Medical Solutions plc

Medical Solutions plc annual report and accounts 2002

Registered number: 79136

01 Corporate statement & highlights
02 Chairman's statement
04 Chief Executive's review of operations
10 Finance Director's report

12 Directors, officers & advisors
14 Directors' report
17 Corporate governance
19 Directors' remuneration report

24 Statement of Directors' responsibilities
25 Independent auditors' report
27 Financial contents
28 Consolidated profit & loss account
29 Balance sheets

30 Consolidated cash flow statement
31 Notes to financial statements
52 Shareholders' notes

Medical Solutions plc provides world leading services and technology for cancer diagnosis and pathology, supporting the Healthcare, Pharmaceutical and Biotechnology sectors.

Turnover increased 4% to £16.8 million
(2001: £16.1 million)

Operating profit £43,000 before amortisation of goodwill and know-how, and termination costs
(2001: loss £258,000)

EBITDA* before the exceptional items of £634,000
(2001: £165,000)

Operating loss £1.4 million
(2001: £1.5 million)

Disposals complete and cash ahead of expectations

Significant strengthening of main Board

Going forward: Clear focus and strategy in place

- cancer diagnosis and pathology
- drug discovery services

Technology division ahead of expectations

Service division – growth continues

* EBITDA calculation is based on operating profit before amortisation of goodwill and know-how and termination costs

The last year has been busy and has seen a significant change in Group structure. It is your Board's belief that now, being a Company focused entirely on cancer and related services, we will see rapid expansion and progress during 2003 and beyond. During the year we have successfully refocused the business, strengthened the Board and post year end, won a very significant contract broadening our cancer services so that while continuing to service the National Health Service ("NHS") and the hospital sector, Medical Solutions will also now work for the Pharmaceutical Industry aiding it with drug discovery.

It was agreed, during 2002, to sell Adams Healthcare and concentrate on the Cancer Diagnosis and Pathology business. As a result of the recent successful sale of Adams Healthcare to EcoLab, Medical Solutions is now cash rich and the Directors look forward, over the next few months, to making several modest acquisitions/investments. Since the year end we have relocated the key technology to the Group's new Nottingham Head Office. Our intention is that this will become a world-renowned centre of excellence for Cancer Diagnosis and drug discovery services over the next five years.

The development of PathLore, Medical Solutions' remote locum service, since its start in June 2001 has been impressive. It has now established a solid business, based on the provision of Pathology Services to the NHS. These services are underpinned by the imaging technologies provided by Medical Solutions' other subsidiaries, Fairfield and Kinetic. However, it should also be pointed out that both imaging divisions also have excellent order books in their own right.

In November 2002 Peterborough Cellular Pathology Services ("PCPS") (tissue banking) was acquired and has proved successful in providing a launch pad for PathLore's Services in supporting the huge demand for characterised biomaterials used in new drug discovery and proteomic based research. The combination of PCPS's comprehensive bioanalytical systems for evaluation of fully consented human tissue, expert pathologist analysis provided by PathLore, and Fairfield and Kinetics technology is unique. This combination of technologies is likely to be in considerable demand by both public and private sectors over the next decade – putting Medical Solutions in a unique position that we aim to exploit.

The remarkable progress in understanding the molecular biology of cancer has provided an enormous range of targets for novel drugs. Innovative methods of clinical development are being sought by the Pharmaceutical Industry to dramatically accelerate bench to market times. This requires good access to carefully controlled clinical samples of cancer and normal tissue. New patient information networks comprising personal and clinical data together with pathology and radiology images will be created to deliver better, more targeted medicines. Our unique combination of technologies is likely to be in considerable demand by both public and private sectors over the next decade.

During the last quarter of 2002 a considerable marketing programme was carried out, aimed at the world's major Pharmaceutical companies. The efforts of our marketing team culminated in the award of our first contract, from AstraZeneca – as announced in January this year. We continue to retain significant interest from a range of other "Big Pharma", and believe that the next level of contract will be substantially larger. The interest we are receiving, proves that our services fill a remarkable niche that even the largest of Pharmaceutical companies are struggling to handle. The availability of ethically assured, well documented, fresh clinical samples with expert reference histopathology and novel image transmission technologies is an exciting prospect for cancer drug developers.

Over the last year the Board has been strengthened. On the Executive team, Charles Green was appointed as Chief Executive and in March 2003 Dr Ian Ellis was promoted to the role of Medical Director. We were also delighted to appoint Professor Karol Sikora, a leading cancer specialist, as Non-Executive Director – his very relevant experience and contacts are already proving immensely useful to Medical Solutions. We seek a further Non-Executive Director and hope to be able to announce this during 2003. I would like to take this opportunity to say that I am grateful to the entire Board for their support during the past few months, and would like to particularly thank Dr Rod Adams whose resignation was received following the sale of Adams Healthcare.

In summary, Medical Solutions now has a unique combination of world-renowned pathologists and leading edge imaging technologies in its PathLore, PCPS, Fairfield Imaging and Kinetic Imaging businesses. These services and technologies are in great demand from the public and private Healthcare systems in the UK and selected overseas markets, and by the Big Pharma and biotechnology companies worldwide. The convergence of world-renowned expertise, state of the art reference laboratory facilities and innovative image analysis and quantitation technology ensures that we provide the high quality of validated data required for accelerating drug development and clinical trials.

Gareth Roberts

Sir Gareth Roberts
Chairman

Overview

During 2002 we built on PathLore's now established position, establishing and marketing a new range of services, whilst achieving a financial performance in line with expectations. EBITDA, calculated before amortisation of goodwill and know-how and exceptional costs, for 2002 was £634,000 (2001: £165,000). We also disposed of the businesses outside our core Cancer Diagnosis and Pathology strategy, resulting a strong cash rich position, at the close of the year.

Our Technology Division, comprising the imaging technologies in Fairfield and Kinetic, has an excellent order book. The network of seven PathSight telepathology systems, centred around Edinburgh, expected last year, will be delivered and invoiced in the first quarter of 2003. This delay was as a result of internal purchasing procedures covering several Health Authorities. In addition, Kinetic's sales in 2002 were depressed through delays in the supply of microscopes, however Kinetic employed two new sales professionals in the second half of last year and consequently its order book is now extremely healthy. We incurred significant costs in marketing SurePath Liquid Based Cytology ("LBC"), the new system for preparation of smear tests, in 2002 ahead of the expected implementation in the second half of 2003, when we hope to achieve a healthy share of the UK market where over five million tests are performed each year.

The Technology Division will increasingly provide support and technology to our Services Division, particularly in the area of scanning and quantitative analysis for our drug discovery clients.

Our Services Division now has a strong base centred around our remote locum service, PathLore. During 2003 we aim to double the number of remote locum cases to 80,000 per annum. PathLore's Reference Laboratory is on track to meet expectations based purely on the provision of HER2 tests. This test is used to establish a patient's receptiveness to Herceptin, the breast cancer drug. PCPS, acquired in November 2002, is in line with full year expectations, on the basis of tissue acquired from Peterborough only and we will roll out this successful model to a further five major teaching hospitals during 2003. As announced in February, we have received our first significant Pharmaceutical drug discovery contract. Although our forecasts for this area of business are modest, we did invest heavily in the last quarter of 2002 in market research and marketing of our unique services in this arena, and we hope this spend will bear fruit in due course.

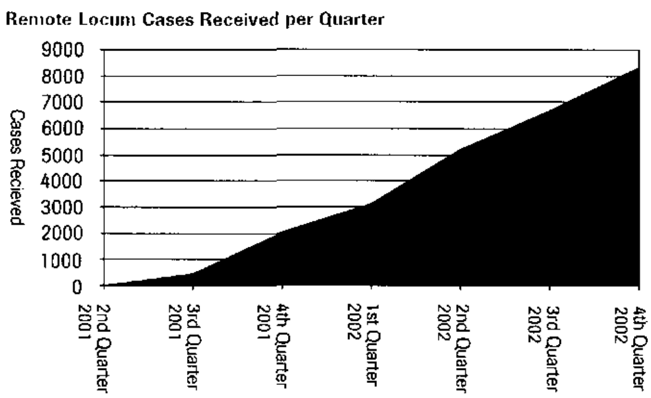
Services Division

Remote locum service – PathLore

In the first six months of 2002 there were several changes made in PathLore's organisation and substantial investments in people and the operations infrastructure. It is felt that this has led to the consolidation of PathLore's position as a premier provider of Pathology Services. There has also been significant commercial activity in the Cancer Diagnosis and Pathology Division which gives the Board much confidence for the future. Our strategy therefore is to build on the Group's leading position in a number of niche areas, in Cancer Diagnosis and Pathology.

PathLore's annualised turnover is now in excess of £1.2 million, and is growing rapidly, month on month. PathLore currently has 60 consultant pathologists providing specialist remote locum services.

There are currently approximately 300 vacancies out of a total requirement of 1,300 consultant histopathologists in the UK, as a result of a manpower planning error several years ago. Our service is identified as the remote specialist locum service.



Reference Laboratory – PathLore

The Reference Laboratory in Nottingham was completed during 2002 enabling it to prepare and analyse a comprehensive range of tests, provide prognostic profiling for the selection of appropriate adjuvant therapy, tissue preparation and evaluation for drug development and clinical trial evaluation and cervical screening and general cytology. Molecular biology and genomics will continue to increase our understanding of disease, provide routes to new therapies and diagnostics and increase our ability to tailor treatment to individual patients. Increasingly, specific drugs will require more specific diagnostics. The PathLore Reference Laboratory is one of only three reference facilities set up in the UK to assess HER2 status. We have considerable experience and expertise in determining HER2 expression and other prognostic and diagnostic markers. This expertise is made commercially available to NHS Trusts and private Healthcare institutions for clinical pathology testing, and to biotechnology and Pharmaceutical companies for research and development and clinical trials.

