46	—	—
Research and development expenditure	207	103	—	—
Trade receivable impairment	(23)	60	—	—
Amortisation of government grants	67	—	67	—
Restructuring costs	347	181	—	151

Services provided by the Group's auditor and network firms

During the year the Group (including its overseas subsidiaries) obtained the following services from the Group's auditor as detailed below:

	Group		Company	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000
Audit services				
– statutory audit	38	59	5	5
Further assurance services	18	—	18	—
Tax services				
– compliance services	—	44	—	44
– advisory services	3	38	3	38
Other services not covered above	—	160	—	160
	59	301	26	247

8. DISCONTINUED OPERATIONS

Group	2005 £'000	2004 £'000
Post tax results from discontinued operations	—	(167)
Loss on disposal of subsidiary net tangible assets	—	(469)
Taxation	—	—
Net loss on disposal	—	(469)
Total	—	(636)

In June 2004, the Group disposed of the trade and assets of Kinetic Imaging Limited and Kinetic Imaging, Inc., generating a loss on disposal of £469,000 after accounting for unamortised goodwill and certain transaction-related legal and professional costs.

Cash flows from discontinued operations

Group	2005 £'000	2004 £'000
Net cash outflows from operating activities	—	(252)
Net cash flows from investing activities	—	—
Net cash flows from financing activities	—	—
Total	—	(252)

During 2004, discontinued operations contributed £560,000 to revenue and a loss of £167,000 to pre-tax loss, after expenses of £727,000. There was no impact on the tax charge as a result of this transaction. The discontinued operations formed part of the UK Diagnostic Pathology business segment.

9. TAXATION

Analysis of charge in year

Group	2005 £'000	2004 £'000
Current tax		
– continuing operations	—	90
Deferred tax (note 21)		
– continuing operations	—	—
Taxation charge	—	90

The tax for the year is lower (2004: lower) than the standard rate of corporation tax in the UK (30%) (2004: 30%). The charge for the year can be reconciled to the loss per the income statement as follows:

Group	2005 £'000	2004 £'000
Loss on ordinary activities before tax	(1,839)	(9,345)
Loss on ordinary activities multiplied by rate of corporation tax of 30%	(552)	(2,804)
Effects of:		
Expenses not deductible for tax purposes including impairment	8	1,181
Crystallisation of gain previously rolled over	—	582
Research and development tax relief	—	(18)
Profit on disposal of non-qualifying assets	—	(75)
Earnings of overseas subsidiary not subject to tax	(485)	(181)
Losses not recognised	1,029	1,315
Adjustments in respect of previous periods	—	90
Total taxation charge (continuing operations)	—	90

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10. LOSS PER SHARE

The calculation of basic and diluted earnings per share for the year was based on the loss attributable to ordinary shareholders of £1,890,000 (2004: loss of £9,435,000) on 196,780,731 ordinary shares (2004: 92,597,733 ordinary shares) being the weighted average number of ordinary shares in issue.

IAS 33 Earnings per Share requires presentation of diluted earnings per share when a company could be called upon to issue shares that would decrease net profit or increase net loss per share. Net loss per share in a loss-making company would only be increased by the exercise of share options, which were out of the money. Assuming that option holders will not exercise out-of-the-money options, no adjustment has been made to the diluted loss per share for out-of-the-money share options.

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year.

Reconciliation of the earnings and weighted average number of shares used in the calculations are set out below:

	2005			2004		
	Earnings £'000	Weighted average number of shares '000s	Per share amount (pence)	Earnings £'000	Weighted average number of shares '000s	Per share amount (pence)
Basic and diluted EPS						
Earnings attributable to ordinary shareholders	(1,890)	196,781	(0.96)	(9,435)	92,598	(10.19)
Earnings per share from continuing operations						
Basic and diluted EPS						
Profit on sale of subsidiary	(1,890)	196,781	(0.96)	(9,435)	92,598	(10.19)
Pre-tax loss from discontinued operations	—	—	—	636	—	(0.69)
Basic and diluted EPS from continuing operations	(1,890)	196,781	(0.96)	(8,799)	92,598	(9.50)

11. INTANGIBLE FIXED ASSETS – GOODWILL

Group	2005 £'000	2004 £'000
Cost		
At 1 January	13,694	14,078
Acquisitions – through business combinations	3,474	–
Disposals	–	(384)
Exchange adjustments	199	–
At 31 December	17,367	13,694
Aggregate amortisation and impairment		
At 1 January 2005	2,563	806
Adjustment to accumulated amortisation	(4)	–
Impairment	–	1,823
Disposals	–	(66)
At 31 December	2,559	2,563
Net book amount at 31 December	14,808	11,131

The Company has £nil (2004: £nil) intangible fixed assets – goodwill.

The 2005 impairment review was initially undertaken at 30 June 2005 and then updated as at 31 December 2005. The review was conducted on a "value in use" basis and assessed whether the carrying value of goodwill was supported by the net present value of future cash flows derived from the attributable assets. A projection period of two years was used for the UK Diagnostic Pathology cash-generating unit ("CGU") and three years for the Dubai Diagnostic Pathology CGUs. After these periods, annual growth rates of 2% and 3% for the UK and Dubai Diagnostic Pathology CGUs respectively have been assumed in perpetuity. The projections for the initial two and three years were derived from existing budgets and three year plans, and represent the base period.

The projections have been discounted using the Group's weighted average cost of capital of 13.93%.

The carrying value of goodwill attributable to each CGU at 31 December 2005 is as follows:

Business segment

CGU	UK Diagnostic Pathology £'000	Dubai Diagnostic Pathology				Group 2005 £,000
		Welcare £'000	HSL £'000	DML £'000	SCL £'000	
Goodwill carrying value	582	11,030	151	1,806	1,239	14,808

The estimates and assumptions made in connection with impairment testing could differ from future actual results of operations and cash flows. Further, future events could cause the Company to conclude that impairment indicators exist and that the asset values associated with a given operation have become impaired. Any resulting impairment loss could have a significant impact on the Company's financial condition and results of operations. The carrying value of goodwill and other intangible assets will continue to be reviewed at least annually for impairment and adjusted to the recoverable amount if required.

At 31 December 2004 the goodwill relating to Fairfield Imaging Limited and Second Opinion Solutions AS, Norway, was impaired by £1,823,000 to £nil, being the value in use, as these entities ceased to trade during that year.

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For the year ended 31 December 2005

12. INTANGIBLE FIXED ASSETS – DEVELOPMENT COSTS

Group	2005 £'000	2004 £'000
Cost		
At 1 January	2,142	2,730
Acquisitions – internally generated	30	248
Disposals	(85)	(836)
At 31 December	2,087	2,142
Aggregate amortisation and impairment		
At 1 January	1,803	1,032
Charge for the year	61	225
Impairment	64	1,226
Disposals	(22)	(680)
At 31 December	1,906	1,803
Net book amount at 31 December	181	339

Intangible fixed assets – development costs represent the costs, and associated amortisation, of internally generated software. All amortisation charges in the year have been charged through administrative expenses. The Company has £nil (2004: £nil) intangible fixed assets – development costs.

During the year, internally developed software applications were impaired by £64,000 (2004: £1,226,000) to £nil, as they have been assessed as having no external commercial or internal value in use to the Group.

