Phytopharm plc
Report and accounts
2007

The pharmaceutical development and functional food company

Developing & Delivering

Contents

Inspired by nature...

We develop novel products in areas of high unmet health needs, to deliver cures and relieve suffering for healthier lives, for longer.

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Successful completion in July 2007 of a Phase Ib healthy volunteer clinical trial for Myogane™, our amyotrophic lateral sclerosis (ALS) product

Cogane™
Data on preclinical models of Parkinson's disease presented at 'The Movement Disorder Society's 11th international congress' in Istanbul, Turkey, June 2007, supporting a novel mode of action for Cogane™ in treating the underlying disease

Data presented at 'Neuroscience 2007, the 37th annual meeting of the Society for Neuroscience', in San Diego USA, November, demonstrating that in a preclinical model, Cogane™ elevates glial-derived neurotrophic factor (GDNF) in the area of the brain involved in Parkinson's disease

Functional foods

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Hoodia extract, our weight management product partnered with Unilever, enters final development stage prior to registration and commercial launch

Good progress in clinical trials with healthy overweight subjects

Phytopica®
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Schering Plough launches Phytopica® in Italy in March and in France in April 2007

PYM60086
In licence of a novel functional food for memory and concentration from the Beijing Institute, China in June 2007

Our strategy

Phytopharm is a pharmaceutical development and functional food company Our products are developed from medicinal plants thereby reducing the development risk, cost and time to market As a virtual company, Phytopharm's model is centred on a lean cash burn with all laboratory, manufacturing and clinical work out-sourced to specialists, while core competencies such as strategy and management are maintained in-house Close collaboration with charitable organisations enhances our interaction with Key Opinion Leaders and accelerates our development programmes increasing their value

Chairman's statement

I was delighted to be invited to join the Board of Directors as Non-Executive Chairman in July 2007

Phytopharm's business strategy of developing pharmaceutical products and functional foods from medicinal plants is appealing and the Company has an impressive portfolio of innovative products in areas of high unmet health needs With the new management team in place, the business has a clear vision and strong growth potential

Non-Executive Directors are closely involved with the governance of the Company and we form the Audit and Remuneration Committees Of particular satisfaction is the high quality of internal operational and financial controls the Group maintains

My Non-Executive Director colleagues and I continue to be impressed by the quality of people in the business and their energy and commitment. The Board and management team have a keen focus on the creation of shareholder value and a series of strategic objectives have been put in place to achieve this goal We look forward to developing our products further and delivering on our objectives in 2008

Alistair Taylor
Non-Executive Chairman

Chief Executive's review

I am pleased to report that Phytopharm is making good progress in developing a broad, balanced portfolio of products with diversified risk and substantial potential value

Upon my appointment to Chief Executive in January 2007, I implemented a series of strategic objectives that included rationalising our pipeline while improving our ability to develop our products

With the appointment of Piers Morgan as Chief Financial Officer in January 2007, the management team is strengthened, bringing significant benefits to the Board and the Company

Over the period we have continued to make good progress in clinical trials with our weight management product, *Hoodia* extract, and advanced successfully into the final development stage prior to registration and launch with our partner Unilever, in September 2007 This final development stage includes supply chain expansion and consumer studies that will evaluate reductions in calorie intake as part of a weight management programme in the general population

It is encouraging that sales of our canine skin health product, Phytopica®, by our partner Schering-Plough have exceeded expectations (103% growth on an annualised basis) and that their European rollout has begun with launches in Italy in March 2007 and France in April 2007

Over the period we have made steady progress with our pharmaceutical products in clinical development We have successfully advanced Myogane™ for amyotrophic lateral sclerosis (ALS) through a Phase Ib healthy volunteer clinical trial in July 2007 and we requested EU orphan medicinal product status for Myogane™ in December 2007 We have also demonstrated that in preclinical models of Parkinson's disease, Cogane™ reverses the neuronal damage and elevates glial-derived neurotrophic factor (GDNF) in the area of the brain involved in Parkinson's disease Elevation of GDNF has been shown to improve symptoms in Parkinson's disease patients

One of our strategic objectives is to share the cost and risk of product development while increasing long term shareholder value The data from our pharmaceutical products has generated considerable interest from charitable organisations and we are finalising strategic financial support from these organisations for further development activities

Phytopharm has developed a broad portfolio of products with diversified risk and substantial value Our functional food products are now generating revenue Our partner Schering Plough continues its European rollout of Phytopica® with revenues exceeding expectations and with their global presence we look forward to continued growth Meanwhile, Unilever is fully funding our programme for *Hoodia* extract, and we look forward to generating royalty income in the near future on product launch

We operate with a low cash burn and with strategic financial support being finalised from charitable organisations to develop further our pharmaceutical products Cogane™ and Myogane™, we will continue to reduce our net development costs while increasing long term shareholder value By delivering on our strategic objectives, we look forward with confidence to building on our achievements and reporting on the continued development of our pipeline over the coming year

Dr Daryl Rees
Chief Executive Officer

Our key strategic objectives:

	Developing	Delivering
Measuring our success against our key strategic objectives	A broad, balanced portfolio of products with diversified risk and substantial potential value	On our strategy to create value for our shareholders

Strategic objective 1

Developing

...a broad, balanced portfolio of products with diversified risk and substantial potential value