Services Division (continued)

Peterborough Cellular Pathology Services (PCPS)

PCPS had approximately 80 customers including all of the major Pharmaceutical and Biotechnology companies. Until recently however, it did not have access to enough tissue and did not have some tissue types at all. To this end, we are rolling out the Peterborough model to five other major teaching hospitals to alleviate this problem during 2003. This will provide a much wider supply of tissue, in terms of value and type.

Looking ahead, and using the Peterborough model, Medical Solutions is developing a centralised biomaterials processing and distribution facility served by six tissue acquisition centres located across the UK which have access to cancer, cardiovascular, respiratory and urological as well as general surgical patients. Rapidly changing technologies have highlighted the need for well characterised high grade human biomaterials linked with associated clinical and treatment outcome information. The PathLore Biomaterials Resource has been established to provide support for research conducted by the academic community and the Biotech/Pharmaceutical Industry for the study of cancer biology and treatment development as well as new drug discovery. Medical Solutions will facilitate the collection, storage and analysis of ethically gathered surplus surgical and Cadaveric human biomaterials. The PathLore Biomaterials Resource offers its clients rapid and flexible access to a plethora of ethically sourced human biomaterials with full donor consent. All human tissue samples are obtained through partnership with medical intermediaries, hospitals and tissue banks based on the model developed by Peterborough Hospitals NHS Trust.

The PathLore Biomaterials Resource is supported by a fully integrated inventory management and web based ordering system. Its primary purpose is to allow the routine collection, processing, storage and analysis of high grade molecular class biomaterials products linked to disease specific demographic, clinical, pathological and outcome information. This will be achieved through building infrastructure and workforce capability in collection, storage and analysis of characterised frozen and paraffin-embedded tissue - linked to virtual microscopical images, pathological, disease specific clinical and outcome information collected prospectively in accordance with the requirements of its growing client base.

Technology Division

Imaging – Fairfield

Fairfield has developed software image analysis management systems for Cancer Diagnosis, prognosis and telepathology. These systems allow tissue samples to be examined at high resolution under the control of a clinician operating from a remote location. This system is ideally suited to the organisation of NHS cancer networks in the UK, and the support of drug research by Pharmaceutical and Biotech companies. The order book for telepathology is excellent.

Fairfield's PathSight telepathology system allows the provision of a networked pathology system for hospitals. The single most important factor in improving cancer survival is early diagnosis and this networking of experts in different hospitals makes a significant contribution to team based patient management with the best information possible being available. It reduces the need for experts to travel between hospitals, a problem exacerbated by the staffing shortages in pathology. Fairfield has received orders to supply three Automatic Ploidy systems as a result of the New England Journal of Medicine paper published at the end of last year.

Fairfields' Virtual Microscope technology will be used to support our drug discovery services, networking the research centres of the major Pharmaceutical companies worldwide.

Imaging – Kinetic

Kinetic is a leader in fluorescent imaging with its Komet product, measuring DNA damage in cells, and Live Cell Imaging products, and has many major cancer research establishments as customers. The Komet assay is becoming a standard FDA requirement for all new drug trials.

The Kinetic Imaging Histometrix system, a quantitative method employing image analysis, will be used in a significant new contract to provide an assay for the selection of patients for future clinical trials based on the expression of the molecular markers. A database for the storage of the expression information in conjunction with demographic, clinical and histopatholigical data will also be developed. There is an as yet unmet demand centred around Research Triangle Park ("RTP"), North Carolina, USA for Kinetics products and services based on expert analysis using the Kinetic products in support of drug discovery. To that end Kinetic will be establishing an operation in RTP headed up by Mark Browne, Kinetics founder and Managing Director.

Technology Division (continued)

SurePath

The SurePath (formerly Autocyte) LBC (new smear test technology) business is about to expand rapidly. We understand that the NHS English pilots for LBC have been completed, however no results will be made public before NICE ("National Institute of Clinical Excellence") report in the summer of 2003. We believe that the results from our SurePath system have been very positive both in the high quality of the slides produced and the level of acceptance by pathologists and cytology screeners.

The original basis for the NICE recommendation to proceed with pilot studies was the economic benefit provided by LBC. The switch to LBC is predicted to reduce the level of unreadable slides from 9% down to 2%. This would prevent approximately 400,000 anxious women having to be recalled for repeat smears in England and Wales each year. The Health Secretary's budget statement last year committed the Government to the establishment of 80 LBC screening centres by the end of 2004. In Scotland, LBC implementation is to be completed by April 2004.

SurePath is one of only two FDA approved LBC systems which have been trialled by NHS and NICE, for implementation in the UK. There are currently 4.7 million smear tests a year in England and Wales. Our consumables are sold at £2.50 per test, which provides significantly better value than those of our competitor.

Prospects

2002 has been an exciting and challenging year – however it is the belief of your Board that the building blocks are now firmly in place for us to take advantage of our unique position within the cancer arena. 2003 is set to be a fast moving and rewarding year for the Group, which is well positioned for expansion, both organically and through appropriate acquisitions. It remains our key aim to create innovative partnerships through the provision of novel technology which will herald a new era of benefits to cancer patients worldwide.

Cancer is a growing global problem. The UK Government is committed to improving the early diagnosis of cancer. We are able to provide a unique offering to the worldwide drug discovery market and are therefore confident that our strategy, which is self financing, will result in a high growth, profitable, and cash generative Group.

Charles Green
Chief Executive

1. Liquid Based Cytology
2. HER2
3. Ki67
4. Histometrix

Turnover for the year to 31 December 2002 was £16,785,000 (2001: £16,100,000), an increase of 4.25%.

On 31 December 2002 the Group sold the trade and assets of Adams Healthcare Limited to Ecolab Limited. On 13 December 2002 the Group sold its 100% interest in the ordinary share capital of CellPath plc to Clinicare Limited. On 19 April 2002 the Group disposed of the trade and assets of Thackray Instruments and PracticePlus. The results of the businesses sold up to the dates of disposal are disclosed within the Group profit and loss account as discontinued operations.

Turnover from continuing operations grew by 22.7% in 2002, whereas that of discontinued operations grew by 1.8%. Our services, which to date have been substantially PathLore's remote locum business, grew from a turnover of £190,000, achieved in PathLore's first six months of operation in 2001 to £1,103,000 in 2002. Of course from 2003 our services also now include our reference laboratory, PCPS existing tissue services, and our combined tissue, pathology and imaging services for the Pharmaceutical and Biotechnology sectors.

In 2002 we did however spend approximately an additional £400,000 marketing this wide range of services and technologies, with particular emphasis on SurePath LBC, our Pharmaceutical and Biotechnology sector services, and Kinetics Imaging.

Our turnover from imaging technologies in 2002 was £488,000 less than in 2001 as a result of problems with the supply of microscopes for both Kinetic and Fairfields imaging systems, and delays in the shipment of PathSight telepathology systems for the Edinburgh based network.

The operating profit before amortisation of goodwill and know-how, and the termination costs for Trevor Twose, former Chief Executive Officer, for the year was £43,000 (2001: £258,000 loss), and the loss before taxation was £1,392,000 (2001: £1,472,000 loss). Operating costs include amortisation of goodwill and know-how on acquisitions of £1,217,000 (2001: £1,214,000). Of the total amortisation in 2002, £1,081,0000 relates to discontinued operations, leaving only £136,000 per annum in respect of the continuing businesses. These remaining intangible assets will continue to be written off over 20 years.

The continuing operations included £606,000 (2001: £668,000) of central Group costs excluding the termination costs for Trevor Twose.

The profit on disposal of fixed assets, discontinued operations, of £76,000 (2001: nil) relates to a CellPath plc building which was surplus to requirements following the sale of Thackray Instruments and PracticePlus.

The loss on disposal of discontinued operations of £8,678,000 (2001: nil) relates to the disposal of the trade and assets of Adams Healthcare Limited, Thackray Instruments and PracticePlus, and the whole of the share capital of CellPath plc. Prior to the disposal of CellPath plc, Medical Solutions had acquired the rights to distribute SurePath LBC systems and consumables in the UK, from CellPath plc.

The Group had net interest payable in the year of £201,000 (2001: payable £136,000), making the loss before tax £10,195,000 (2001: loss £1,608,000).

Tax on the loss on ordinary activities in 2002 consists of research and development credits repaid by the Inland Revenue. Corporation tax and deferred tax provisions of £509,000 were released in 2001 as a result of research and development credits and Group tax losses.

Tax on the sale of discontinued activities of £2,128,000 in 2002 represents the best estimate of the tax charge on the disposal of the trade and assets of Adams Healthcare. Every effort will be made to reduce the estimated charge, and the rollover of the taxable gains into potential future acquisitions is being considered.

The Group had cash and short-term deposits at the end of the year of £16,320,000 (2001: £4,276,000) and borrowings of £4,372,000 (including overdraft and chattel mortgage) (2001: £3,174,000). These borrowings have been repaid since the 31 December 2002, with the exception of the chattel mortgage of £640,000 taken out to finance the acquisition of PathLore's Reference Laboratory equipment. Also included in creditors falling due within one year is the maximum tax on the disposal of discontinued activities of £2,128,000 and accruals for disposal costs of £401,000. This leaves net cash of £10,100,000.

During 2002 the deferred consideration of £2,861,000 included in creditors falling due within one year at 31 December 2001 was paid.

The cash resources, taken with the Group's operational cash flow and banking facilities, are sufficient to meet the Group's needs for the foreseeable future.

The net cash inflow in the year of £11,065,000 includes capital expenditure and financial investment of £1,381,000. This consists of £982,000 of capital expenditure, £539,000 capitalised development costs and the proceeds of the sale of the CellPath building, of £140,000. The capital expenditure mainly relates to the development of the Reference Laboratory in Nottingham. The net receipt of cash from acquisitions and disposals consists of the disposals of the discontinued activities and the repayment of the deferred consideration.

The net assets of the Group at the end of the year were £16,028,000 (2001: £28,218,000). Intangibles, including development costs and goodwill total £4,010,000 (2001: £22,914,000), and tangible assets were £1,144,000 (2001: £3,851,000). Net current assets at 31 December 2002 were £13,229,000 (2001: £3,863,000).