13. PROPERTY, PLANT AND EQUIPMENT

a) Group

2005	Freehold land and buildings £'000	Leasehold improvements £'000	Plant and machinery £'000	Computer software, fixture and fittings £'000	Motor vehicles £'000	Total £'000
Cost or valuation						
At 1 January 2005	–	748	1,045	1,939	103	3,835
Exchange adjustments	–	–	–	16	–	16
Additions at cost	–	11	169	79	3	262
Acquisitions	–	–	–	34	–	34
Disposals	–	–	(25)	(260)	(95)	(380)
At 31 December 2005	–	759	1,189	1,808	11	3,767
Accumulated depreciation						
At 1 January 2005	–	72	183	858	43	1,156
Charge for the year	–	76	220	391	13	700
Disposals	–	–	(4)	(73)	(53)	(130)
At 31 December 2005	–	148	399	1,176	3	1,726
Net book amount at 31 December 2005	–	611	790	632	8	2,041

13. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

a) Group (continued)

2004	Freehold land and buildings £'000	Leasehold improvements £'000	Plant and machinery £'000	Computer software, fixture and fittings £'000	Motor vehicles £'000	Total £'000
Cost or valuation						
At 1 January 2004	4,059	—	701	2,282	175	7,217
Exchange adjustments	—	—	—	(9)	—	(9)
Additions at cost	—	151	344	454	13	962
Transfers	(641)	641	—	—	—	—
Disposals	(3,418)	(44)	—	(788)	(85)	(4,335)
At 31 December 2004	—	748	1,045	1,939	103	3,835
Accumulated depreciation						
At 1 January 2004	—	—	—	559	64	623
Charge for the year	—	73	183	617	22	895
Disposals	—	(1)	—	(318)	(43)	(362)
At 31 December 2004	—	72	183	858	43	1,156
Net book amount at 31 December 2004	—	676	862	1,081	60	2,679

Assets held under finance leases and chattel mortgages have the following net book amount:

	2005				2004			
	Plant and machinery £'000	Fixtures and fittings £'000	Motor vehicles £'000	Total £'000	Plant and machinery £'000	Fixtures and fittings £'000	Motor vehicles £'000	Total £'000
Cost	652	433	—	1,085	652	433	77	1,162
Aggregate depreciation	(255)	(316)	—	(571)	(124)	(254)	(42)	(420)
Net book amount	397	117	—	514	528	179	35	742

In accordance with IFRS 1 First Time Adoption of International Financial Reporting Standards and IAS 17 Leases, the Group has reviewed the classification of all leases at the opening balance sheet date of 1 January 2004.

Plant and machinery includes:

	2005 £'000	2004 £'000
Assets held for use in operating leases:		
Cost	1,189	1,045
Aggregate depreciation	(179)	—
Charge for year	(220)	(183)
Net book amount	790	862

Plant and machinery held for use in operating leases relate to LBC machines and ancillary equipment supplied to Health Authorities and hospitals in England and Wales under consumable supply, rental and maintenance agreements. These agreements are typically for a period of five years. At the year end there were 41 (2004: 38) LBC machines held for use under such agreements.

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13. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

b) Company

	Freehold land and buildings £'000	Leasehold improvements £'000	Computer software, fixture and fittings £'000	Motor vehicles £'000	Total £'000
2005					
Cost or valuation					
At 1 January 2005	—	748	93	58	899
Additions at cost	—	—	—	—	—
Disposals	—	—	—	(58)	(58)
At 31 December 2005	—	748	93	—	841
Accumulated depreciation					
At 1 January 2005	—	72	38	29	139
Charge for the year	—	76	27	7	110
Disposals	—	—	—	(36)	(36)
At 31 December 2005	—	148	65	—	213
Net book amount at 31 December 2005	—	600	28	—	628

	Freehold land and buildings £'000	Leasehold improvements £'000	Computer software, fixture and fittings £'000	Motor vehicles £'000	Total £'000
2004					
Cost or valuation					
At 1 January 2004	4,059	—	93	118	4,270
Additions at cost	—	151	—	—	151
Transfers	(641)	641	—	—	—
Disposals	(3,418)	(44)	—	(60)	(3,522)
At 31 December 2004	—	748	93	58	899
Accumulated depreciation					
At 1 January 2004	—	—	11	39	50
Charge for the year	—	73	27	16	116
Disposals	—	(1)	—	(26)	(27)
At 31 December 2004	—	72	38	29	139
Net book amount at 31 December 2004	—	676	55	29	760

14. INVESTMENTS

Fixed asset investments

	Group		Company	
	2005	2004	2005	2004
	£'000	£'000	£'000	As restated £'000
Shares in Group undertakings				
Cost at 1 January	—	2	33,238	33,238
Additions in year	—	—	592	—
Disposals	—	(2)	—	—
	—	—	33,830	33,238
Aggregate impairment	—	—	(10,963)	(10,963)
Net book amount at 31 December	—	—	22,867	22,275

For details of the restatement, see note 36.

14. INVESTMENTS (CONTINUED)

The subsidiary undertakings of Medical Solutions plc and their respective activities were as follows at 31 December 2005:

	Country of incorporation	Principal activity	Percentage held
Pathlore Ltd	England	Provision of pathology services	100%
Medical Solutions London Limited	England	Histopathology services	100%
Fairfield Imaging Limited	England	Dormant	100%
Fairfield Research Limited	England	Dormant	100% ²
Fairfield Telepathology Limited	England	Dormant	100% ²
Medical Solutions (Leeds) Limited	England	Dormant	100%
Kinetic Imaging Limited	England	Dormant	100%
Kinetic Imaging, Inc.	USA	Dormant	100% ³
Quinoderm Limited	England	Dormant	100% ⁴
Histological Solutions Limited	England	Dormant	100%
Second Opinion Solutions AS	Norway	Holds intellectual property	73.5%
Medical Solutions FZ LLC	UAE	Pathology laboratory and intermediate holding company	100%
Dubai Medical Laboratory FZ LLC	UAE	Intermediate holding company	100%
Specialised Clinical Laboratory FZ LLC	UAE	Intermediate holding company	100%
Dubai Medical Laboratory (Civil Partnership)	UAE ¹	Pathology laboratory	80%
Specialised Clinical Laboratory (Civil Partnership)	UAE ¹	Pathology laboratory	100%
Histopathology and Speciality Laboratory (Civil Partnership)	UAE ¹	Pathology laboratory	100%

1. These businesses are partnerships and therefore registered, rather than incorporated, in UAE.

2. Held indirectly via Fairfield Imaging Limited.

3. Held indirectly via Kinetic Imaging Limited.

4. Held indirectly via Medical Solutions (Leeds) Limited.

All of the above entities are included in the consolidated results of the Group.

All of the above entities have an accounting reference date of 31 December other than Histological Solutions Limited which is 31 January. This was the accounting reference date on acquisition at which time the trade and assets of Histological Solutions Limited were hived into Pathlore Ltd leaving the company dormant.

15. INVENTORIES

	Group		Company	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000
Raw materials	350	609*	—	—
Work in progress	10	36	—	—
Finished goods	413	233*	—	—
	773	878	—	—

* £157,000 of consumable stock relating to the LBC activities of the Group have been reclassified from Raw materials to Finished goods as the Directors believe this more accurately reflects the nature of these inventories.

The Group consumed £2,509,000 (2004: £1,675,000) of inventories during the year and applied a write down of £304,000 (2004: £170,000) to specific Raw materials stock to reflect the net realisable value of those items.

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16. TRADE AND OTHER RECEIVABLES

	Group		Company	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000
Amounts falling due within one year:				
Trade debtors	2,762	1,267	—	—
Less: Provision for impairment of receivables	(84)	(77)	—	—
Trade debtors net	2,678	1,190	—	—
Amounts owed by Group	—	—	3,173	46
Other debtors	157	234	12	183
Prepayments and accrued income	377	2,924	11	2,261
	3,212	4,348	3,196	2,490

17. CASH AND CASH EQUIVALENTS

	Group		Company	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000
Cash and cash equivalents				
Cash at bank and in hand	238	1,990	493	1,888
Short term bank deposits	2,075	—	2,075	—
	2,313	1,990*	2,568	1,888*

* including a restricted cash deposit of £2 million.