How we are achieving this

Cogane™
an orally active, neurotrophic factor inducer for Parkinson's & Alzheimer's disease

Myogane™
an orally active, neurotrophic factor inducer for ALS

PYM60086
a novel functional food for memory and concentration

Cogane™ is being developed for Parkinson's and Alzheimer's disease and has potential as a treatment for neuropsychiatric disorders A consistent feature of Parkinson's disease is the loss of dopamine-containing neurones in the *substantia nigra* area of the brain In 2007, we presented data showing that in pre-clinical models of Parkinson's disease, Cogane™ reverses the neuronal damage and elevates glial-derived neurotrophic factor (GDNF) in this area of the brain Elevation of GDNF has been shown to improve symptoms in Parkinson's disease patients

Myogane™ is being developed for ALS (also known as Lou Gehrig's disease) ALS is the most common motor neurone disease and results from progressive degeneration of motor neurones Myogane™ protects against neuronal damage when administered orally to preclinical models of ALS, delays the loss of muscle strength and extends survival time In July 2007 we successfully advanced our oral liquid formulation of Myogane™ through a Phase Ib healthy volunteer clinical trial

PYM60086 is a functional food that we licensed from the Beijing Institute, China in July 2007 This in-licence fulfils one of our strategic objectives of expanding our product portfolio with a functional food candidate for memory and concentration, an area in which we have established expertise

Cogane™

Elevates glial-derived neurotrophic factor (GDNF) in the area of the brain involved in Parkinson's disease

Strategic objective 2

Delivering

...on our strategy to create value for our stakeholders

How we are achieving this

Hoodia extract
weight management
functional food product

Hoodia extract contains a novel satiety stimulator that reduces calorie intake in overweight subjects We have continued to make good progress in clinical trials and in September 2007 advanced successfully into the final development stage prior to registration and launch with our partner Unilever This final development stage includes supply chain expansion and consumer studies that will evaluate reductions in calorie intake as part of a weight management programme in the general population

Phytopica®
natural, three plant product
for canine skin health

Phytopica® is a novel three in one approach to help maintain a normal healthy immune system, support normal white cell function and provide antioxidant benefits Sales of Phytopica® by our partner Schering-Plough have exceeded expectations (103% growth on an annualised basis) and their European rollout has begun with launches in Italy in March 2007 and France in April 2007 Schering-Plough will continue to explore the marketing and distribution of Phytopica® in further countries worldwide

Cogane™
an orally active, neurotrophic
factor inducer for Parkinson's &
Alzheimer's disease

Our Cogane data has generated considerable interest from charitable organisations and we are now finalising the strategic financial support from these organisations for further development activities

Hoodia extract

Hoodia extract enters final development stage prior to registration and commercial launch

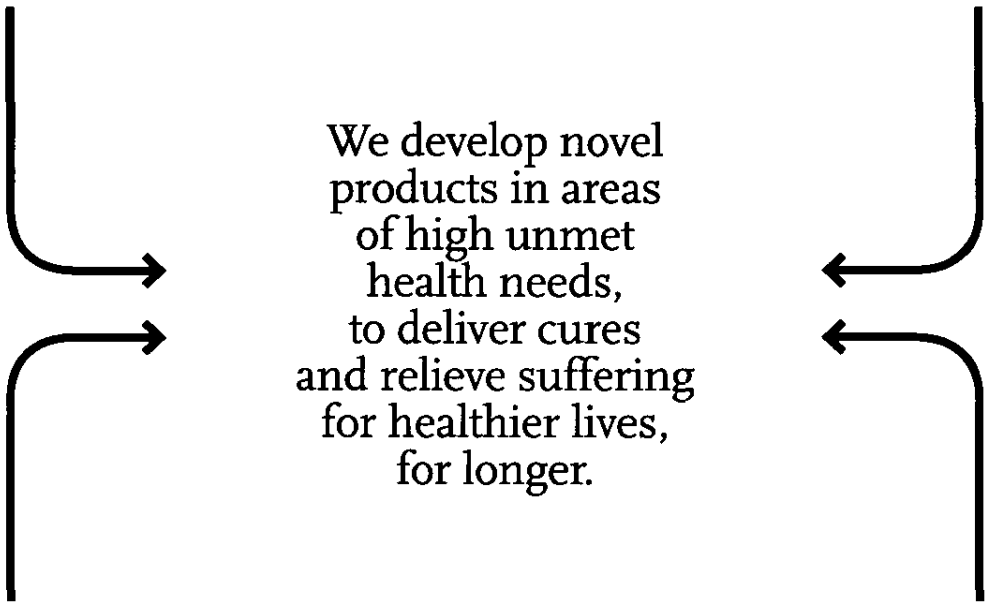
Our business strategy

Medicinal plants – history of use

- Reduces development cost and time
- Reduces risk
- Pharmaceuticals and functional foods

Balanced portfolio

- High value products (major CNS and asthma)
- Low cost, rapid development products (orphan pharmaceuticals, functional foods)
- Human and veterinary markets



We develop novel products in areas of high unmet health needs, to deliver cures and relieve suffering for healthier lives, for longer.