The Group had 79,403,240 ordinary shares in issue at 31 December 2002 (2001: 78,958 232). 445,008 shares were issued at 22p, resulting in an increase in the Share Premium Account of £89,000, in consideration for the acquisition of Histological Solutions Limited from the principals of PCPS.

Andrew Longstaffe
Finance Director

Sir Gareth Roberts (62)
Chairman
Sir Gareth was appointed Non-Executive Chairman in April 2000, having joined the Board as Non-Executive Director in August 1999. He chairs the Remuneration and Audit Committees. Sir Gareth has an international reputation for his research on semiconductors and molecular electronics and is the author of over 200 publications and patents. He was elected a Fellow of The Royal Society in 1984. He is President of the Science Council and Chairs the Research Committee of the Higher Education Funding Council. He was elected President of Wolfson College, Oxford in January 2001 and serves on the Board of ISIS Ltd. the exploitation arm of the University. Sir Gareth has also held two senior industrial posts, the first as senior research scientist with Xerox Corporation in America and the second as Director of Research and Chief Scientist of Thorn EMI.

Professor Karol Sikora (53)
Non-Executive Director
Karol FRCR FRCP PhD, studied medical science and biochemistry at Cambridge, gaining a double first. He became Clinical Director for Cancer Services at Hammersmith in London where, during the following 12 years, he established a major cancer research laboratory. Following a spell 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 Adviser to HCA Healthcare, where he 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 A Green (49)

Chief Executive Officer
Charles has significant experience of corporate acquisitions gained through his employment as Business Development Director of Texas Holdings Limited since 1993. He orchestrated the purchase by Texas of a controlling stake in the holding company of Sheffield United F.C. where he was Chief Executive until March 1998 and was responsible for its flotation in January 1997. He was Executive Director of Medical Solutions plc on flotation in 1999 and returned as Chief Executive Officer in February 2002 on the departure of the former CEO.

Directors

C.A. Green	Chief Executive Officer
R.H. Adams	Executive Director (resigned 21 January 2003)
A.D. Longstaffe	Executive Director
T. Twose	Executive Director (resigned 8 February 2002)
I.O. Ellis	Executive Director (appointed 24 March 2003)
Sir G.G. Roberts	Non-Executive Chairman (Senior Independent Non-Executive Director)
D.E. Seymour	Non-Executive Director (resigned 22 April 2002)
K. Sikora	Non-Executive Director (appointed 22 April 2002)

Dr Ian Ellis (47)
Medical Director
Ian is Reader in Pathology at the University of Nottingham and Honorary Consultant Histopathologist at Nottingham City Hospital. He has

in the classification of breast cancer and is regularly invited to speak at National and International meetings on aspects of breast pathology. He is the author of over 200 peer reviewed publications. He is a Fellow and a Speciality Advisor of The Royal College of Pathologists and sits on a range of Committees specialising in breast pathology. He has acted as an advisor to the DoH, WHO and IARC.

Andrew D Longstaffe (44)
Finance Director and Company Secretary
Andy joined the Board in May 2000 on the acquisition of Adams Healthcare Limited, where he was Finance Director. Andy joined DePuy in 1989 and was Group Financial Controller during the international expansion of the business from a turnover of £20 million to £250 million. He was responsible for DePuy Healthcare, part of which became Adams Healthcare, from 1994. He is a Chartered Accountant who trained with Deloitte, Haskins & Sells in the UK and worked for them in South Africa for three years. His experience includes Stock Exchange circulars, leveraged buy-outs and due diligence reports.

Medical and Scientific Advisory Board
Sir Gareth Roberts (Chairman)

External Members
Professor Nick Wright
President of the Pathological Society of Great Britain and Northern Ireland
Professor David Kerr
University of Oxford
Dr Havaard Danielsen
Radium Hospital, Oslo
Professor Gordon Duff
University of Sheffield
Professor Iain MacIntyre
William Harvey Research Institute

Members on Boards of Medical Solutions' Companies
Dr Noah Clinch
Fairfield Imaging
Professor Karol Sikora
Medical Solutions plc

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

Registered Number
0079136

Auditors
Deloitte & Touche
Manchester

Stockbrokers
Evolution Beeson Gregory Limited
The Registry
Royal Mint Court
London EC3N 4LB

Solicitors
Hammonds
2 Park Lane
Leeds LS3 1ES

Principal Bankers
The Royal Bank of Scotland plc
Manchester Corporate Office
P.O. Box 546
Manchester M60 2DB

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

The Directors present their annual report on the affairs of the Group, together with the financial statements and auditors' report for the year ended 31 December 2002.

Results and dividends

Turnover for the year amounted to £16,785,000 (2001: £16,100,000). The operating loss for the year was £1,392,000, compared to £1,472,000 in 2001. The loss for the year before taxation amounted to £10,195,000 compared to a loss of £1,608,000 in 2001. No dividend can be paid (2001: £nil).

A review of operations and future prospects is contained in the Chairman's statement, Chief Executive's Review of Operations and Finance Director's Report.

Principal activities

Medical Solutions plc is a holding Company.

PathLore Limited provides expert remote Pathology Services through 60 consultant pathologists. PathLore Limited provides a comprehensive network of experts and includes some of the most experienced histopathologists in the UK. It was conceived in response to the overwhelming demand on Pathology resources. Key services include primary and secondary specialist opinions, a reference laboratory preparing and analysing a comprehensive range of tests, prognostic profiling for selection of appropriate adjuvant therapy, tissue preparation and evaluation for drug development and clinical trial evaluation, and cervical screening and general cytology.

Fairfield Imaging Limited is involved in the marketing and sale of microscopy hardware and software and image analysis and management systems, development of intellectual property in Cancer Diagnosis/prognosis systems and the development, support and assembly of diagnostic telepathology workstations.

Kinetic Imaging Limited is a leader in fluorescent imaging with its Komet product and Live Cell Imaging products, and has many major cancer research establishments as customers.

Second Opinion Solutions AS holds the intellectual property for PathSight, a Fairfield Imaging product.

Adams Healthcare Limited's principal activities were the manufacture and distribution of Pharmaceutical products to the hospital and industrial markets. The trade and assets of Adams Healthcare were sold on 31 December 2002.

CellPath plc offered a range of chemicals, consumables, laboratory instruments and software for histopathology laboratories, and included Thackray Instruments and PracticePlus. These two businesses distribute surgical instruments to hospital markets and practice equipment to General Practitioners. Thackray Instruments and PracticePlus were sold on 19 April 2002 and CellPath was sold on 13 December 2002. Prior to the disposal of CellPath plc, Medical Solutions had acquired the rights to distribute SurePath LBC systems and consumables in the UK from CellPath plc.

New property

To support our intention to develop a world-renowned centre of excellence for Cancer Diagnosis and drug discovery services in Nottingham over the next five years, in January 2003 the Company acquired the freehold to a new building, 1 Orchard Place, Nottingham Business Park, near Junction 26 of the M1. The new building will house Medical Solutions' Head Office, the Technology Division and new laboratories for the Services Division. Fairfield Imaging moved its operations from Tunbridge Wells to Nottingham on 28 February 2003. Kinetic Imaging will move from Bromborough, Merseyside on 30 June 2003, and Medical Solutions moved its Head Office on the disposal of Adams Healthcare. The freehold of the new building cost £3.2 million, and the estimated cost of fit out and new laboratories is approximately £1 million. A commercial mortgage of £2 million has been agreed for the building, and we anticipate that a substantial element of the fit out and laboratories will be financed through leasing and grants.

Share capital

At the year end a total of 79,403,240 (2001: 78,958,232) ordinary shares of 2p were in issue.

On 26 June 2002 445,008 ordinary 2p shares were issued to the value of £97,902, to the principals of PCPS, in consideration for the acquisition of Histological Solutions Limited.

Directors and their interests

Mr T.M. Twose resigned as a Director and Chief Executive Officer on 8 February 2002.

Mr R.H. Adams resigned as a Director on 21 January 2003 following the disposal of Adams Healthcare Limited.

On 25 March 2002 Mr C.A. Green became an Executive Director. He was previously a Non-Executive Director.

Prof K. Sikora was appointed on 22 April 2002 as a Non-Executive Director. On the same day Mr D. Seymour resigned as a Non-Executive Director.

Dr I. Ellis was appointed as Medical Director on 24 March 2003.

No contract existed during the year or at the year end in which any Director of the Company was interested.

None of the Directors have a service contract with the Company requiring more than 12 months' notice of termination to be given. The details of the Directors' contracts are given in the Directors' Remuneration Report.

The Directors' interests in the ordinary shares of the Company at 31 December 2002 and at 1 January 2002 or the date of appointment were:

	Beneficial holdings	
	31 December 2002 number of shares	1 January 2002 or date of appointment number of shares
Mr C.A. Green	222,222	222,222
Sir G.G. Roberts	210,223	176,666
Mr A.D. Longstaffe	689,038	689,038
Mr R.H. Adams	1,598,591	1,598,591
Prof K. Sikora	–	–

On 13 January 2003 Mr C.A. Green purchased 66,200 ordinary 2p shares and Mr A.D. Longstaffe purchased 66,200 ordinary 2p shares.

As at the date of this report there have been no further changes to the Directors' shareholdings.

Substantial shareholders

On 4 April 2003 the Company had been notified, in accordance with sections 198 to 208 of the Companies Act 1985, of the following interests of 3 per cent or more in the Company's ordinary share capital:

	Number	Percentage of ordinary share capital
Texas Holdings Limited	5,669,759	7.18%
Edinburgh Fund Managers	5,635,750	7.10%
Invesco Asset Management	5,149,166	6.48%
M&G Investment Management	5,000,000	6.30%
Singer & Friedlander	3,510,960	4.42%
Noah Clinch	2,630,989	3.31%
Cantor Fitzgerald	2,425,000	3.05%

Disabled employees

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. 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, as far as possible, be identical with that of other employees.