The weighted average interest rate on short term deposits at the year end was 4.06% (2004: nil deposits) and these deposits have an average maturity of six days (2004: nil deposits).

18. TRADE AND OTHER PAYABLES – CURRENT

	Group		Company	
	2005 £'000	2004 £'000	2005 £'000	2004 As restated £'000
Trade payables	1,827	2,338	172	576
Amounts owed to Group undertakings	—	—	12,171	13,250
Current tax	—	29	—	29
Other tax and social security	165	133	32	—
Other creditors	62	—	—	—
Accruals	832	1,095	215	583
Deferred income	172	195	128	195
	3,058	3,790	12,718	14,633

For details of the restatement, see note 36.

19. FINANCIAL LIABILITIES – BORROWINGS

	Group		Company	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000
Current				
Bank loans	277	2,298	—	1,986
Overdraft	—	678	—	—
Finance lease obligations	24	63	—	27
	301	3,039	—	2,013
	Group		Company	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000
Non-current (all due within five years)				
Bank loans	213	451	—	—
Finance lease obligations	80	89	—	—
	293	540	—	—

Overdrafts of the Group are secured by floating charges over certain assets of Medical Solutions plc and Pathlore Ltd.

Bank loans of £490,000 (2004: £763,000) represent chattel mortgages secured over certain assets of Pathlore Ltd, of which £314,000 is at a fixed rate of interest and £176,000 at a variable rate of interest. At 31 December 2004, the bank loan of the Company was secured by a fixed charge over a £2 million cash deposit held by the Company. Bank loans are denominated in Sterling. Variable interest rates are based at LIBOR.

The weighted average interest rates at the balance sheet dates were as follows:

	2005		2004	
	Fixed %	Variable %	Fixed %	Variable %
Bank overdraft	—	—	—	6.4
Bank loans	6.1	6.5	6.2	6.6
Finance leases	11.3	—	11.3	—

20. PROVISIONS

Group	Deferred consideration on acquisitions £'000	Other £'000	Total £'000
At 1 January 2004	2,122	—	2,122
Revision to consideration	(143)	—	(143)
Settlement of deferred consideration in cash	(200)	—	(200)
Amortisation of discount (note 6)	244	—	244
At 31 December 2004	2,023	—	2,023
At 1 January 2005	2,023	—	2,023
Revision to consideration	611	15	626
Settlement of deferred consideration in cash	(76)	—	(76)
Settlement of deferred consideration in shares	(304)	—	(304)
Amortisation of discount (note 6)	174	—	174
At 31 December 2005	2,428	15	2,443

This can be analysed between current and non-current as follows:

	Group		Company	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000
Current	2,443	1,197	2,428	1,091
Non-current	—	826	—	826
	2,443	2,023	2,428	1,917

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20. PROVISIONS CONTINUED

Deferred consideration for acquisitions

During May 2003, the Company entered into an agreement with Welcare Hospital LLC, Dubai, Welcare Hospitals Management Company Limited and Mr S Varkey to acquire the Welcare pathology laboratory ("the Welcare Laboratory") and to supply pathology services to Welcare Hospital over a 20 year period. The consideration for the acquisition comprised an initial payment of £7 million together with further deferred consideration of up to £5 million. The quantum of the deferred consideration being dependent upon performance of the Welcare Laboratory in the three year period subsequent to the acquisition by the Company, with final settlement of the balance of deferred consideration due in June 2006. As the Company believes that there is a high level of certainty that this deferred consideration will become payable, it has been provided for.

Further, under IAS 19 Financial Instruments: Recognition and Measurement, when the settlement of a liability is deferred, the fair value of the deferred element payable is discounted to its fair value. Accordingly, the deferred consideration payable on the acquisition of the Welcare Laboratory has been discounted and classified as a current (2004: current and non-current) liability. The cost of the discount is systematically charged to profit and loss as a finance cost over the period until the deferred consideration is settled (note 6).

21. DEFERRED TAX

The following are the major deferred tax liabilities and assets not recognised by the Group and movements thereon during the current and prior year:

Deferred tax assets and liabilities	Accelerated tax depreciation £'000	Tax losses £'000	Total £'000
At 1 January 2004	131	(155)	(24)
Movement in the year	(72)	(1,413)	(1,485)
At 31 December 2004	59	(1,568)	(1,509)
At 1 January 2005	59	(1,568)	(1,509)
Movement in the year	17	(898)	(881)
At 31 December 2005	76	(2,466)	(2,390)

At the balance sheet date, the Group has unused tax losses of £8.2 million (2004: £5.2 million) available for offset of future profits. A deferred tax asset has been recognised for £0.3 million (2004: £0.2 million) of the losses to offset the liability arising on the accelerated capital allowances. No deferred tax asset has been recognised in respect of the remaining £7.9 million of losses (2004: £5.0 million) due to the unpredictability of future profit streams.

No deferred tax asset has been recognised in respect of unremitted earnings from the Dubai subsidiaries, which are subject to UK tax if dividends are paid and no UK losses arise in the same period. No taxable remittances are anticipated in the foreseeable future with an exit from Dubai planned.

Potential deferred tax assets arise on the unrealised gains on employee share options as a tax deduction for the intrinsic value is available to the Company on exercise. These have not been recognised in view of the losses carried forward but the potential asset was £20,000 at 31 December 2005 (2004: £nil, 2003: £630,000).

22. CALLED UP SHARE CAPITAL

Group and Company

	2005		2004	
	Number	£'000	Number	£'000
Authorised				
Ordinary shares of 2p each	350,000,000	7,000	130,000,000	2,600
Issued and fully paid				
	Number	£'000	Number	£'000
Ordinary shares of 2p each				
At 1 January	97,994,108	1,960	89,403,240	1,788
Issued and fully paid	105,771,124	2,115	8,840,868	177
Shares cancelled	—	—	(250,000)	(5)
At 31 December	203,765,232	4,075	97,994,108	1,960

During the year a total of 105,771,124 ordinary shares of 2p each were issued (2004: 8,840,868) for total consideration of £7,182,000 (2004: £3,139,000). Of this amount, £6,365,000 was raised in cash (note 27); £304,000 in settlement of deferred consideration outstanding in respect of the Welcare Laboratory and HSL (note 20) and £513,000 as part consideration for the acquisitions of DML and SCL (note 5).

22. CALLED UP SHARE CAPITAL CONTINUED

Potential issues of ordinary shares

Certain senior executives and employees hold options to subscribe for shares in the Company at prices ranging from 6.25p to 48.00p under the share option schemes approved by shareholders in 1999 and 2001. No options on shares were exercised in 2005 (2004: nil). The number of shares subject to options, the periods in which they were granted and the periods in which they may be exercised are given below:

Year of grant	Exercise price (pence)	Exercise period	2005 Number	2004 Number
1999	48.00	28 September 2002 to 27 September 2009	416,667	416,667
2000	124.00	9 May 2003 to 8 May 2010	—	2,500
2002	27.75	25 March 2005 to 24 March 2012	25,000	25,000
2003	22.00	13 January 2006 to 12 January 2013	3,335,824	3,335,824
2003	22.00	13 January 2006 to 12 January 2013	2,004,267	2,474,267
2003	32.50	22 September 2006 to 21 September 2013	1,130,000	1,420,000
2003	46.00	27 October 2006 to 26 October 2013	—	40,000
2004	34.25	16 October 2007 to 15 October 2014	133,695	181,532
2005	6.25	3 May 2008 to 2 May 2015	1,025,000	—
2005	6.75	19 January 2008 to 18 January 2015	4,000,000	—
			12,070,453	7,895,790

23. SHARE-BASED COMPENSATION

The Company has three share-related schemes in place, being the 1999 unapproved share option scheme, the 2001 Inland Revenue approved share option scheme and the Inland Revenue approved savings related scheme.