Virtual operation

- Internal expertise with outsourced development activities
- Reduces costs/maximises efficiency
- Enhances collaboration with KOLs and specialist contractors worldwide
- Enhances innovative partnering

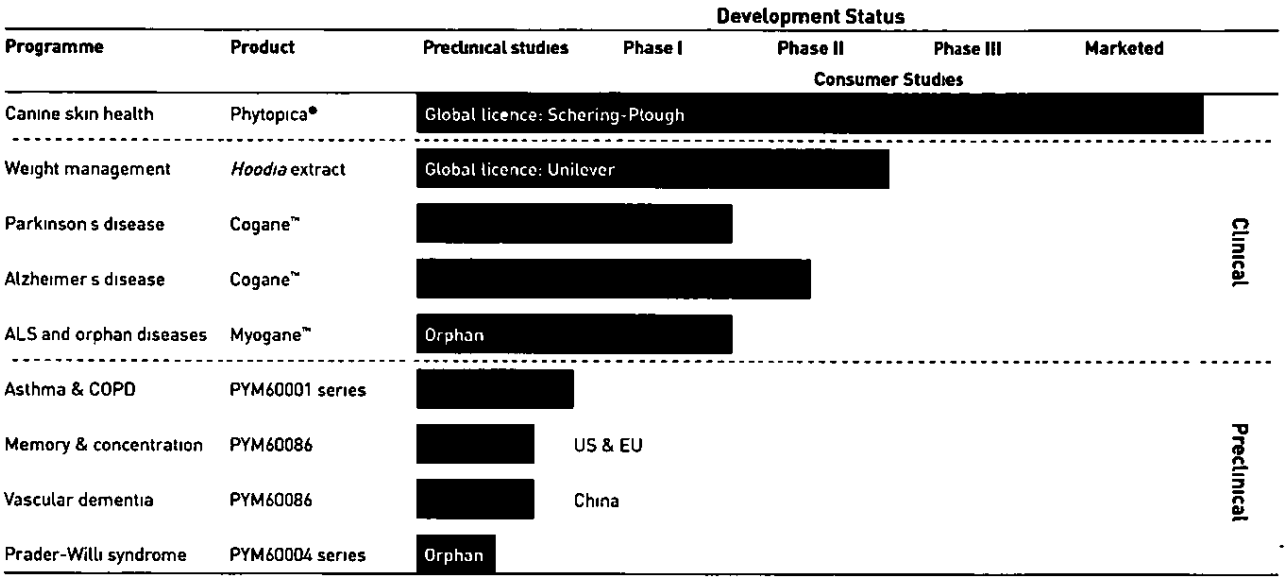
Partner with charitable organisations

- Reduces development cost
- Enhances collaboration with KOLs
- Validates novel treatments for diseases with high unmet medical need and enhances value

KOL = Key Opinion Leader

Our pipeline

Company pipeline



Pharmaceutical products

Single chemicals greater than 98 % purity

Functional foods

Standardised plant extracts where the chemical composition is not fully specified

Pharmaceutical products

Overview

Cogane™ (PYM50028) is an orally active, neurotrophic factor inducer being developed as a disease modifying agent for Parkinson's and Alzheimer's disease and has the potential as a treatment for neuropsychiatric disorders Myogane™ (PYM50018) is an orally active, neurotrophic factor inducer being developed as a disease modifying agent for ALS (also known as Lou Gehrig's disease)

Myogane™ has been granted Orphan Drug and Fast Track status by the US FDA The Orphan Drug Act was created by the United States Congress to provide assistance and incentives for sponsors to develop drugs judged to be of potential benefit for a qualifying disease Orphan drug designation qualifies a product for possible financial incentives, including seven years of marketing exclusivity upon FDA approval, and the potential of an expedited approval The Fast Track programme is designed to expedite the review of drug candidates for the treatment of patients with serious or life-threatening diseases where there is an unmet medical need for new therapeutic approaches Having a Fast Track designation allows a company to file a New Drug Application (NDA) on a rolling basis as data becomes available This enables the FDA to review the filing as it is received, rather than waiting for the entire document prior to commencing the review process With a Fast Track designation, there is often the opportunity for more frequent interactions with the FDA and the option of requesting evaluation of studies using surrogate endpoints In addition, there may be the possibility of a priority review, which could decrease the typical review period

Parkinson's and Alzheimer's disease

Parkinson's disease is a movement disorder characterised by muscle rigidity, tremor, a slowing of physical movement (bradykinesia) and, in extreme cases, a loss of physical movement (akinesia) The primary symptoms are the result of altered signaling of an area of the brain, the striatum, responsible for the control of movement This is caused by degeneration of dopaminergic neurones between the striatum and the *substantia nigra* part of the brain leading to insufficient formation and action of dopamine

The prevalence of the disease is estimated to be 100 to 200 per 100,000 population (Source Datamonitor) In the US alone, there are estimated to be one million patients with diagnosed Parkinson's disease with associated healthcare costs of $25 billion (Source Northwest Parkinson's Foundation submission to US Congress) Parkinson's disease can affect people of any age, though the incidence is higher in older people The cause of Parkinson's disease in the majority of cases is unknown Possible

$25 billion

In the US there are one million patients diagnosed with Parkinson's disease with associated healthcare costs estimated at up to $25 billion

The Cure Parkinson's Trust, supported by Movers and Shakers has funded some of our preclinical studies and was co-founded by four individuals with Parkinson's who are determined to help find a cure for this debilitating disease

mechanisms include oxidative damage of nerve cells coupled with loss of neurotrophic factors Neurotrophic factors are essential for the survival and maintenance of nerve cells and provide protection against toxic insults, however as proteins, their utility as pharmacological treatments are limited (Source The Cure Parkinson's Trust)