Employee consultation

The Group places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the performance of the Group. The employee share scheme which is open to all employees has been running successfully since its inception in September 2000.

Charitable and political donations

The Group made no charitable or political donations during the year (2001: £nil).

Supplier payment policy

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. It is the Group's policy to abide by its agreed terms of business provided the supplier meets its obligations. The number of days purchases represented by Group trade creditors at 31 December 2002 was 72 days (2001: 71 days).

Medical Solutions plc holds the investments in the Group companies, does not trade itself and does not have suppliers within the meaning of the Companies Act 1985.

Auditors

On 31 July 2002 Arthur Andersen resigned as auditors of the Company and the Directors appointed Deloitte & Touche to fill the casual vacancy. A resolution re-appointing Deloitte & Touche as auditors for the ensuing year will be proposed at the Annual General Meeting.

By order of the Board,

A.D. Longstaffe
Secretary
1 Orchard Place
Nottingham Business Park
Nottingham
NG8 6PX
29 April 2003

Statement of Compliance with the Code of Best Practice

The Group continues to be committed to high standards of corporate governance and the Board believes that the Group has been in compliance with the Provisions of the Code of Best Practice set out in section 1 of the Combined Code on corporate governance issued by the Financial Services Authority with the exception of:

- The Audit Committee has currently only two Non-Executive Directors and therefore does not comprise at least three Non-Executive Directors (D.3.1). This is due to the several months required to recruit new Non-Executive Directors. The Chairman is in the process of identifying and appointing one further Non-Executive Director with significant financial experience. The Chief Executive Officer is also a member of the Audit Committee.
- The same Non-Executive Director is currently serving as the Senior Non-Executive Director and the Chairman. These duties should be separate (A.2.1). This is due to only two Non-Executive Directors currently being appointed, which limits the segregation of duties.

Statement about applying the Principles of Good Governance

The Group has applied the Principles of Good Governance set out in section 1 of the Combined Code by complying with the Code of Best Practice, as reported above. Further explanation of how the Principles have been applied is set out below and, in connection with Directors' remuneration, in the Remuneration Report.

Remuneration and Audit Committee

The Remuneration and Audit Committees are both chaired by Sir G.G. Roberts. The other Non-Executive Director is also a member of the Remuneration Committee. The Audit Committee consists of the Chief Executive Officer, the Non-Executive Chairman and the other Non-Executive Director. The Finance Director acts as Secretary of the Committee.

Independence

Medical Solutions plc considers that its current Non-Executive Directors are independent for the purposes of the Combined Code.

Dialogue with institutional shareholders

The Directors seek to build on a mutual understanding of objectives between the Group and its institutional shareholders, in particular by communicating regularly throughout the year (by holding regular meetings) and encouraging them to participate in the Annual General Meeting.

Maintenance of a sound system of internal controls

In applying the principle D.2 of the Combined Code that the Board should maintain a sound system of internal control to safeguard shareholders' investment and the Company's assets, the Directors recognise that they have overall responsibility for ensuring that the Group maintains a system of internal control to provide them with reasonable assurance regarding effective and efficient operation, 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.

Maintenance of a sound system of internal controls (continued)

The key features of the internal control system that operated during the year covered by the financial statements are described below:

The Board meets regularly (at least ten times a year) to review all aspects of the Group's performance, concentrating mainly on financial performance, business risks and development. A number of matters are reserved for the Board's specific approval, including major capital expenditure, banking, Group budgets and dividend policy.

The following sets out the ongoing process for identifying, evaluating and managing significant risks found by the Company. This process has been in place for the year under review and up until the date of approving these statements and is reviewed regularly by the Board.

There is a clearly defined organisational structure with minimum levels of financial control to which each operating subsidiary must conform. The Group operates a comprehensive annual planning and budgeting process. Each operating division holds monthly meetings, chaired by a Group Director, for which a comprehensive financial reporting pack is prepared. The financial results are then consolidated and presented to the Group Board which enables the Board to monitor variances against plan, identify risks, assess their implications and set down subsequent control procedures. The Board also receives reports on other important subjects such as banking, environmental issues, legal and insurance matters.

The internal control system is continuously evaluated, regularly reviewed by the Board and accords with the Turnbull guidance.

The Board's monitoring covers all controls, including financial, operational and compliance controls and risk management. It is based principally on reviewing reports from management to consider whether significant risks are identified, evaluated, managed and controlled and whether any significant weaknesses are promptly remedied and indicate a need for more extensive monitoring. During the year in compliance with provisions the Directors have undertaken a review of the effectiveness of the Group's system of internal controls. The review covered all controls, including financial, operational and compliance controls and risk management. No significant previously unidentified risks were uncovered as part of this process. The Board has reviewed during the year under principle D.2.2 the need for an internal audit team and has concluded, based on the size of the Group, the involvement of the Directors and the effectiveness of the existing systems that this is not required.

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
29 April 2003

Introduction

This report has been prepared in accordance with the Directors' Remuneration Report Regulations 2002, which introduced new statutory requirements for the disclosure of Directors' remuneration in respect of periods ending on or after 31 December 2002. The report also meets the relevant requirements of the Listing Rules of the Financial Services Authority and describes how the Board has applied the Principles of Good Governance relating to Directors' remuneration. As required by the Regulations, a resolution to approve the report will be proposed at the Annual General Meeting of the Company at which the financial statements will be approved.

The Regulations require the auditors 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). The report has therefore been divided into separate sections for audited and unaudited information.

Unaudited information

Remuneration Committee

The Company has established a Remuneration Committee which is constituted in accordance with the recommendations of the Combined Code. The members of the Committee are Sir G.G. Roberts and Prof K. Sikora, who are all independent Non-Executive Directors and the Committee is chaired by Sir G.G. Roberts.

None of the 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 Committee makes recommendations to the Board. No Director plays a part in any discussion about his or her own remuneration.

In determining the Directors' remuneration for the year, the Committee consulted Mr C.A. Green about its proposals.

Remuneration policy

Executive remuneration packages are prudently designed to attract, motivate and retain Directors of the high calibre needed to maintain the Group's position and to reward them for enhancing value to shareholders. The performance measurement of the Executive Directors and key members of senior management and the determination of their annual remuneration package are undertaken by the Committee. The remuneration of the Non-Executive Directors is determined by the Board within limits set out in the Articles of Association.

There are four main elements of the remuneration package for Executive Directors and senior management:

- Basic annual salary (including Directors' fees) and benefits;
- Annual discretionary bonus payments with no defined cap as awarded by the Remuneration Committee;
- Share option incentives; and
- Pension arrangements.

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 prior to the beginning of each year and when an individual changes position or responsibility. In deciding appropriate levels, the Committee considers the Group as a whole and relies on objective research which gives up-to-date information on a comparator Group of companies which comprises the top ten companies by capitalisation within the Pharmaceuticals and Biotech sector.

Mr R.H. Adams' and Mr A.D. Longstaffe's salaries were increased by 10% from 1 June 2002. At a Board meeting on 24 July 2001, all the Executives and Non-Executive Directors agreed to defer salary increases awarded by the Remuneration Committee on 12 July 2001 until the end of that year, in the light of the Company's performance at the time.

In addition to basic salary, the Executive Directors receive certain benefits-in-kind, principally cars and private Healthcare.

Annual bonus payments

Bonuses were awarded to Mr R.H. Adams in the year of £30,000 for the performance of Adams Healthcare. All other bonuses of the Directors disclosed in this report relate to the successful completion of the disposal of the Adams Healthcare and CellPath businesses.

Share options

Share options are granted to Executive Directors and senior employees to encourage them to identify with shareholder interest and to meet performance objectives. Share options are granted and exercised under the rules of the Inland Revenue approved Executive share option scheme (under which no new options can be issued after 31 December 2000) and the unapproved Executive share option scheme.

The Company's policy is to grant options at the discretion of the 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.

The exercise price of the options granted under the above schemes is equal to the market value of the Company's shares at the time when the options are granted. The Company also operates a SAYE share option scheme for eligible employees.

The Company does not operate any long-term incentive schemes other than the share option schemes described above. No significant amendments are proposed to be made to the terms and conditions of any entitlement of a Director to share options.

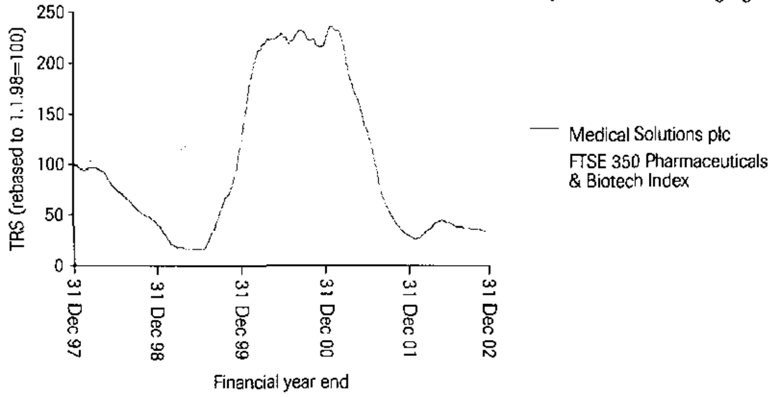
Pension arrangements

Executive Directors along with all employees are eligible to be members of the Company's defined contribution pension scheme. 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.

Performance graph

The following graph shows the Company's performance, measured by total shareholder return, compared with the performance of the FTSE350 Pharmaceuticals and Biotech Index also measured by total shareholder return. The Directors are of the opinion that the FTSE350 Pharmaceuticals and Biotech Index provides the most appropriate comparative, based on the Group operations.

TRS Performance v FTSE 350 Pharmaceuticals & Biotech Index (three month averaging



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. However, it may be necessary occasionally to offer long notice periods to new Directors. There are currently no Directors with service contracts with notice periods exceeding one year. In the event of early termination, the Directors' contracts provide for compensation up to a maximum of that payable for the notice period. The service contract for Mr C.A. Green had not been finalised as at 31 December 2002.