Under the 1999 unapproved and 2001 Inland Revenue approved schemes (collectively the "share option schemes"), the Remuneration Committee can grant options over shares in the Company to employees of the Company. Options are granted with a fixed exercise price equal to the market price of the shares under option at the date of grant. The contractual life of an option is ten years. Awards under the share option schemes are generally reserved for employees at senior management level and above and ten employees are currently eligible to participate in this group. There are no reload features. The Company does not make annual grants on a fixed date, but rather at the discretion of the Remuneration Committee.

Options granted under the share option schemes will become exercisable on the third anniversary of the date of grant. Exercise of an option is subject to continued employment. Options were valued using the Black-Scholes option-pricing model. No performance conditions were included in the fair value calculations. The fair value per option granted and the assumptions used in the calculation are as follows:

Grant date	3 May 2005	19 January 2005	15 October 2004
Share price at grant date	6.25p	6.75p	34.25p
Exercise price	6.25p	6.75p	34.25p
Number of employees	72	1	15
Shares under option	1,800,000	4,000,000	181,532
Vesting period (years)	3	3	3
Expected volatility	76.2%	74.6%	76.2%
Option life (years)	7	7	7
Expected life (years)	3.25	4.00	3.25
Risk free rate	4.1%	4.1%	4.1%
Expected dividends expressed as a dividend yield	nil	nil	nil
Possibility of ceasing employment before vesting	49.3%	nil	30.0%
Expectations of meeting performance criteria	N/A	N/A	N/A
Fair value per option	3.39p	3.93p	18.52p

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23. SHARE-BASED COMPENSATION CONTINUED

The expected volatility is based on historical volatility over the last three years and the expected life is the average expected period to exercise. The risk free rate of return is the yield on zero-coupon UK Government bonds of a term consistent with the assumed option life. A reconciliation of option movements over the year to 31 December 2005 is shown below:

	2005		2004	
	Number	Weighted average exercise price (pence)	Number	Weighted average exercise price (pence)
Outstanding at 1 January	7,895,790	25.71	7,829,258	25.54
Granted	5,800,000	6.59	181,532	34.25
Forfeited	(1,625,337)	17.47	(115,000)	27.48
Exercised	—	—	—	—
Outstanding at 31 December	12,070,453	17.64	7,895,790	25.71
Exercisable at 31 December	441,667	46.85	419,167	48.45

Range of exercise prices (pence)	2005				2004			
	Weighted average exercise prices (pence)	Number of shares	Weighted average remaining life (years):		Weighted average exercise price (pence)	Number of shares	Weighted average remaining life (years):	
			Expected	Contractual			Expected	Contractual
6.25 – 20.00	6.65	5,025,000	2.96	9.12	—	—	—	—
21.00 – 30.00	22.03	5,365,091	0.54	7.04	22.02	5,835,091	1.53	8.04
31.00 – 40.00	32.69	1,263,695	1.31	7.84	32.70	1,601,532	2.31	8.85
41.00 – 100.00	48.00	416,667	1.87	3.75	47.82	456,667	2.37	5.10
101.00 – 124.00	—	—	—	—	124.00	2,500	2.68	5.36

No share options have been exercised during the year (2004: nil).

The total charge (pre and post-deferred tax) for the year relating to employee share-based payment plans was £304,000 (2004: £320,000), all of which related to equity-settled share-based payment transactions.

24. SHARE PREMIUM ACCOUNT

Group and Company	2005 £'000	2004 £'000
At 1 January	27,912	25,059
On shares issued on open offer and/or placing (note 27)	4,372	2,853
At 31 December	32,284	27,912

25. OTHER RESERVES

	Merger and other reserves				Total £'000
	Merger reserve £'000	Other reserve £'000	Capital redemption reserve £'000	EBT reserve £'000	
Balance at 1 January 2004	3,467	1,136	—	(45)	4,558
Cancellation of shares in EBT	—	—	5	45	50
Balance at 31 December 2004	3,467	1,136	5	—	4,608
Balance at 31 December 2005	3,467	1,136	5	—	4,608

Merger reserve

Under the provisions of section 131 of the Companies Act 1985, the premium on shares in the Company issued in consideration for the acquisition of subsidiaries, where an interest greater than 90% was acquired, has been credited to a merger reserve. The transactions giving rise to the merger reserve were the acquisitions during 1999 of Fairfield Imaging Limited (£700,000) and Cellpath plc (£567,000) and the 2003 acquisition of the Welcare Laboratory (£2,200,000).

Other reserve

On 31 January 2001, the Court made an order confirming the reduction in the Company's share capital following a resolution to cancel the deferred shares in issue. The rights attaching to those deferred shares, which were not listed or quoted on any recognised stock exchange, were minimal thereby rendering them effectively valueless. The cancelled nominal value of the shares of £1,136,000 was credited to a non-distributable other reserve.

Capital redemption reserve EBT

During 2003, 250,000 ordinary shares with a nominal value of £5,000 were bought by the Company and were used for the Company's Employee Benefit Trust ("EBT"). The consideration paid for the shares was debited to the EBT reserve. On 30 July 2004 the 250,000 shares were cancelled and the nominal value of the shares was credited to a capital redemption reserve.

Foreign currency translation reserve

As detailed in the Group Statement of Changes in Shareholders' Equity, at 31 December 2005 the Group has a foreign currency translation reserve of £117,000 (2004: deficit of £190,000). As described in note 1, exchange differences arising on the translation of opening net assets and results of overseas operations are reported in the foreign currency translation reserve. The Company has £nil (2004: £nil) foreign currency translation reserve.

26. RETAINED EARNINGS

	Group		Company	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000
At 1 January	(22,317)	(13,157)	(25,630)	(13,754)
Loss for the year	(1,890)	(9,435)	(1,528)	(12,196)
Share option scheme – value of employee service	304	320	304	320
Shares in EBT	—	(45)	—	—
At 31 December	(23,903)	(22,317)	(26,854)	(25,630)

In accordance with the exemption allowed by section 230 of the Companies Act 1985, the Company has not presented its own income statement. The loss after tax dealt with in the financial statements of the Parent Company amounted to £1,224,000 (2004: £12,196,000).

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27. FUND RAISING

On 22 December 2004, the Group announced that it intended to raise £6.4 million before expenses through a Placing and Open Offer. The net proceeds of the Placing and Open Offer would be used to invest in specialist equipment required to drive future revenue growth within the Group's Drug Development Services and LBC operations, reduce the Group's debt position, pay deferred consideration in respect of historic acquisitions and to fund the Group's general working capital requirements. At an Extraordinary General Meeting of the Company held on 14 January 2005, all resolutions necessary to approve the Placing and Open Offer together with certain other matters were duly passed and dealings in the new shares issued commenced on 19 January 2005. As a result of the Placing and Open Offer, the Group raised net proceeds of £5.7 million, which were employed in the manner described above.