At present, there is no cure for Parkinson's disease, but a variety of medications provide temporary relief from the symptoms, usually by dopamine replacement therapy

Alzheimer's disease is a neurodegenerative disorder that mainly affects the elderly and is characterised by a progressive loss of learning ability and memory Alzheimer's disease is thought to affect 4 5 million people in the US, and it is believed that this number will continue to grow to approximately 16 million by 2050 (Source Alzheimer's Association)

There is an urgent need for the development of new approaches to both Parkinson's and Alzheimer's disease and non-peptide orally bioavailable neurotrophic factor inducers that readily cross the blood brain barrier represent an important therapeutic approach

The estimated market size in 2010 is approximately $5bn for Parkinson's disease, $8bn for Alzheimer's disease and $13bn for the neuropsychiatric disorders schizophrenia, depression and anxiety

Mode of action

Cogane™ (PYM50028) is a novel non-peptide, orally bioavailable neurotrophic factor inducer that readily crosses the blood brain barrier In preclinical studies, Cogane™ stimulates the release of neuronal growth factors and increases neurite outgrowth Importantly, Cogane™ also reverses the decrease of neuronal growth factors and reverses dopaminergic neuronal degeneration observed in vitro When administered orally to preclinical models of Parkinson's disease, Cogane™ reverses the loss of dopaminergic neurones and elevates glial derived neurotrophic factor (GDNF)

Cogane™ restores the learning and memory ability in Alzheimer's disease preclinical models and thereby offers the potential to arrest or reverse the progression of Alzheimer's disease

The neuroprotective, neurorestorative and neurotrophic actions of Cogane™ suggest potential beneficial effects in other neuro-degenerative diseases including diabetic neuropathy and neuropsychiatric disorders such as schizophrenia, depression and anxiety

Progress to date

In our Phase IIa clinical study of Cogane™ in mild and moderate Alzheimer's disease patients The more moderate Alzheimer's patients showed a decline in cognition in the placebo group with an encouraging trend for slower disease progression in the Cogane™ treated group This, coupled with its excellent safety profile and tolerability, provides positive data for longer term studies for efficacy determination in both Parkinson's and Alzheimer's disease

1 to 2 in 1,000

100 to 200 per 100,000 population have Parkinson's disease

Direct infusions of GDNF in the brain of Parkinson's disease patients has been shown to restore the control of movement

Pharmaceutical products continued

Over the period we have made significant progress demonstrating that in preclinical models of Parkinson's disease, Cogane™ reverses the damage to dopamine-containing neurones and elevates GDNF in the area of the brain involved in Parkinson's disease These studies were partly funded by The Cure Parkinson's Trust Elevation of GDNF has been shown to improve symptoms in Parkinson's disease patients and our data has generated considerable interest from charitable organisations We are now finalising strategic financial support from these organisations for further development activities for Parkinson's disease

Motor neurone disease

Amyotrophic lateral sclerosis (ALS, also known as Lou Gehrig's disease) is the most prevalent form of motor neurone disease which generally strikes people between 40 and 60 years of age It is characterised by progressive loss of both lower (spinal cord and brain stem) and upper (cerebral cortex) motor neurones, which leads to severe muscle weakness and wasting, followed by paralysis and death, generally caused by respiratory failure

ALS is considered an orphan disease (i e the condition is rare) as it affects fewer than 200,000 in the US (US definition) and affects no more than 5 in 10,000 people (EU definition) Approximately 350,000 patients suffer from ALS world wide, of which 50% die within 18 months of diagnosis The financial cost to families of patients is exceedingly high, and it is estimated that care can cost an average of $200,000 per patient per year (Source International Alliance of ALS Associations)

The precise causes of motor neurone degeneration in ALS patients remain unknown Approximately five to 10% of cases appear to be of familial origin and possible mechanisms include loss of neurotrophic factors coupled with oxidative and glutamate mediated damage of nerve cells Neurotrophic factors are essential for the survival and maintenance of nerve cells and provide protection against toxic insults, however as proteins, their utility as pharmacological treatments are limited Riluzole (Rilutek™), a glutamate modulator, is the only agent indicated for the treatment of this condition and increases average survival by only a few months (source Datamonitor) There is an urgent need for the development of new approaches to this devastating condition and non-peptide orally bioavailable neurotrophic factor inducers that readily cross the blood brain barrier represent an important therapeutic approach

Mode of action

Myogane™ is a novel non-peptide, orally bioavailable neurotrophic factor inducer that readily crosses the blood brain barrier In preclinical studies, Myogane™ stimulates the release of neuronal growth factors and increases neurite outgrowth Myogane™ also reverses the decrease of neuronal growth factors, reverses oxidative and glutamate damage and reverses neuronal degeneration observed in motor neurones in vitro When administered orally to preclinical models of ALS, Myogane™ delays the loss of muscle strength and extends survival time

$200,000

In the advanced stage of ALS, supportive care can cost an average of $200,000 per patient per year

ALS is characterised by the progressive degeneration of motor neurones leading to severe paralysis, muscle wasting and eventually death