Non-Executive Directors

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. The Non-Executives receive further fees for additional work performed for the Company in respect of membership of the Remuneration Committee and Audit Committee. Non-Executive Directors cannot now participate in any of the Company's share option schemes and are not eligible to join the Company's pension scheme.

Audited information

Directors' emoluments and compensation

	Fees/basic salary £'000	Compensation for loss of office £'000	Pension contributions £'000	Bonus £'000	Taxable benefits in kind £'000	**Total 2002 £'000**	Total 2001 £'000
Executive Directors							
R.H. Adams (resigned 21 January 2003)	114	140	7	80	14	**355**	127
A.D. Longstaffe	93	–	5	40	12	**150**	105
T.M. Twose (resigned 8 February 2002)	15	193	–	–	13	**221**	150
C.A. Green	112	–	–	40	–	**152**	25
Non-Executive Directors							
Sir G.G. Roberts	33	–	–	–	7	**40**	35
D.E. Seymour (resigned 22 April 2002)	6	–	–	–	–	**6**	15
K. Sikora (appointed 22 April 2002)	20	–	–	–	–	**20**	2
	393	333	12	160	46	**944**	459
Fees from third parties						**–**	(19)
						944	440

On 25 March 2002 Mr C.A. Green became an Executive Director. He was previously a Non-Executive Director. Of the £152,000 remuneration, £2,500 was related to Mr C.A. Green services as a Non-Executive Director.

No bonuses were paid in respect of the prior year.

Of the amounts disclosed above, £152,450 (2001: £2,500) was paid to a third party, Searby Farming Company, on behalf of Mr C.A. Green.

Mr T.M. Twose was paid £193,000 compensation and was reimbursed £12,500 in respect of his legal costs, for loss of office on his resignation as Director and Chief Executive Officer of the Company on 8 February 2002. In addition, the Company incurred £12,500 of related legal costs.

Fees received from third parties in the prior year include £10,000 from Cytocell Plc and £9,383 from EPTTCO in respect of Directors' services provided by Mr T.M. Twose.

The Directors hold options under the unapproved share option scheme authorised by shareholders on 23 August 1999 as follows:

	Date granted	Number	Option price	First exercisable date	Last exercisable date
C.A. Green	29 Sept 1999	416,667	48p	28 Sept 2002	28 Sept 2009
G.G. Roberts	2 Nov 2000	89,286	112p	1 Nov 2003	1 Nov 2010
A.D. Longstaffe	2 Nov 2000	241,071	112p	1 Nov 2003	1 Nov 2010
	26 Mar 2001	89,552	100.5p	27 Mar 2004	27 Mar 2011

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. The performance criteria are set out before in Share Option section of this Remuneration Report.

The market price of the ordinary shares at 31 December 2002 was 19.5p and the range during the year was 14.75p to 31.0p.

Directors' pension entitlements

Two Directors were members of money purchase schemes during the year. Contributions paid by the Company in respect of such Directors were as follows:

	2002 **£**	2001 £
R.H. Adams	**7,000**	6,000
A.D. Longstaffe	**5,000**	4,000

Approval

This report was approved by the Board of Directors on 29 April 2003 and signed on its behalf by:

Gareth Roberts

Sir G.G. Roberts
Chairman of Remuneration Committee
29 April 2003

Statement of Directors' responsibilities

United Kingdom 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 and loss of the Group for that period. In preparing those financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and Group and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

To the members of Medical Solutions plc

We have audited the financial statements of Medical Solutions plc for the year ended 31 December 2002 which comprise the consolidated profit and loss account, the balance sheets, the consolidated cash flow statement, the statement of total recognised gains and losses and the related notes numbered 1 to 30. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the part of the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

As described in the statement of Directors' responsibilities, the Company's Directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. They are also responsible for the preparation of the other information contained in the annual report including the Directors' Remuneration Report. Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report described as having been audited in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

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 described as having been audited have been properly prepared in accordance with the Companies Act 1985. 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 transactions with the Company and other members of the Group is not disclosed.

We review whether the corporate governance statement reflects the Company's compliance with the seven provisions of the 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 the Directors' Report and the other information contained in the annual report for the above year as described in the contents section including the unaudited part of the Directors' Remuneration Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom auditing standards 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 described as having been 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 circumstances of the Company and the Group, 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 described as having been 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 described as having been audited.

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2002 and of the loss of the Group for the year then ended; and
- the financial statements and part of the Directors' Remuneration Report described as having been audited have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche

Deloitte & Touche
Chartered Accountants and Registered Auditors
Manchester
29 April 2003

Financial contents

28 Consolidated profit & loss account

29 Balance sheets

30 Consolidated cash flow statement

31 Notes to financial statements

52 Shareholders' notes

Consolidated profit & loss account

For the year ended 31 December 2002

	Notes	2002 £'000	2001 £'000
Turnover			
Continuing operations	2	**2,295**	1,870
Discontinued operations	2	**14,490**	14,230
	2	**16,785**	16,100
Operating profit (loss)			
Continuing operations	2	**(2,113)**	(1,502)
Discontinued operations		**721**	30
Operating profit/(loss) before goodwill and know-how amortisation and termination costs		**43**	(258)
Goodwill and know-how amortisation		**(1,217)**	(1,214)
Termination costs	3	**(218)**	–
Operating loss		**(1,392)**	(1,472)
Profit on disposal of fixed assets, discontinued operations	4	**76**	–
Loss on disposal of discontinued operations	5	**(8,678)**	–
Loss on ordinary activities before finance charges		**(9,994)**	(1,472)
Finance charges (net)	6	**(201)**	(136)
Loss on ordinary activities before taxation	7	**(10,195)**	(1,608)
Tax on loss on ordinary continuing activities		**35**	509
Tax on sale of discontinued activities		**(2,128)**	–
Total tax loss on ordinary activities	9	**(2,093)**	509
Loss for the financial year		**(12,288)**	(1,099)
Loss per ordinary share	11	**(15.51)p**	(1.39)p
Diluted loss per ordinary share	11	**(15.51)p**	(1.39)p

The accompanying notes are an integral part of this consolidated profit and loss account.

There are no recognised gains and losses in either year other than the loss for the year.

Balance sheets

31 December 2002

	Notes	Group 2002 £'000	Group 2001 £'000	Company 2002 £'000	Company 2001 £'000
Fixed assets					
Development costs and know-how	12	**1,563**	3,349	**–**	–
Goodwill	13	**2,447**	19,565	**–**	–
Intangible assets		**4,010**	22,914	**–**	–
Tangible assets	14	**1,144**	3,851	**30**	44
Investments	15	**–**	11	**11,328**	23,646
		5,154	26,776	**11,358**	23,690
Current assets					
Stocks	17	**1,027**	2,238	**–**	–
Debtors	18	**1,302**	3,450	**3,840**	4,374
Cash at bank and in hand		**16,320**	4,276	**15,688**	3,412
		18,649	9,964	**19,528**	7,786
Creditors: Amounts falling due within one year	19	**(5,420)**	(6,101)	**(14,858)**	(2,858)
Net current assets		**13,229**	3,863	**4,670**	4,928
Total assets less current liabilities		**18,383**	30,639	**16,028**	28,618
Creditors: Amounts falling due after more than one year	20	**(2,355)**	(2,421)	**–**	–
Net assets		**16,028**	28,218	**16,028**	28,618
Capital and reserves					
Called-up share capital	22	**1,588**	1,579	**1,588**	1,579
Share premium account	23	**25,059**	24,970	**25,059**	24,970
Merger reserve	23	**1,267**	1,267	**1,267**	1,267
Other reserve	23	**1,136**	1,136	**1,136**	1,136
Profit and loss account	23	**(13,022)**	(734)	**(13,022)**	(334)
Equity shareholders' funds		**16,028**	28,218	**16,028**	28,618

The accompanying notes are an integral part of these balance sheets.

The financial statements were approved by the Board of Directors on 29 April 2003 and signed on its behalf by:

A. D. Longstaffe
Finance Director

29 April 2003

Consolidated cash flow statement

For the year ended 31 December 2002

	Notes	**2002 £'000**	2001 £'000
Net cash (outflow) inflow from operating activities	24	**(36)**	154
Returns on investments and servicing of finance	25	**(198)**	(136)
Capital expenditure and financial investment	25	**(1,381)**	(2,119)
Acquisitions and disposals	25	**12,611**	(315)
Cash inflow (outflow) before management of liquid resources and financing		**10,996**	(2,416)
Financing	25	**69**	615
Increase (decrease) in cash in the year	26	**11,065**	(1,801)

The accompanying notes are an integral part of this consolidated cash flow statement.

1 Statement of accounting policies

The principal accounting policies are summarised below. They have all been applied consistently throughout the year and the preceding year with the exception of the policy for deferred taxation where FRS 19 "Deferred Tax" has been implemented during the year. No adjustment was required in respect of this implementation.

a) Accounting convention
The financial statements are prepared under the historical cost convention and in accordance with applicable accounting standards.

b) Basis of consolidation
The consolidated financial statements include the Company and all its subsidiary undertakings drawn up to 31 December each year. The results of subsidiaries and business undertakings acquired or sold are included in the consolidated profit and loss account for the periods from or to the date on which control passed. Acquisitions are accounted for under the acquisition method.

c) Intangible assets – goodwill
Goodwill arising on the acquisition of subsidiary undertakings and businesses, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised and written off on a straight-line basis over its useful economic life, which is 20 years. Provision is made for any impairment.

d) Intangible assets – development costs and know-how
Development costs are written off, 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 of the product over the period during which the Group is expected to benefit, which is four years. Development costs on projects in progress are not amortised. Provision is made for any impairment.

Know-how represents the industrial information and techniques bought by the management team which assists directly in the manufacturing of the products. This includes formulations, test reports, operating and testing procedures, instructions on use and information on operating conditions, whether human or in machine-readable form.

e) 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, other than freehold land, at rates calculated to write off the cost, less estimated residual value, of each asset evenly over its expected useful life as follows:

Freehold buildings	–	50 years
Plant and machinery	–	5 – 15 years
Fixtures and fittings	–	3 – 10 years
Motor vehicles	–	4 years

f) Government grants
Government grants of a revenue nature are credited to the profit and loss account in the same period as the related expenditure.