28. RECONCILIATION OF CASH FLOWS

	Group		Company	
	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
Loss for the year from operations	(1,839)	(9,435)	(1,528)	(12,196)
Taxation	—	90	—	29
Depreciation of tangible fixed assets	700	895	110	116
Recognition of grant income	(67)	—	(67)	—
Impairment of goodwill	—	1,823	—	—
Amortisation of capitalised development costs	61	225	—	—
Impairment of capitalised development costs	64	1,226	—	—
Impairment of tangible fixed assets	140	—	—	—
(Profit)/loss on sale of property, plant and equipment	(383)	(607)	4	(945)
Loss on sale of discontinued operations	—	469	—	—
Interest payable	251	264	182	234
Interest receivable	(108)	—	(98)	—
Share-based payments – value of employee service	304	320	304	320
Decrease in inventories	175	272	—	—
(Increase)/decrease in trade and other receivables	(684)	467	(172)	4,253
(Decrease)/increase in creditors	(678)	1,155	(1,819)	984
Cash used in operations	(2,064)	(2,836)	(3,084)	(7,205)

All of the cash used in the year was used in continuing operations. Cash used in continuing operations in the year ended 31 December 2004 was £2,603,000 (discontinued operations £233,000).

29. MAJOR NON-CASH TRANSACTIONS

Part of the consideration for the purchase of DML and SCL in the year, and settlement of the deferred consideration for the purchase of the Welcare Laboratory, comprised shares. Further details of the acquisitions are set out in notes 5 and 20 respectively and the value of share capital issued in note 22.

30. EMPLOYEES AND DIRECTORS

	Group		Company	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000
Staff costs for the Group during the year				
Wages and salaries	3,728	3,543	618	661
Social security costs	294	314	72	49
Pension costs (note 31)	123	76	57	7
Other post-employment benefits	30	15	—	—
Share-based compensation	304	320	304	320
	4,479	4,268	1,051	1,037
Less amounts capitalised	(30)	(248)	—	—
	4,449	4,020	1,051	1,037

	Group		Company	
	2005 £'000	2004 £'000	2005 Number	2004 Number
Number of people (including Executive Directors) employed at the year end				
By business segment				
UK Diagnostic Pathology	21	46	—	—
Dubai Diagnostic Pathology	58	32	—	—
Drug Development Services	8	9	—	—
Cytology	11	9	—	—
Central services	16	17	7	7
	114	113	7	7

	Group	
	2005 £'000	2004 £'000
Key management compensation		
Salaries and short term employee benefits	1,077	854
Pensions and other post-employment benefits	63	13
Termination benefits	57	—
Share-based compensation	240	233
	1,437	1,100

The key management figures given above include Executive and Non-Executive Directors.

	Group	
	2005 £'000	2004 £'000
Directors		
Aggregate emoluments	582	624
Company contributions to money purchase pension schemes	34	7
	616	631

Three Directors (2004: two) have retirement benefits accruing under money purchase pension schemes.

31. PENSION COMMITMENTS

The Group operates a defined contribution pension scheme and makes payments to other, personal defined contribution pension scheme arrangements on behalf of certain employees. The charges in the year amounted to:

	2005 £'000	2004 £'000
Group		
Defined contribution schemes	123	76

The year end creditor amounted to £45,000 (2004: £13,000).

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32. OPERATING LEASE COMMITMENTS – MINIMUM LEASE PAYMENTS

Group	2005		2004	
	Property £'000	Other £'000	Property £'000	Other £'000
Commitments under non-cancellable operating leases expiring:				
– Within one year	71	12	22	–
– Later than one year and less than five years	–	15	751	109
– After five years	9,519	–	9,667	–

The Group leases offices, laboratory facilities and a warehouse under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. The Group also leases plant and machines under non-cancellable operating lease agreements.

Company	2005		2004	
	Property £'000	Other £'000	Property £'000	Other £'000
Commitments under non-cancellable operating leases expiring:				
– Within one year	–	5	–	–
– Later than one year and less than five years	–	–	–	17

33. FINANCIAL COMMITMENTS

Group and Company

Contracted, but not provided, capital commitments as at 31 December 2005 were £nil (2004: £nil).

34. CONTINGENT LIABILITIES

Company

Under the terms of the Group's current banking facilities, the Company was liable for the repayment and discharge of all monies owing in respect of the bank borrowings of all subsidiary undertakings. At 31 December 2005 this amounted to £482,000 (2004: £2,664,000).

35. RELATED PARTY DISCLOSURES

The aggregated balances with subsidiaries are shown in notes 16 and 18. These amounts are all due within one year and do not bear interest. There are no material sales to, or purchases from, subsidiary companies. The aggregated balances with subsidiaries have arisen from corporate acquisition or disposal activities by the Company and Group.

Group personnel costs, legal and professional fees are incurred by the Company and no recharges are made to other Group companies.

Key management compensation is disclosed in note 30.

During the year, an amount of £7,515 (2004: £57,222) was charged by NKJ Consulting Limited, a company of which Dr Johnston is a director, for consultancy services provided to the Group. The consultancy agreement with NKJ Consulting Limited was terminated on Dr Johnston becoming an employee of the Group on 14 January 2005. There was no amount outstanding at 31 December 2005 (2004: £17,080).

For the year ended 31 December 2005, the Company was charged an amount of £27,500 (2004: £nil) by Manntex Limited, of whom Mr Slinger is an employee, in respect of Non-Executive Director fees for Mr Slinger. An amount of £2,250 was outstanding at 31 December 2005.

During 2004, Manntex Limited provided advice on the renewal of the Group's banking facilities for which the Company was charged £23,500 during the year ended 31 December 2004. A similar service was not provided in the year ended 31 December 2005.

During 2005, the Company was charged an amount of £39,375 (2004: £210,000) by HFG Limited, of whom Mr Green is a Director, in respect of fees for Mr Green as Chief Executive Officer of the Company. During 2005, Mr Green became an employee of the Group, and the arrangement with HFG Limited ceased.

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36. PRIOR YEAR COMPARATIVES

Deferred consideration

The Group notes that under UK GAAP, deferred contingent consideration of £2.2 million as at 31 December 2004 payable in cash or shares at the Company's option, should have been reflected within Equity shareholders' funds rather than as a liability. However, under IFRS the appropriate treatment is to reflect such amounts within Liabilities and thus no net adjustment has been made to the financial statements concerned.

Investments

On the acquisition of HSL by Medical Solutions FZ LLC (a 100% subsidiary of the Company) during September 2003, an amount of £350,000 was recognised by the Company as consideration for the business acquired. This amount, including both amounts settled and a deferred element, was recognised as an investment of the Company at the date of acquisition and at 1 January 2004, the date of transition to IFRS.

During 2004, the fair value of the deferred element of the consideration was reassessed based on changes in the Company share price in the period following acquisition. At 31 December 2004, the amount recognised as investments was amended to £207,000 as a result of this.

The legal and beneficial ownership in HSL has always resided with Medical Solutions FZ LLC, whereas the cost of investment was recognised by the Company. This anomaly arose because consideration paid to the vendors had been settled by the Company, rather than by Medical Solutions FZ LLC, without the creation of an intercompany balance due from Medical Solutions FZ LLC to the Company for the same amount.

This was corrected during 2005 and the cost of investment in HSL is now recognised by Medical Solutions FZ LLC.

The impact of correcting this error has been to reduce investments of the Company at 1 January 2004 by £350,000 (from £23,073,000 to £22,723,000) and at 31 December 2004 by £206,000 (from £22,929,000 to £22,723,000).

The corresponding adjustments have been to amounts owed to Group undertakings by the Company and provisions (current liabilities) as follows:

- to reduce the amounts owed to Group undertakings by the Company at 1 January 2004 by £100,000 (from £13,006,000 to £12,906,000) and at 31 December 2004 by £100,000 (from £13,350,000 to £13,250,000); and
- to reduce provisions at 1 January 2004 by £250,000 (from £600,000 to £350,000) and at 31 December 2004 by £106,000 (from £1,257,000 to £1,151,000).