Progress to date
Phytopharm has successfully completed a Phase Ia clinical study conducted under an investigational new drug (IND) filed with the United States Food and Drug Administration (FDA) and confirmed that Myogane™ was well absorbed with an excellent safety profile The FDA has also granted Orphan Drug and Fast Track designation to Myogane™ for the treatment of ALS In July 2007, we successfully progressed through a Phase Ib healthy volunteer clinical trial with a new liquid formulation suitable for ALS patients conducted under a clinical trial authorisation (CTA) filed with the Medicines and Healthcare products Regulatory Agency (MHRA) Our data has generated considerable interest from charitable organisations and we are progressing discussions for further development activities with these organisations

The neuroprotective, neurorestorative and neurotrophic actions of Myogane™ suggest potential beneficial effects in other orphan motor neurodegenerative diseases including Huntington's disease, Friedrich's ataxia, progressive supranuclear palsy and multiple system atrophy The aggregate market size for these orphan diseases is estimated to be in excess of $1bn

Asthma and COPD

Asthma is a chronic inflammatory disorder of the airways that causes recurrent episodes of wheezing, breathlessness, chest tightness and coughing In addition, asthma is usually associated with widespread but variable airflow obstruction Inhibition of inflammation and opening of the airways are therefore key components of asthma treatment

Mode of action
Our lead candidates have novel anti-inflammatory and airway relaxant activity in several models of asthma

Progress to date
Steady progress has been made in identifying novel synthetic molecules from the PYM60001 series that can be developed as a pharmaceutical medicine for the treatment of asthma and chronic obstructive pulmonary disease (COPD) Preclinical comparative 'proof of concept' studies with marketed products have demonstrated encouraging results showing improved beneficial effects in several models of asthma

Prader-Willi syndrome

Prader-Willi syndrome is an orphan disease (i e the condition is rare) as it affects fewer than 200,000 in the US (US definition) and affects no more than 5 in 10,000 people (EU definition) It is characterised by clearly definable features including obesity due to hyperphagia and a decreased calorific requirement owing to low energy expenditure

Mode of action
The mechanism of action of the chemical series based on the active components of our *Hoodia* extract (see below) is under investigation

Progress to date
Proteomic research is helping to define novel targets and the design of new molecules from the PYM60004 series as pharmaceutical candidates for Prader Willi syndrome

£850 million
Approximately eight million people in the UK have been diagnosed with asthma and the condition costs the NHS on average £850 million per year

1 in 15,000
Prader-Willi syndrome (PWS) is a genetic disorder that occurs in approximately one out of every 15,000 births

Asthma is a chronic inflammatory condition of the airways with widespread variable airflow obstruction

Functional foods

Overview

Our patented functional food, *Hoodia* extract for incorporation into weight loss products is making continued good progress In September 2007, we advanced into the final development stage with our licensing partner, Unilever

Our marketed veterinary functional food for canine skin health, Phytopica®, has shown an increase in sales (103% growth on an annualised basis) following launch in the UK, Italy and France by our partner, Schering-Plough

Functional foods are foodstuffs that provide health or physiological benefits above their nutritional value and have a health claim on the packaging Currently gut and heart health products dominate with new interest in areas of weight control, memory and concentration, anti-fatigue, immune system function and skin health The global value of functional foods is estimated to be up to $65bn The growth potential is predicted to be 50% from 2005 to 2010 with an accelerating trend for new products

Dietary weight management

Obesity is a major health problem and growing rapidly in numbers and seventy In the US 66% of adults are overweight or obese (Source US National Centre for Statistics) and healthcare costs are thought to amount to $100 billion (Source American Obesity Association) The problem is growing in Europe, and in the UK about 43% of men and 34% of women are overweight, and a further 22% of men and 23% of women are obese (Source British Heart Foundation) There is a rising level of premature obesity in children and obesity is increasing in the developing world

In 2002, the market for the dietary control of obesity was $2 3 billion in the US alone, and this has continued to grow (Source Market Research Report, Weight control-US)

Mode of action

Our weight management functional food product is based on an extract of the succulent plant, *Hoodia*, which contains a novel satiety stimulator that reduces calorie intake in

Hoodia extract

Enters final development stage

66%

In the US 66% of adults are overweight or obese

Unilever have a range of functional foods on the market

overweight subjects, as demonstrated in our double-blind, placebo-controlled clinical study In this study, overweight but otherwise healthy male volunteers were randomly allocated to receive either *Hoodia* extract or placebo twice daily for 15 days The *Hoodia* extract group showed a statistically significant reduction in the average daily calorie intake compared with placebo (p= 0 014) with a statistically significant reduction in body fat content compared with the placebo (p=0 035) No serious adverse effects were experienced by any of the subjects, and the safety data are consistent with a satisfactory overall safety profile The kinetic data confirm that the systemic exposure to biologically active constituents of *Hoodia* was consistent with the observed clinical effects

Progress to date

In December 2004, we announced that we had granted an exclusive global licence for the *Hoodia* extract to Unilever plc Under the terms of the agreement, Phytopharm and Unilever are collaborating on a five-stage research, development and launch programme of safety and efficacy studies with a view to bringing new weight management products to market Over the period we have continued to advance successfully through clinical trials in healthy overweight subjects as well as all other aspects of our Joint Development Agreement

In September 2007, we announced that we had successfully progressed into stage 3 of our Joint Development Agreement. Stage 3 activities include supply chain expansion and consumer studies that will evaluate reductions in calorie intake as part of a weight management programme in the general population, and is the final stage prior to submission for regulatory approval Stage 4 and 5 activities comprise registration and launch respectively