Government grants of a capital nature are released to the profit and loss account by equal annual instalments over the expected useful lives of the relevant assets.

g) Leasing and hire purchase commitments
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 lives. The interest element of the rental obligation is charged to the profit and loss account over the period of the lease and represents a constant proportion of the balance of capital repayments outstanding.

Costs in respect of operating leases are charged to the profit and loss account on a straight-line basis over the period of the lease.

1 Statement of accounting policies (continued)

h) Stocks and work in progress
Stocks and work in progress 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 the normal level of activity. Net realisable value is the price at which stock 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. Provision is made where necessary for obsolete, slow-moving and defective stock.

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

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the Company's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

j) Turnover
Turnover represents amounts receivable for goods and services provided in the normal course of business, net of trade discounts, VAT and other sales-related taxes.

k) Foreign currencies
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 profit and loss account.

l) Investments
Fixed asset investments are shown at cost less provision for impairment.

m) Pensions
The Group operates defined contribution pension schemes for the benefit of the directors and employees of the Group. The assets of the schemes are administered by trustees in funds independent from those of the Group.

The amount charged to the profit and loss account in respect of pension costs and other post-retirement benefits is the contributions payable in the year. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

2 Turnover and segmental analysis

	Continuing operations		Discontinued operations		Total	
	2002 £'000	2001 £'000	**2002 £'000**	2001 £'000	**2002 £'000**	2001 £'000
Turnover	**2,295**	1,870	**14,490**	14,230	**16,785**	16,100
Cost of sales	**(1,241)**	(1,114)	**(7,464)**	(8,079)	**(8,705)**	(9,193)
Gross profit	**1,054**	756	**7,026**	6,151	**8,080**	6,907
Selling and distribution costs	**(613)**	(332)	**(3,321)**	(2,923)	**(3,934)**	(3,255)
Research and development costs	**(474)**	(430)	**(419)**	(309)	**(893)**	(739)
Administrative expenses excluding goodwill and know-how amortisation and termination costs	**(1,726)**	(1,360)	**(1,484)**	(1,811)	**(3,210)**	(3,171)
Operating profit/(loss) before goodwill and know-how amortisation and termination costs	**(1,759)**	(1,366)	**1,802**	1,108	**43**	(258)
Amortisation of goodwill and know-how	**(136)**	(136)	**(1,081)**	(1,078)	**(1,217)**	(1,214)
Termination costs	**(218)**	–	**–**	–	**(218)**	–
Operating profit/(loss)	**(2,113)**	(1,502)	**721**	30	**(1,392)**	(1,472)
Profit on sale of fixed assets	**–**	–	**76**	–	**76**	–
Loss on sale of discontinued operations	**–**	–	**(8,678)**	–	**(8,678)**	–
(Loss)/profit on ordinary activities before finance charges and taxation	**(2,113)**	(1,502)	**(7,881)**	30	**(9,994)**	(1,472)
Finance charges (net)					**(201)**	(136)
Loss before taxation					**(10,195)**	(1,608)

In the prior year the directors reported two business segments, being the Pharmaceutical Division and the Cancer Diagnosis and Pathology Division.

All of the Pharmaceutical Division was discontinued during the year. In addition CellPath plc, which was disclosed with the Cancer Diagnosis and Pathology Division was discontinued. Discontinued operations shown above include the results for the Pharmaceutical Division and for CellPath plc. The prior year comparatives are disclosed on a consistent basis.

The Directors consider that they now operate in two business segments, namely Services and Technology. In the prior year these segments formed a part, and were disclosed, in the Cancer Diagnosis and Pathology Division. The continuing operations can be analysed between these two segments as follows, with the prior year comparatives disclosed on a consistent basis.

2 Turnover and segmental analysis *(continued)*

	Technology		Services		Total	
	2002 £'000	2001 £'000	**2002 £'000**	2001 £'000	**2002 £'000**	2001 £'000
Turnover	**1,192**	1,680	**1,103**	190	**2,295**	1,870
Gross profit	**643**	678	**411**	78	**1,054**	756
Operating profit/(loss) before goodwill and know-how amortisation and termination costs	**(824)**	(567)	**(329)**	(131)	**(1,153)**	(698)
Amortisation of goodwill and know-how	**(125)**	(125)	**(11)**	(11)	**(136)**	(136)
					(1,289)	(834)
Termination costs					**(218)**	–
Common costs					**(606)**	(668)
Operating loss on ordinary activities before finance charges and taxation					**(2,113)**	(1,502)
Segment net (liabilities) assets	**111**	1,041	**(141)**	222	**(30)**	1,263
Unallocated net assets					**16,058**	4,929
Discontinued net assets					**–**	22,026
Net assets					**16,028**	28,218

Unallocated net assets primarily comprise the cash available to the Group

	2002 Total £'000	2001 Total £'000
Turnover by destination		
United Kingdom and Republic of Ireland	**14,170**	13,716
Other European Union	**835**	941
Rest of Europe	**206**	372
The Americas	**228**	122
Africa	**51**	84
Asia	**462**	281
Other	**833**	584
	16,785	16,100

All turnover originated in the United Kingdom.

3 Other operating expenses (net)

	2002 £'000	2001 £'000
Selling and distribution costs	**3,934**	3,255
Research and development costs	**893**	739
Administrative expenses	**4,645**	4,385
	9,472	8,379

Included within administrative expenses is £218,000 of termination costs relating to Mr. T.M. Twose, who was paid compensation for loss of office on his resignation as Director and Chief Executive Officer of the Company on 8 February 2002.

4 Profit on sale of fixed assets, discontinued operations

During the year the Group sold a building for £140,000 realising a profit on disposal of £76,000. There is no tax impact.

5 Loss on disposal of discontinued operations

On 31 December 2002 the Group sold the trade and assets of Adams Healthcare Limited to Ecolab Limited for cash consideration of £14,678,000. The loss on disposal after costs and goodwill write off amounts to £7,753,000. On 13 December 2002 the Group sold 100% of the share capital of CellPath plc to Clinicare Limited for cash consideration of £1,559,000. After costs and goodwill write off the loss on disposal amounted to £1,271,000.

On 19 April 2002 the Group sold the trade and assets of the Thackray Instruments and Practice Plus businesses for consideration of £740,000, of which £190,000 was received by the Group and a further £550,000 receivable was sold as part of the CellPath plc disposal. After costs of £123,000 the profit on disposal amounts to £346,000.

The loss on disposal is as follows:

	£'000
Consideration to the Group, net of overdraft sold	16,451
Less costs of disposal	(1,391)
Net assets sold	(7,588)
Profit before goodwill write off	7,472
Goodwill write off	(16,150)
Loss on sale	(8,678)
Loss on sale of Adams Healthcare	(7,753)
Loss on sale of CellPath	(1,271)
Profit on sale of Thackray	346
	(8,678)

There is a tax charge of £2,128,000 relating to the disposal of the Adams Healthcare trade and assets. The other disposals have no tax effect.

6 Finance charges (net)

	2002 £'000	2001 £'000
Interest receivable and similar income	**63**	113
Bank loans and overdrafts	**(241)**	(214)
Finance leases and hire purchase contracts	**(23)**	(35)
	(201)	(136)

7 Loss on ordinary activities before taxation

Loss on ordinary activities before taxation is stated after charging (crediting):

	2002 £'000	2001 £'000
Depreciation of tangible fixed assets		
– owned	**432**	323
– held under finance leases and hire purchase contracts	**159**	100
Amortisation of development costs	**183**	150
Amortisation of goodwill	**1,067**	1,063
Amortisation of know-how	**150**	150
Termination costs	**218**	–
Loss on sale of businesses	**8,678**	–
Profit on sale of fixed assets	**(76)**	–
Operating lease rentals		
– plant and machinery	**9**	–
– other	**220**	231
Auditors' remuneration		
– audit services	**45**	48
– other services	**109**	19
Research and development costs expensed	**710**	589

8 Staff costs

The average monthly number of employees (including Executive Directors) during the year was:

	2002 £'000	2001 £'000
Management	**11**	15
Administration and finance	**42**	40
Production, development and technical	**93**	108
Sales and marketing	**20**	41
	166	204

Their aggregate remuneration comprised:

	2002 £'000	2001 £'000
Wages and salaries	**4,871**	3,696
Social security costs	**451**	340
Other pension costs	**121**	73
	5,443	4,109
Less amounts recharged to third parties	**(66)**	(18)
Less amounts capitalised	**(289)**	(242)
	5,088	3,849

Details of the Directors' remuneration are given in the Directors' Remuneration Report.

9 Tax on loss on ordinary activities

The tax (charge)/credit comprises:

	2002 £'000	2001 £'000
UK corporation tax	**2,093**	–
Adjustments in respect of previous period – UK corporation tax	**–**	(210)
Total current tax	**2,093**	(210)
Deferred tax		
Origination and reversal of timing differences	**–**	(299)
Total tax on loss on ordinary activities	**2,093**	(509)

The charge to UK corporation tax includes £2,128,000 relating to the disposal of the trade and assets of Adams Healthcare.

9 Tax on loss on ordinary activities (continued)
The difference between the total current tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the loss before tax is as follows:

	2002 £'000	2001 £'000
Group loss on ordinary activities before tax	**10,195**	1,608
Tax on Group loss on ordinary activities at standard UK corporation tax rate of 30% (2001: 30%)	**(3,059)**	(482)
Effects of:		
Gain on businesses sold not taxable	**(594)**	–
Goodwill on businesses sold	**4,886**	–
Goodwill and know-how amortisation not deductible for tax purposes	**365**	364
Other expenses not deductible for tax	**402**	118
Capital allowances in excess of depreciation	**93**	–
Adjustments in respect of previous periods	**–**	(210)
Group current tax charge (credit) for the year	**2,093**	(210)

Losses within the Parent Company and certain subsidiaries which are available for relief against future profits of the same trade are approximately £1,300,000 (2001: £2,505,000).