As a consequence, there has been no impact on the net assets of the Company and no change in equity.

There is no impact on the Group balance sheet at either 1 January 2004 or 31 December 2004 as a result of this adjustment.

37. EVENTS AFTER THE BALANCE SHEET DATE

Deferred consideration in respect of the acquisition of the Welcare Laboratory

On 13 March 2006, the Company entered into an agreement with the Welcare Hospital and Welcare World Health Systems Limited ("Welcare Parties") in respect of the deferred consideration outstanding following the acquisition of the Welcare Laboratory from the Welcare Parties in 2003. Under this agreement, the Company will exchange a shareholding of 16.7% in its subsidiary Medical Solutions FZ LLC in satisfaction of the outstanding deferred consideration recognised at 13 March 2006 of £2.5 million.

On conclusion of this transaction, Welcare Hospital will release cash to the Company amounting to £0.9 million, which has been withheld pending settlement of the deferred consideration.

This transfer of shares in Medical Solutions FZ LLC requires ratification by the Dubai Healthcare City authorities.

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38. RECONCILIATION OF NET ASSETS AND LOSS UNDER UK GAAP TO IFRS

Medical Solutions plc reported under UK GAAP in its previously reported financial statements for the year ended 31 December 2004. The analysis below shows a reconciliation of net assets and loss as reported under UK GAAP as at 31 December 2004 to the revised net assets and profit under IFRS as reported in these financial statements. In addition, there is a reconciliation of net assets under UK GAAP to IFRS at the transition date for the Company, being 1 January 2004.

(a) Group

		Group		
		UK GAAP £'000	Effect of transition to IFRS £'000	IFRS £'000
Reconciliation of loss for the year ended 31 December 2004				
Revenue from continuing operations	iii	6,586	(560)	6,026
Cost of sales		(5,133)	423	(4,710)
Gross profit		1,453	(137)	1,316
Selling and distribution expenses		(923)	57	(866)
Administrative expenses	i,ii	(9,885)	486	(9,399)
Research and development		(148)	45	(103)
Gain on sale of fixed assets		607	—	607
Operating loss from continuing operations		(8,896)	451	(8,445)
Interest payable and similar charges	i	(20)	(244)	(264)
Loss before tax from continuing operations		(8,916)	207	(8,709)
Taxation		(90)	—	(90)
Loss after tax but before loss on sale of discontinued operations		(9,006)	207	(8,799)
Loss on sale of discontinued operations	iii	(469)	(167)	(636)
Loss for the year		(9,475)	40	(9,435)
Attributable to:				
Equity holders of the Parent Company		(9,475)	40	(9,435)
Loss for the year		(9,475)	40	(9,435)

38. RECONCILIATION OF NET ASSETS AND LOSS UNDER UK GAAP TO IFRS (CONTINUED)

(a) Group (continued)

		Group		
		UK GAAP	Effect of	IFRS
Reconciliation of equity at 1 January 2004 (date of transition to IFRS)	Footnote	£'000	transition to IFRS £'000	£'000
Non-current assets				
Goodwill	i	13,934	(478)	13,456
Other intangible assets		1,700	—	1,700
Property, plant and equipment		6,594	—	6,594
		22,228	(478)	21,750
Current assets				
Inventories		1,461	—	1,461
Trade and other receivables		2,783	—	2,783
Financial assets				
– cash and cash equivalents		3,250	—	3,250
		7,494	—	7,494
Current liabilities				
Trade and other payables		2,287	—	2,287
Financial liabilities				
– borrowings		2,678	—	2,678
Provisions	i	600	(30)	570
		5,565	(30)	5,535
Net current assets		1,929	30	1,959
Total assets less current liabilities		24,157	(448)	23,709
Non-current liabilities				
Financial liabilities				
– borrowings		4,045	—	4,045
Provisions	i	2,000	(448)	1,552
		6,045	(448)	5,597
Net assets		18,112	—	18,112
Equity				
Issued share capital		1,788	—	1,788
Share premium		25,059	—	25,059
Other reserves		4,422	—	4,422
Profit and loss reserve	ii	(13,157)	—	(13,157)
Total equity attributable to equity holders of the Parent Company		18,112	—	18,112
Total equity		18,112	—	18,112

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38. RECONCILIATION OF NET ASSETS AND LOSS UNDER UK GAAP TO IFRS (CONTINUED)

(a) Group (continued)

Reconciliation of equity at 31 December 2004	Footnote	Group		
		UK GAAP £'000	Effect of transition to IFRS £'000	IFRS £'000
Non-current assets				
Goodwill	i	11,005	126	11,131
Other intangible assets		339	—	339
Property, plant and equipment		2,679	—	2,679
		14,023	126	14,149
Current assets				
Inventories		878	—	878
Trade and other receivables		4,348	—	4,348
Financial assets				
– cash and cash equivalents		1,990	—	1,990
		7,216	—	7,216
Current liabilities				
Trade and other payables		3,790	—	3,790
Financial liabilities				
– borrowings		3,039	—	3,039
Provisions	i	1,257	(60)	1,197
		8,086	(60)	8,026
Net current liabilities		(870)	60	(810)
Total assets less current liabilities		13,153	186	13,339
Non-current liabilities				
Financial liabilities				
– borrowings		540	—	540
Provisions	i	1,000	(174)	826
		1,540	(174)	1,366
Net assets		11,613	360	11,973
Equity				
Issued share capital		1,960	—	1,960
Share premium		27,912	—	27,912
Other reserves		4,418	—	4,418
Profit and loss reserve	i,ii	(22,677)	360	(22,317)
Total equity attributable to equity holders of the Parent Company		11,613	360	11,973
Total equity		11,613	360	11,973

38. RECONCILIATION OF NET ASSETS AND LOSS UNDER UK GAAP TO IFRS (CONTINUED)

(b) Company

		Company		
		UK GAAP £'000	Effect of transition to IFRS £'000	IFRS £'000
Reconciliation of loss for the year ended 31 December 2004				
Revenue from continuing operations		—	—	—
Cost of sales		—	—	—
Gross profit		—	—	—
Administrative expenses	i,ii	(12,558)	(320)	(12,878)
Gain on sale of fixed assets		945	—	945
Operating loss from continuing operations		(11,613)	(320)	(11,933)
Interest payable and similar charges	i	(20)	(214)	(234)
Loss before tax from continuing operations		(11,633)	(534)	(12,167)
Taxation		(29)	—	(29)
Loss after tax from continuing operations		(11,662)	(534)	(12,196)
Loss for the year		(11,662)	(534)	(12,196)
Attributable to:				
Equity holders of the Parent Company		(11,662)	(534)	(12,196)
Loss for the year		(11,662)	(534)	(12,196)

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For the year ended 31 December 2005

38. RECONCILIATION OF NET ASSETS AND PROFIT UNDER UK GAAP TO IFRS (CONTINUED)

(b) Company (continued)

		Company		
		UK GAAP As restated £'000	Effect of transition to IFRS £'000	IFRS £'000
Reconciliation of equity at 1 January 2004 (date of transition to IFRS)		Footnote		
Non-current assets				
Investments		22,723	(448)	22,275
Property, plant and equipment		4,220	—	4,220
		26,943	(448)	26,495
Current assets				
Trade and other receivables		7,298	—	7,298
Financial assets				
– cash and cash equivalents		3,007	—	3,007
		10,305	—	10,305
Current liabilities				
Trade and other payables		13,306	—	13,306
Financial liabilities				
– borrowings		670	—	670
Provisions	i	350	—	350
		14,326	—	14,326
Net current liabilities		(4,021)	—	(4,021)
Total assets less current liabilities		22,922	(448)	22,474
Non-current liabilities				
Financial liabilities				
– borrowings		3,271	—	3,271
Provisions	i	2,000	(448)	1,552
		5,271	(448)	4,823
Net assets		17,651	—	17,651
Equity				
Issued share capital		1,788	—	1,788
Share premium		25,059	—	25,059
Other reserves		4,558	—	4,558
Profit and loss reserve	ii	(13,754)	—	(13,754)
Total equity attributable to equity holders of the Parent Company		17,651	—	17,651
Total equity		17,651	—	17,651

For details of the restatement, see note 36.