As part of the agreement, Unilever is committed to fully funding the development programme In addition, Phytopharm will receive an undisclosed royalty on sales of all products containing the extract

Separately, Unilever is also managing the agronomy programme, including scale up for launch, undertaking manufacturing and market research activities, and supporting the international patent programme for the products

Extracts of *Hoodia* and the active molecules therein are the subject of a global patenting programme, with major patents granted in the US, UK, Europe and Japan and pending in all other major territories

Phytopharm and Unilever have become aware of many companies that are selling products over the Internet and in some stores claiming to contain *Hoodia* and causing weight loss Analysis of these products has demonstrated that the great majority of them contain little or no *Hoodia*

Phytopharm and Unilever have made contact with the relevant authorities concerning this development and are satisfied with the progress being made to limit this activity

$2.3 billion

US market for weight management products in 2002

Functional foods continued

Canine skin health

Canine dermatological disorders are well recognised by veterinarians to be a major problem, with an estimated 15% of the UK dog population (around 900,000 dogs) affected by skin conditions (Source Animal Pharm) Maintenance of a healthy skin and coat and alleviation of itching are of major importance to canine general health and quality of life

Mode of action

Phytopica® is a natural, three plant product for canine skin health that provides a novel three in one approach to help maintain a normal healthy immune system, support normal white cell function and provide antioxidant benefits The beneficial effects and excellent safety profile of Phytopica® have been proven extensively in clinical trials and the product has been found to be suitable for all dogs whatever size or breed

Progress to date

In January 2006, Phytopharm entered into an exclusive global agreement with Schering-Plough Animal Health ('Schering-Plough') for Phytopica® Under the terms of the agreement, Phytopharm is responsible for manufacturing Phytopica® whilst Schering-Plough is responsible for the global sales, marketing and distribution In April 2006, Schering-Plough launched Phytopica® in the UK and the product has enjoyed firm support from veterinary dermatologists, with sales exceeding expectations

Schering Plough launched Phytopica® in Italy and France in March and April 2007, respectively France is one of the largest companion animal markets in Europe with more than 8 5 million dogs and, of these, some 15% referred to veterinarians may be affected by skin conditions

Schering-Plough will continue to seek to market and distribute Phytopica® in further countries worldwide With Schering-Plough's global presence we look forward to strong growth from this product

Memory and concentration

There is growing interest in functional foods for memory and concentration PYM60086 has been selected from a library of compounds derived from Traditional Chinese Medicine (TCM) licensed from the Beijing Institute (Institute of Radiation Medicine, the Academy of Military Medical Sciences, Beijing) Preclinical studies suggest that PYM60086 may help to reverse normal age related memory loss and improve concentration

Mode of action

PYM60086 is an extract of a TCM used as tonic for the elderly with memory enhancing properties Research at the Beijing Institute has shown that in preclinical studies PYM60086 increases blood flow to the brain, has antioxidant and anti-inflammatory

Phytopica

Launched in UK, Italy and France with 103% growth in sales

900,000

An estimated 15% of the UK dog population (around 900,000 dogs) affected by skin conditions

properties and is a neurotrophic factor inducer When administered orally to several preclinical models, PYM60086 improves memory and learning

Progress to date
In July 2007, we licensed a novel functional food candidate for memory and concentration from The Beijing Institute Under the terms of the Collaboration and Licence Agreement, Phytopharm and The Beijing Institute will collaborate to progress The Beijing Institute's lead product for memory and concentration (PYM60086)

Phytopharm will develop this lead product through further preclinical testing and progress into clinical trials The collaboration and Licence Agreement also extends to certain other patented compounds that may have utility in other disease areas including vascular disorders and stroke Phytopharm has been granted an exclusive licence from The Beijing Institute to develop and commercialise these products globally in return for royalty and milestone payments to The Beijing Institute upon the achievement of certain pre-defined goals The Beijing Institute's scientists bring significant knowledge on TCM and we look forward to working with them to advance the lead product through clinical development

PYM60086

Novel functional food in-licensed from the Beijing Institute

The global value of functional foods is estimated to be up to $65bn
The growth potential is predicted to be 50% from 2005 to 2010 with an accelerating trend for new products

Financial review

The financial performance for the 13 month period ended 30 September 2007 reflects the Group's ongoing pharmaceutical development and functional food activities

Period end
During the period the Group changed its financial year end to 30 September 2007 for administrative reasons The financial results for the period therefore comprise 13 months of trading for the period ended 30 September 2007, results for the comparative period comprise trading for the 12 months ended 31 August 2006

Income statement
The increased revenue of £3 12 million for the 13 month period (12 months 2006 £1 88 million) was generated from our two collaboration agreements firstly with Unilever for the development of *Hoodia* extract for dietary weight management, and secondly with Schering-Plough for the global sales, marketing and distribution of Phytopica® for canine skin health Revenue from Unilever represents reimbursement to the Group of development expenditure relating to the *Hoodia* extract programme, together with funding of certain Phytopharm staff, and therefore the level of revenue in each period depends on the nature of the ongoing activities and level of related expenditure at that particular time Revenue from Schering-Plough comprises the sale of Phytopica® by Phytopharm to Schering-Plough for onward distribution and eventual sale to end users Of the revenue in the period to 30 September 2007, £2 64 million represents revenue from Unilever, and £0 48 million represents product sales to Schering-Plough (103% growth on an annualised basis), for the corresponding 12 month period to 31 August 2006 revenue amounted to £1 66 million and product sales amounted to £0 22 million