Deferred tax
Not provided deferred tax is as follows:

	2002 £'000	2001 £'000
Group		
Accelerated capital allowances	**64**	157
Other timing differences	**(3)**	(1)
Tax losses available	**(390)**	(751)
Potential deferred tax asset	**(329)**	(595)
Company		
Accelerated capital allowances	**(1)**	–
Tax losses available	**(390)**	(751)
Potential deferred tax asset	**(391)**	(751)

The deferred tax asset is not recognised as the Group does not anticipate taxable profits arising within the immediate future.

10 Loss attributable to members of the Parent Company
In accordance with the exemption allowed by section 230 of the Companies Act 1985 the Company has not presented its own profit and loss account. The loss after taxation dealt with in the financial statements of the Parent Company amounted to £12,688,000 (2001: £556,000).

11 (Loss)/earnings per ordinary share

The calculations of loss per share are based on the following profits and numbers of shares.

	Basic		Diluted	
	2002 £'000	2001 £'000	**2002 £'000**	2001 £'000
Loss for the financial year	**(12,288)**	(1,099)	**(12,288)**	(1,099)

	2002 Number of shares	2001 Number of shares
Weighted average number of shares:		
For basic earnings per share and diluted earnings per share	**79,187,442**	78,958,232

Share options are not taken into account when calculating the diluted earnings per share as, on conversion to ordinary shares, they would decrease the loss per ordinary share, hence are not considered as dilutive.

12 Intangible fixed asset – development costs and know-how

Group

	Development costs £'000	Know-how £'000	Total £'000
Cost			
At 1 January 2002	1,652	3,130	4,782
Additions	539	–	539
Reclassification	88	(88)	–
Disposals	–	(3,042)	(3,042)
At 31 December 2002	**2,279**	**–**	**2,279**
Amortisation			
At 1 January 2002	533	900	1,433
Charge for the year	183	150	333
Disposals	–	(1,050)	(1,050)
At 31 December 2002	**716**	**–**	**716**
Net book value			
At 31 December 2002	**1,563**	**–**	**1,563**
At 1 January 2002	1,119	2,230	3,349

Included in the capitalised development costs there is a balance of £793,000 (2001: £630,000) in relation to Fairfield DNA nucleotpying. Sales are expected to commence in 2003, from which date the related costs will be written off over four years.

Also included in capitalised development costs is a balance of £168,000 (2001: £90,000) relating to the development of the Pathsight Virtual Microscope technology. Sales are expected to commence in 2003, from which date the related costs will be written off over four years.

13 Intangible fixed assets – goodwill
Group

	£'000
Cost	
At 1 January 2002	21,558
Disposals	(18,838)
Additions	98
At 31 December 2002	**2,818**
Amortisation	
At 1 January 2002	1,993
Charge for the year	1,067
Disposals	(2,689)
At 31 December 2002	**371**
Net book value	
At 31 December 2002	**2,447**
At 1 January 2002	19,565

Goodwill disposed of during the year relates to the sale of the businesses of Adams Healthcare Limited, CellPath plc and Thackray Instruments and Practice Plus.

14 Tangible fixed assets
Group

	Freehold land and buildings £'000	Plant and machinery £'000	Fixtures and fittings £'000	Motor vehicles £'000	Total £'000
Cost					
At 1 January 2002	2,169	1,375	1,835	162	5,541
Additions	120	336	712	35	1,203
Disposal of businesses	(2,149)	(1,179)	(1,494)	(36)	(4,858)
Disposals	(140)	(33)	(169)	(93)	(435)
At 31 December 2002	**–**	**499**	**884**	**68**	**1,451**
Depreciation					
At 1 January 2002	198	504	930	58	1,690
Charge for the year	66	197	298	30	591
Disposal of businesses	(200)	(648)	(950)	(16)	(1,814)
Disposals	(64)	(25)	(34)	(37)	(160)
At 31 December 2002	**–**	**28**	**244**	**35**	**307**
Net book value					
At 31 December 2002	**–**	**471**	**640**	**33**	**1,144**
At 1 January 2002	1,971	871	905	104	3,851

There is no material difference between the market valuation and the historic cost of freehold buildings.

The total net book value of fixed assets includes £30,000 (2001: £409,507) of assets held under finance leases and hire purchase contracts.

14 Tangible fixed assets (continued)
Company

	Fixtures and fittings £'000	Motor Vehicles £'000	Total £'000
Cost			
At 1 January 2002	8	47	55
Additions	15	–	15
Disposals	–	(23)	(23)
At 31 December 2002	**23**	**24**	**47**
Depreciation			
At 1 January 2002	1	10	11
Charge for year	–	12	12
Disposals	–	(6)	(6)
At 31 December 2002	**1**	**16**	**17**
Net book value			
At 31 December 2002	**22**	**8**	**30**
At 1 January 2002	7	37	44

15 Fixed assets investments

Group

	£'000
Cost	
At 1 January 2002 and **31 December 2002**	**11**
Provisions	
At 1 January 2002	–
Impairment	(11)
At 31 December 2002	**(11)**
Net book value	
At 31 December 2002	**–**
At 1 January 2002	11

The Group investment in Data-og Billedsystemer AS was impaired in the year to £Nil.

Company

Cost	
At 1 January 2002	23,646
Additions	97
Disposals	(1,452)
At 31 December 2002	**22,291**
Provisions	
At 1 January 2002	–
Impairment	10,963
At 31 December 2002	**10,963**
Net book value	
At 31 December 2002	**11,328**
At 1 January 2002	23,646

On 13 December 2002 the Company disposed of 100% of the share capital of CellPath plc. The impairment in the year relates to the write down required of the investment in Adams Healthcare Limited following the disposal of the trade and assets in the year.

On 26 June 2002 445,008 ordinary 2p shares were issued to the value of £97,902, to the principals of PCPS, in consideration for the acquisition of Histological Solutions Limited. Histological Solutions Limited did not trade during the year and will remain dormant. PCPS, formerly a business unit within Peterborough Hospital NHS Trust, was acquired by Medical Solutions plc for an annual licence fee and now trades within PathLore Limited. The related trading results are considered immaterial to the Group in 2002 and are not separately disclosed.

15 Fixed assets investments (continued)

Company (continued)

The subsidiary undertakings of Medical Solutions plc and their respective activities were as follows at 31 December 2002:

	Country of incorporation	Principal activity	£'000 Percentage held
Fairfield Imaging Limited	England	Marketing and sale of microscopy hardware and software and image analysis and management systems, development of intellectual property in a cancer diagnosis/prognosis system and development, support and assembly of diagnostic telepathology workstations.	100%
Fairfield Research Limited	England	Dormant	100%*
Fairfield Telepathology Limited	England	Dormant	100%*
Adams Healthcare Limited	England	Non-trading following sales of trade and assets on 31 December 2002.	100%
Kinetic Imaging Limited	England	Provision of computerised systems and equipment together with consultancy services for medical research.	100%
Quinoderm Limited	England	Dormant.	100%
Second Opinion Solutions AS	Norway	Holds intellectual property	75.3%
PathLore Limited	England	Provision of Pathology Services	100%
Histological Solutions Limited	England	Dormant	100%

* held indirectly

16 Disposal of businesses

On 31 December 2002 the Group sold the trade and assets of Adams Healthcare Limited to Ecolab Limited. On 13 December 2002 the Group sold its 100% interest in the ordinary share capital of CellPath plc to Clinicare Limited. On 19 April 2002 the Group disposed of the trade and assets of Thackray Instruments and PracticePlus. The results of the businesses sold up to the dates of disposal are disclosed within the Group profit and loss account as discontinued operations.

Net assets disposed of and the related sale proceeds were as follows:

	£'000
Fixed assets (including know-how of £1,992,000)	5,036
Current assets	4,830
Current liabilities	(2,171)
Finance leases	(130)
Net assets	7,565
Related goodwill	16,149
Loss on sale	(8,678)
Sale proceeds	15,036
Satisfied by:	
Cash	16,427
Less costs of disposal paid	(1,003)
Net cash consideration	15,424
Less costs of disposal accrued	(388)
Net consideration	15,036

17 Stocks

	Group	
	2002 £'000	2001 £'000
Raw materials and consumables	**6**	714
Work in progress	**78**	50
Finished goods and goods for resale	**943**	1,474
	1,027	2,238

The directors consider that the difference between the amounts shown and the replacement cost is not significant.

18 Debtors

Amounts falling due within one year:

	Group		Company	
	2002 £'000	2001 £'000	**2002 £'000**	2001 £'000
Trade debtors	**744**	2,908	**–**	70
Amounts owed by Group undertakings	**–**	–	**3,701**	4,260
VAT	**229**	32	**114**	(6)
Other debtors	**299**	101	**–**	–
Prepayments and accrued income	**30**	409	**25**	50
	1,302	3,450	**3,840**	4,374

19 Creditors: Amounts falling due within one year

	Group		Company	
	2002 £'000	2001 £'000	**2002 £'000**	2001 £'000
Bank loans and overdrafts	**2,038**	938	**–**	–
Finance leases and hire purchase contracts	**9**	125	**–**	–
Trade creditors	**634**	1,088	**–**	(2)
Amounts owed to Group undertakings	**–**	–	**14,825**	–
Corporation tax	**2,137**	11	**–**	–
Other taxes and social security	**65**	324	**33**	–
Other creditors	**34**	34	**–**	(8)
Accruals and deferred income	**503**	720	**–**	7
Deferred consideration	**–**	2,861	**–**	2,861
	5,420	6,101	**14,858**	2,858

The deferred consideration representing the loan notes issued on the Quinoderm Limited acquisition in 2000 was paid in full on 30 June 2002.