38. RECONCILIATION OF NET ASSETS AND PROFIT UNDER UK GAAP TO IFRS (CONTINUED)
(b) Company (continued)

		Company		
		UK GAAP As restated £'000	Effect of transition to IFRS £'000	IFRS £'000
Reconciliation of equity at 31 December 2004				
	Footnote			
Non-current assets				
Investments		22,723	(448)	22,275
Property, plant and equipment		760	—	760
		23,483	(448)	23,035
Current assets				
Trade and other receivables		2,490	—	2,490
Financial assets				
– cash and cash equivalents		1,888	—	1,888
		4,378	—	4,378
Current liabilities				
Trade and other payables		14,633	—	14,633
Financial liabilities				
– borrowings		2,013	—	2,013
Provisions	i	1,151	(60)	1,091
		17,797	(60)	17,737
Net current liabilities		(13,419)	(60)	(13,359)
Total assets less current liabilities		10,064	(388)	9,676
Non-current liabilities				
Provisions	i	1,000	(174)	826
		1,000	(174)	826
Net assets		9,064	(214)	8,850
Equity				
Issued share capital		1,960	—	1,960
Share premium		27,912	—	27,912
Other reserves		4,608	—	4,608
Profit and loss reserve	i,ii	(25,416)	(214)	(25,630)
Total equity attributable to equity holders of the Parent Company		9,064	(214)	8,850
Total equity		9,064	(214)	8,850

For details of the restatement, see note 36.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2005

38. RECONCILIATION OF NET ASSETS AND PROFIT UNDER UK GAAP TO IFRS (CONTINUED)

Reconciliation of cash flows

There is no difference between the cash flows previously reported under UK GAAP and those reported under IFRS. Certain presentational differences between UK GAAP and IFRS have been reflected in the 31 December 2005 cash flow statement.

Footnotes to the reconciliation of equity

i) Business combinations: goodwill and deferred consideration

The Directors have elected, under IFRS 1, not to apply IFRS 3 to acquisitions that occurred prior to 1 January 2004. The carrying value of goodwill at 1 January 2004 represents the £13.9 million recognised under UK GAAP at the date of transition subsequently adjusted for the impact of discounting the deferred consideration (see below). The Group has applied IFRS 3 to acquisitions that have occurred since 1 January 2004.

Goodwill on business combinations (from date of transition to IFRS) is not amortised under IFRS 3, but is tested annually for impairment. Goodwill amortisation amounting to £715,000 charged under UK GAAP has been written back in the year ended 31 December 2004.

Annual impairment reviews have resulted in the following adjustments to the carrying values of goodwill:

- £1.8 million as at 31 December 2004 – being the impairment required to reduce the goodwill to the carrying value indicated by the impairment reviews.

Further, under IFRS 39 Financial Instruments: Recognition and Measurement, when settlement of a liability is deferred, the fair value of the deferred element payable is discounted to its fair value. Accordingly, the deferred consideration payable on the acquisition of the Welcare Laboratory and HSL by the Group during 2003 has been discounted and classified as a current and non-current liability as appropriate. The cost of the discount is systematically charged to profit and loss as a finance cost over the period until the deferred consideration is settled.

The effect is to decrease Group goodwill at 1 January 2004 and 31 December 2004 by £478,000. The additional finance cost charged to the Group profit and loss account in respect of the discount is £244,000 for the year ended 31 December 2004.

For the Company, the effect is to decrease the cost of investment in Welcare at 1 January 2004 and 31 December 2004 by £448,000. The additional finance cost charged to the Company profit and loss in respect of the discount is £214,000 for the year ended 31 December 2004.

Group summary

As a result of the above adjustments, the carrying value of goodwill has been:

- decreased by £478,000 at 1 January 2004, being the discount applied to the deferred consideration of which £30,000 is related to deferred consideration payable within one year and £448,000 to that payable after one year; and
- increased by £126,000 at 31 December 2004, being the net effect of the discount applied (£478,000), the goodwill amortised during the period under UK GAAP written back (£715,000) and an additional impairment charge of £111,000 being that element of the £715,000 which relates to fully impaired goodwill at 31 December 2004.

ii) Share-based compensation

Share-based compensation included Executive Directors and employee share option schemes. Fair value is determined at the date of grant and is calculated using the Black-Scholes option pricing model. Under UK GAAP an expense would have been recorded in respect of share options granted based upon their intrinsic value (which was considered to be nil as options were granted at market value). In restating the financial results of the Company and Group, an expense has been recorded based upon the fair value of the share options granted.

IFRS 2 requires the fair value of all share-based compensation to be charged against the income statement over the respective vesting periods. The Group has taken advantage of the transitional provisions of IFRS 1 not to recalculate equity settled awards granted before 7 November 2002.

The effect of accounting for equity-settled share-based compensation transactions at fair value on the consolidated income statement is to increase administrative expenses by £320,000 for the year ended 31 December 2004. A charge of £304,000 has been recognised for the year ended 30 December 2005.

The effect of accounting for equity-settled share-based compensation transactions at fair value on the consolidated balance sheet at 1 January 2004 is to increase the loss to that date by £248,000, but also to increase retained earnings by the same amount. The impact on equity of accounting for share-based compensation under IFRS is therefore neutral.

38. RECONCILIATION OF NET ASSETS AND PROFIT UNDER UK GAAP TO IFRS (CONTINUED)

Footnotes to the reconciliation of equity (continued)

iii) Disclosure of continuing operations

The income statement is required to show the results of continuing operations. Accordingly, the income and expenditure relating to discontinued operations has been excluded and the net loss combined with the loss on disposal of discontinued operations.

The effect of the above adjustments on total equity is as follows:

Group	Footnote	1 January 2004 £'000	31 December 2004 £'000
Goodwill			
– write back of amortisation	i	–	715
– discounting of deferred consideration	i	(478)	–
– impairment	i	–	(111)
Share-based compensation	ii	–	(320)
Finance costs – discount on deferred consideration	i	478	(244)
Adjustment to the loss for the year		–	40
Reserve adjustments for share-based compensation	ii	–	320
Total adjustment to equity (attributable to equity holders of the Parent Company)		–	360

The effect of the above adjustments on net income is as follows:

Group	Footnote	Year ended 31 December 2004 £'000
Administrative expenses		
– write-back of goodwill amortisation	i	715
– goodwill impairment	i	(111)
– share-based compensation	ii	(320)
Finance costs	i	(244)
Adjustment to the loss for the year		40
Loss on discontinued operations	iii	167
Adjustment to the loss before discontinued operations		207

NOTICE OF ANNUAL GENERAL MEETING

To the shareholders of Medical Solutions plc

Notice is hereby given that the AGM of Medical Solutions plc will be held at 1 Orchard Place, Nottingham Business Park, Nottingham NG8 6PX on 8 June 2006 at 10.30 am for the following purposes:

ORDINARY BUSINESS


1. To receive and adopt the financial statements for the year ended 31 December 2005 together with the Directors' Report, the auditor's report on those financial statements and the auditable part of the Directors' Remuneration Report.
2. To appoint PricewaterhouseCoopers LLP as auditor of the Company to hold office from the conclusion of the Meeting at which the Annual Report and Accounts are laid before the Company and to authorise the Directors to determine its remuneration.