Expenditure on development has continued as planned for the 13 months ended 30 September 2007 A total of £7 50 million was spent during the 13 month period, compared to £6 54 million for the 12 months ended 31 August 2006 The *Hoodia* extract programme for dietary weight management continues to make encouraging progress, with the initiation of Stage 3 activities of the five Stage Unilever Development and Launch Agreement. Stage 3 is the final stage prior to registration and commercial launch of the product. Unilever continues to make substantial further investment in this project, independently of the funding it pays to Phytopharm

Expenditure on selling, general and administrative expenses for the 13 months ended 30 September 2007 rose slightly to £1 92 million from £1 63 million for the 12 months ended 31 August 2006

Interest receivable for the 13 months ended 30 September 2007 amounted to £0 22 million, compared to £0 38 million for the year to 31 August 2006, reflecting the lower average cash balance during the period

The reduced overall operating loss for the 13 month period to 30 September 2007 was £6 55 million compared to £6 62 million for the 12 month period to 31 August 2006 The loss after tax for the 13 month period to 30 September 2007 was slightly higher at £5 81 million from £5 64 million for the 12 months ended 31 August 2006, although on a pro rata basis, the overall loss ran at a lower level than in the previous financial period

Balance sheet

Non-current assets comprise property, plant and equipment At 30 September 2007 these amounted to £0 20 million compared to £0 20 million at 31 August 2006

Current assets amounted to £3 95 million at 30 September 2007 and comprised inventories of £0 68 million, amounts receivable of £1 03 million (of which £0 52 million related to R&D tax credits), and cash resources of £2 24 million Inventories fell slightly in the 13 months ended 30 September 2007 as the Group manufactured and sold through further finished stocks of Phytopica® to support the launches in Italy and France in March and April 2007 respectively Amounts receivable excluding R&D tax credits at £0 52 million at 30 September 2007 are broadly in line with previous levels of £0 57 million at 31 August 2006 The level of R&D tax credit receivable by the Group, at £0 52 million, is slightly lower than the previous period of £0 60 million at 31 August 2006, reflecting the fact that during the period a higher proportion of the Group's R&D activities have been related to the *Hoodia* extract programme which, because it is fully reimbursed by Unilever, does not qualify for R&D tax credits Cash resources, described as cash and cash equivalents, are invested for periods of 90 days or less The decrease in cash resources during the period to £2 24 million reflects the cash utilised in the business during the period

Current liabilities at 30 September 2007 have reduced to £1 35 million from £1 74 million at 31 August 2006 reflecting a reduction in trade payables and accruals for clinical trial expenditure relating to the Group's development activities

The increase on Share Capital and Share Premium accounts for the period ended 30 September 2007 reflects the issue of new shares for cash on 1 March 2007, to raise £1 68 million (£1 53 million net of expenses) and the recovery of VAT of £0 04 million previously written off against that reserve following a change in HMRC policy with respect to the Group's May 2005 fund raising

Cash flow

The net cash used in operating activities for the 13 months ended 30 September 2007 was £5 46 million, a reduction from £5 85 million in the 12 month period ended 31 August 2006 Our goal is to increase shareholder value by progressing our products through development, subject to available resources Taking into account the future revenues from Phytopica® and the funding by Unilever of the *Hoodia* programme, Phytopharm expects its 2008 net cash outflow, funded from available resources, to be lower than in previous years Cash outflows in respect of Cogane™, and the rate of its development, may be favourably impacted through the funding by charitable organisations, as discussed above, and likewise any future partnering arrangements in respect of Myogane™ would bring similar benefits By delivering on our strategic objectives, we look forward with confidence to building on our achievements and reporting on the continued development of our pipeline over the coming year

Corporate social responsibility

Delivering responsibly

To our employees

Phytopharm places considerable value on the involvement of its employees and seeks to keep them informed on the Group's business strategy and objectives to assist them in working towards these goals This is achieved through formal and informal meetings where employees have the opportunity to ask questions as well as receive information

Employee training and development requirements are assessed as part of the performance appraisal process Additional training maybe undertaken as required to provide staff with continuous professional development

The Group operates an equal opportunities policy Full consideration is given to all job applicants, irrespective of gender, age, marital status, disability, sexuality, race, colour, religion, political belief, ethnic or national origin or any other conditions not relevant to the performance of the job, who can demonstrate that they have the necessary skills and abilities

Phytopharm is committed to health and safety, has well-developed health and safety policies and procedures to safeguard all of its employees, partners, contractors and visitors The Board is aware of its legal and moral obligations for health and safety at work and is committed to preventing accidents and minimising occupational ill health

To ethical business practices

As a semi-virtual company, Phytopharm has adopted the key principles of SA8000, Social Accountability International's standard that provides a comprehensive and flexible system for managing ethical workplace conditions throughout global supply chains In adopting these principles Phytopharm addresses the issue of fair treatment to all its employees who are required to follow a code of conduct that includes social awareness Phytopharm also promotes SA8000 standards amongst its partners, suppliers and contractors worldwide Assessment of compliance to these principles and other applicable regulatory or legal requirements, is through audit and improvement; plans are agreed and implemented to raise the level of compliance where appropriate