20 Creditors: Amounts falling due after one year

	Group	
	2002 £'000	2001 £'000
Bank loans	**2,334**	2,235
Finance leases and hire purchase contracts	**21**	186
	2,355	2,421

20 Creditors: Amounts falling due after one year (continued)

Bank loans

Within one year	**550**	429
Between one and two years	**550**	857
Between two and five years	**1,784**	1,378
	2,884	2,664

Bank loans of £2,244,000 are secured by fixed and floating charges over the assets of Adams Healthcare Limited.

A bank loan of £640,000 represents a chattel mortgage secured over certain assets of PathLore Limited.

	£'000	£'000
Finance leases and hire purchase contracts		
Between one and two years	**11**	135
Between two and five years	**13**	65
	24	200
Less: finance charges allocated to future periods	**(3)**	(14)
	21	186

21 Derivatives and other financial instruments

The numerical disclosures in this note deal with financial assets and financial liabilities as defined in Financial Reporting Standard 13 *Derivatives and Other Financial Instruments: Disclosures (FRS 13).* Certain financial assets such as investments in subsidiary and associated companies are excluded from the scope of these disclosures.

As permitted by FRS 13, short-term debtors and creditors have been excluded from the disclosures, other than the currency disclosures.

Liquidity

The Group's overall objective is to ensure that it is, at all times, able to meet its financial commitments as and when they fall due.

Interest rate profile

The Group's exposure to interest rate fluctuations is managed by fixing interest rates in the short to medium-term on borrowings. The interest rate profiles on cash and borrowings are shown below. The fair value of financial assets and liabilities is not materially different from their carrying values.

Cash

There were no balances on short-term deposit at the year end (2001: £3,200,000). The available cash at 31 December 2002, derived from disposals of CellPath plc and Adams Healthcare Limited net assets on 13 December 2002 and 31 December 2002 respectively, was deposited in solicitors' escrow accounts, earning interest based on current LIBOR.

Borrowings

There was also an overdraft of £1,488,000 at the year-end (2001: £509,000). The overdraft is payable on demand.

The bank loan of £2,244,000 is stated net of £115,560 finance costs capitalised as allowed by FRS4. The total finance costs of £161,207 were capitalised in 2001 and are amortised over the duration of loan which is seven years.

There are no un-drawn committed borrowing facilities available to the Group as at 31 December 2002.

Currency exposure

Where possible the Group invoices in sterling to mitigate currency exposure. In situations where invoices are raised in other currencies, the Group seeks to minimise its risk by its pricing policy.

22 Share capital
Group and Company

	2002		2001	
	Number	**£'000**	Number	£'000
Authorised				
Ordinary shares of 2p	**100,000,000**	**2,000**	100,000,000	2,000
Authorised, called-up and fully paid				
Ordinary shares of 2p	**79,403,240**	**1,588**	78,958,232	1,579

On 24 June 2002 the Company issued 445,008 ordinary 2p shares as consideration for the acquisition of Histological Solutions Limited.

Details of the options are as follows:

Note	Ordinary shares at 31 December 2001	Granted during the year	Lapsed during the year	**Ordinary shares at 31 December 2002**	Exercise price	Date exercisable	Expiry date
1	75,000	–	–	**75,000**	44p	28.09.2002	28.09.2009
2	416,667	–	–	**416,667**	48p	28.09.2002	28.09.2009
2	68,750	–	–	**68,750**	132p	04.04.2003	04.04.2010
2	145,000	–	(58,750)	**86,250**	124p	09.05.2003	09.05.2010
2	733,835	–	–	**733,835**	133p	15.08.2003	15.08.2010
3	190,172	–	–	**190,172**	133p	30.09.2003	30.09.2010
2	892,857	–	–	**892,857**	112p	01.11.2003	01.11.2010
2	880,597	–	(517,413)	**363,184**	100.5p	27.03.2004	27.03.2011
2	463,868	–	–	**463,868**	52.5p	11.07.2004	11.07.2011
2	–	125,000	(100,000)	**25.000**	27.75p	25.03.2005	25.03.2012

Note 1: granted under the approved share option scheme

Note 2: granted under the unapproved share option scheme

Note 3: granted under the approved SAYE share option scheme

23 Reconciliation of movement in shareholders' funds and reserves

Group

	Share capital £'000	Share premium account £'000	Merger reserve £'000	Other reserve £'000	Profit and loss account £'000	Total shareholders' funds £'000
At 1 January 2002	1,579	24,970	1,267	1,136	(734)	28,218
Shares issued	9	89	–	–	–	98
Loss for the year	–	–	–	–	(12,288)	(12,288)
At 31 December 2002	**1,588**	**25,059**	**1,267**	**1,136**	**(13,022)**	**16,028**

Company

	Share capital £'000	Share premium account £'000	Merger reserve £'000	Other reserve £'000	Profit and loss account £'000	Total shareholders' funds £'000
At 1 January 2002	1,579	24,970	1,267	1,136	(334)	28,618
Shares issued	9	89	–	–	–	98
Loss for the year	–	–	–	–	(12,688)	(12,688)
At 31 December 2002	**1,588**	**25,059**	**1,267**	**1,136**	**(13,022)**	**16,028**

24 Reconciliation of operating loss to operating cash (outflow)/inflow

	2002 £'000	2001 £'000
Operating (loss)/profit	**(1,392)**	(1,472)
Goodwill amortisation	**1,067**	1,063
Depreciation charges	**591**	423
Amortisation of development costs and know-how	**333**	300
Increase in stocks	**(732)**	(65)
(Increase)/decrease in debtors	**(737)**	759
Increase/(decrease) in creditors	**834**	(854)
Net cash (outflow)/inflow from operating activities	**(36)**	154

Net cash inflow from operating activities of discontinued operations amounted to £1,255,000.

25 Analysis of cash flows

	2002 £'000	2001 £'000
Returns on investments and servicing of finance		
Interest received	**63**	113
Interest paid	**(238)**	(214)
Interest element of finance leases and hire purchase rental payments	**(23)**	(35)
Net cash (outflow)/inflow	**(198)**	(136)
Capital expenditure and financial investment		
Purchase of tangible fixed assets	**(982)**	(1,697)
Capitalisation of development costs	**(539)**	(434)
Sale of tangible fixed assets	**140**	12
Net cash outflow	**(1,381)**	(2,119)
Acquisitions and disposals		
Deferred consideration for acquisitions in prior years	**(2,837)**	–
Sale of businesses (including overdraft sold of £24,000)	**15,448**	–
Purchase of subsidiary undertakings	**–**	(180)
Acquisition expenses	**–**	(135)
Net cash outflow	**12,611**	(315)
Financing		
Capital element of finance leases and hire purchase rental payments	**(151)**	(97)
Increase/(decrease) in short-term borrowings	**21**	(187)
Increase/(decrease) in long-term borrowings	**199**	899
Net cash inflow	**69**	615

26 Analysis and reconciliation of net funds

	At 1 January 2002 £'000	Cash flow £'000	Other non-cash changes £'000	Disposals £'000	**At 31 December 2002 £'000**
Cash in hand and at bank	4,276	12,044	–	–	**16,320**
Overdrafts	(509)	(979)	–	–	**(1,488)**
	3,767	11,065	–	–	**14,832**
Debt due after one year	(2,235)	(199)	100	–	**(2,334)**
Debt due within one year	(429)	(21)	(100)	–	**(550)**
Finance leases	(311)	151	–	130	**(30)**
	(2,975)	(69)	–	130	**(2,914)**
Total	792	10,996	–	130	**11,918**

	2002 £'000	2001 £'000
Increase/(decrease) in cash in the year	**11,065**	(1,801)
Cash inflow from increase in debt and lease financing	**(69)**	(615)
Change in net debt funds resulting from cash flows	**10,996**	(2,416)
Finance leases disposed with subsidiaries	**130**	–
New finance leases	**–**	(133)
Movement in net funds in year	**11,126**	(2,549)
Net funds at 1 January	**792**	3,341
Net funds at 31 December	**11,918**	792

Major non-cash transactions
On 24 June 2002 the Company issued 445,008 ordinary 2p shares as consideration for the acquisition of Histological Solutions Limited. The market value of the shares issued was £97,902.

27 Financial commitments

Group

Contracted, but not provided capital commitments as at 31 December 2002 were £Nil (2001: £Nil).

The Group is committed to making the following payments during the next year under non-cancellable operating leases:

	2002		2001	
	Land and buildings £'000	**Motor vehicles and other £'000**	Land and buildings £'000	Motor vehicles and other £'000
Date of lease termination				
– within one year	**–**	**–**	–	38
– between two to five years	**66**	**21**	76	105

28 Pension arrangements

The Group operates a defined contribution pension scheme for which pension costs charged for the year amounted to £121,000 (2001: £73,000).

29 Contingencies

Company

Under the terms of the Group's current bank 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 2002 this amounted to £3,732,000 (2001: £3,170,000).

There is deferred contingent consideration payable in respect of PathLore Limited acquisition in 2000 up to a total £400,000. In accordance to the deed dated 24 January 2001 between Medical Solutions plc and Dr Ian Ellis containing the restrictive covenant and consideration, the first £200,000 payment shall be due when the operating profit of Medical Solutions plc and its subsidiaries (derived from turnover less cost of sales and other operating expenses only) as shown by the consolidated accounts of Medical Solutions plc ("the Operating Profit") for any financial year ending prior to 31 December 2005 shall reach £300,000 with the second £200,000 when the Medical Solutions plc Operating Profits reaches £600,000, for any financial year ending prior 31 December 2006. In the event of any sale of any business or subsidiary of the Medical Solutions plc Group during the period of the Deed or any change in the accounting reference date of Medical Solutions plc or any of its subsidiaries, the terms of the Deed shall be further adjusted so as to ensure that Dr I. Ellis is not prejudiced by the sale or the change in accounting reference date.

30 Related party transactions

Mr N. Clinch who is a substantial shareholder of the Company as disclosed in the Directors' report, received a salary of £62,619 in the year in respect of his directorship of the Company's subsidiary Fairfield Imaging Limited.