SPECIAL BUSINESS

To consider and, if thought fit, to pass the following resolutions of which resolutions 3 and 5 will be proposed as ordinary resolutions and resolution 4 will be proposed as a special resolution:

3. That the Directors be and they are generally and unconditionally authorised for the purposes of section 80 of the Companies Act 1985 (the Act) to allot and issue relevant securities (as defined in that section) up to a maximum aggregate nominal amount of £1,344,851 representing 33% of the Company's issued share capital as at 20 April 2006 provided that this authority shall expire on the earlier of the conclusion of the next AGM of the Company and 15 months after the date of passing of this resolution or such earlier date (if any) on which this authority is revoked save that the Company may prior to the expiry of such period make an offer or agreement which would or might require relevant securities to be allotted after the expiry of this period and the Directors may allot relevant securities in pursuance of any such offer or agreement notwithstanding the expiry of the authority given in this paragraph, so that all previous authorities of the Directors pursuant to section 80 of the Act be and they are revoked.
4. That subject to resolution 3 being passed the Directors be and they are generally empowered pursuant to section 95 of the Act to allot equity securities (within the meaning of section 94 of the Act and including without limitation section 94(3A) of the Act) of the Company for cash or sell relevant securities (as defined in section 94 of the Act) pursuant to the authority of the Directors under section 80 of the Act conferred by resolution 3 as if section 89(1) of the Act did not apply to such allotment or sale and at any time prior to the expiry of such power conferred by this resolution to make an offer or agreement which would or might require equity securities to be allotted after the expiry of such power notwithstanding the expiry of such power provided that such power shall, subject as aforesaid, expire on the earlier of the conclusion of the next AGM of the Company and 15 months after the date of passing of this resolution or such earlier date (if any) on which the said authority is revoked, and provided that the power conferred by this resolution shall be limited to:
 - (i) allotments of equity securities where such securities have been offered (whether by way of rights issue, open offer or otherwise) to holders of ordinary shares in the capital of the Company made in proportion (as nearly as may be) to their existing holdings of ordinary shares but subject to the Directors having a right to make such exclusions or other arrangements in connection with the offering as they deem necessary or expedient:
 - (a) to deal with equity securities representing fractional entitlements; and
 - (b) to deal with legal or practical problems under the laws of, or the requirements of any recognised regulatory body or any stock exchange in, any territory; and
 - (ii) the allotment of equity securities for cash other than pursuant to paragraph (i) above up to a maximum aggregate nominal amount of £407,530 representing approximately 10% of the nominal value of the current issued ordinary share capital of the Company at 20 April 2006.
5. That the Directors' Remuneration Report set out in the 2005 Annual Report and Accounts be approved.

By order of the Board



Dr Neil Johnston
Company Secretary
24 April 2006

Registered office:
1 Orchard Place
Nottingham Business Park
Nottingham NG8 6PX

NOTES

1. Only those shareholders registered in the register of members of the Company as at 10.30 am on 6 June 2006 shall be entitled to attend or vote at the aforesaid General Meeting in respect of the number of shares registered in their name at that time. Changes to entries on the relevant register of securities after 6 June 2006 shall be disregarded in determining the rights of any person to attend or vote at the Meeting.
2. Members who are entitled to attend and vote at the Meeting are entitled to appoint one or more proxies to attend and, on a poll, to vote instead of them. A proxy need not be a member of the Company.
3. In the case of joint holders the signature of one holder on the form of proxy will be accepted but the vote of the senior who tenders a vote whether in person or by proxy will be accepted to the exclusion of the votes of any other joint holders and for this purpose seniority shall be determined by the order in which the names stand in the register of members in respect of such joint holding.
4. In the case of a corporation the form of proxy must be executed under its common seal or signed on its behalf by a duly authorised attorney or a duly authorised officer of the corporation.
5. To be valid the form of proxy together with any power of attorney or other authority under which it is executed or a notarially certified copy thereof must be sent to the Company's registrars at Lloyds TSB, Registrar's Department, The Causeway, Worthing, West Sussex BN99 6ZL no later than 48 hours before the start of the Meeting.
6. Completion of the form of proxy will not affect the right of a member to attend and vote at the Meeting.
7. The register of Directors' share interests and copies of the Directors' services contracts will be available for inspection at the registered office of the Company during normal business hours on any weekday (public holidays excluded) from the date of this Notice until the AGM and will be available for inspection at the place of the AGM from 10.15 am on 8 June 2006 and during the Meeting.

EXPLANATORY NOTES TO THE NOTICE OF ANNUAL GENERAL MEETING

To the shareholders of Medical Solutions plc

ITEM 1: ANNUAL REPORT AND ACCOUNTS

The Directors must present to shareholders at the AGM the report of the Directors and the accounts of the Company for the year ended 31 December 2005. The report of the Directors, the financial statements, the report of the Remuneration Committee and the report of the Company's auditor on the accounts, are contained within the 2005 Annual Report and Accounts.

ITEM 2: RE-APPOINTMENT OF AUDITOR

The auditor of a Company must be appointed at each General Meeting at which accounts are presented. Resolution 2 proposes the appointment of PricewaterhouseCoopers LLP to hold office until the conclusion of the next AGM to be held in 2007. The resolution also gives authority to the Directors to determine the auditor's remuneration.

ITEM 3: AUTHORITY TO ALLOT SHARES

Resolution 3 proposes to seek renewal of the authority of the Directors to allot ordinary shares. The nominal amount of relevant securities to which this authority will relate represents approximately 33% of the nominal amount of the issued ordinary share capital of the Company. The authority will expire on the earlier of the conclusion of the next AGM of the Company and 15 months after the date of passing of this resolution or earlier if revoked.

ITEM 4: DISAPPLICATION OF PRE-EMPTION RIGHTS

At the AGM held on 27 June 2005, the Directors were empowered to make limited allotments of ordinary shares for cash other than according to the statutory pre-emption rights, which require a company to offer all allotments of ordinary shares for cash proportionately to existing shareholders first.

Resolution 4 proposes to seek renewal of this power of the Directors to continue to provide for the best interests of shareholders when opportunities arise, so that the Company can follow normal practices in the event of a rights issue or other pre-emptive issue and so that ordinary shares may be issued wholly for cash other than proportionately to existing ordinary shareholders up to a maximum nominal amount, representing approximately 10% of the Company's issued ordinary share capital.

There are presently no plans to allot ordinary shares wholly for cash. Shares allotted under an employee share scheme are not subject to statutory pre-emption rights. This resolution also allows for the sale by the Company of treasury shares which it may hold.

The authority sought by resolution 4 will last until the earlier of the conclusion of the next AGM of the Company and 15 months after the date of passing of the resolution or earlier if revoked.

Resolution 4 will be proposed as a special resolution.

ITEM 5: DIRECTORS' REMUNERATION REPORT

Resolution 5 proposes the approval of the Directors' Remuneration Report by shareholders at the AGM.

The report, which is made on behalf of the full Board, explains the different elements which comprise Executive remuneration, including how base salaries and annual and long term incentive remuneration are determined for Executive Directors of the Company.

Medical Solutions plc
1 Orchard Place
Nottingham Business Park
Nottingham
NG8 6PX
www.medical-solutions.co.uk