By starting with a plant extract that has a history of clinical use Phytopharm's unique approach reduces the need for lengthy preclinical testing Nevertheless, regulatory authorities worldwide require that all new medicines must be subjected to rigorous safety testing in preclinical models and in human clinical studies before they are approved for use to protect people from potentially toxic effects The use of preclinical tests to develop medicines is the subject of enormous ethical sensitivity that rightly commands a high level of public interest Phytopharm is committed to implementing the three R's – Reducing the number of preclinical tests used for research, Replacement by alternative methods whenever possible and Refinement of the techniques used to eliminate or reduce suffering Phytopharm has no testing facilities itself but uses regulated and licensed Contract Research Organisations and other licensed institutions that comply with government requirements Phytopharm implements robust review processes to ensure the highest quality standards are maintained

To the environment

Phytopharm recognises that protecting the environment is a primary corporate responsibility and that environmental matters are not just the responsibility of the Board of Directors, but also an area in which each employee, corporate partner and third party contractor has a contribution to make Phytopharm therefore encourages all employees, partners and contractors to operate in an environmentally responsible manner. Where appropriate these requirements have been incorporated into the Company's standard operating procedures and the environmental performance of contractors is reviewed as part of the audit process It is Phytopharm's policy to undertake reasonable measures to assess the environmental impact of its operations, processes and products and the Company aims to continuously improve environmental performance and compliance within these areas

Biodiversity Treaty

Phytopharm's policy is to embrace the principles of the International Convention on Biodiversity and address the challenging issues it presents The Group endeavours to enter into commercial arrangements with organisations and companies in third world countries that bring financial and technology transfer rewards to the originating country or inventor These financial rewards may take the form of milestone payments or royalty shares in successful products Examples of technology transfer include training of farmers to cultivate botanical raw materials in accordance with the principles of Good Agricultural Practice (GAP) and the installation of Good Manufacturing Practice (GMP) compliant facilities and training of staff responsible for its correct operation and maintenance

Quality Assurance

As a responsible company, Phytopharm's products are developed in accordance with recognised quality guidelines and appropriate national and international legislation to ensure the efficacy of the product and the safety of the consumer. In order to achieve this, the Company has adopted the following guidelines

Good Agricultural Practice (GAP)

The principles of GAP are applied to the cultivation and post-harvest processing of botanical raw materials The Group's GAP manual and associated technical documentation

Environmental responsibility and sustainability

Wild populations of *Hoodia* are vulnerable. We only use cultivated plants and have developed methods which avoid the use of pesticides and minimise water use in the fragile conditions of the Kalahari desert

Corporate social responsibility continued

have been developed with reference to recognised codes of practice The manual provides a framework for cultivation protocols that are implemented by working with local farmers, agronomists and horticulturalists in the countries where crops are grown The cultivation protocols are developed to combine local practice with the principles of GAP to ensure a synergy between developing agricultural systems and western agricultural practices Compliance to the protocols is assessed by the review of crop record sheets and monitoring visits to the growing sites

Good Laboratory Practice (GLP)
The Group requires that contractors involved in the conduct of key non-clinical studies and the analysis of such studies apply the appropriate level of GLP to their facilities and the conduct of studies therein These requirements are detailed in the GLP regulations Statutory Instrument 199 No 3106 and they have been incorporated into the Company's quality system. Compliance is reviewed by routine monitoring visits and/or audit, training may be provided to ensure the level of compliance is acceptable

Good Manufacturing Practice (GMP)
The Group requires that all contractors directly managed by Phytopharm and involved in the operational aspects of manufacture, analysis, packing, labelling, release, storage, distribution of its materials and products apply the appropriate level of GMP to their facilities, as defined in GMP regulation and guideline documents

These practices are mandatory requirements for products designated for use in clinical trials conducted in accordance with competent authorities' regulatory requirements Guidelines are detailed in UK, European, US and ICH publications and have been incorporated into the Company's quality system Compliance is routinely monitored by audit and training may be provided to ensure the level of compliance is acceptable

Good Clinical Practice (GCP)
GCP is an international ethical and scientific quality standard for designing, conducting, recording and reporting studies that involve the participation of human subjects Studies conducted in Europe and North America must have ethical and regulatory approval prior to initiation and compliance with the stated protocol is independently monitored and further assessed by audit. These actions help to provide assurance that the rights, safety and wellbeing of study subjects are protected, consistent with the principles that have their origin in the Declaration of Helsinki, and that the clinical trial data are credible These requirements have been incorporated into the Group's standard operating procedures and working documentation

All seed for the expansion of the *Hoodia* agronomy programme is collected from existing cultivations to ensure we do not put pressure on wild *Hoodia* populations

Board of directors

Leading strategically

Top row from left:
Mr Alistair Taylor
Dr Daryl Rees
Mr Piers Morgan

Bottom row from left:
Mr Alexander Morrison
Dr Peter Blower

1 Mr Alistair Taylor
Non-Executive Chairman
Mr Taylor is formerly Executive Chairman of UK listed Lombard Medical Technologies plc and has 45 years experience in the healthcare industry ten years in pharmaceuticals and 35 years in medical devices He was Chief Executive Officer of Biocompatibles International plc from 1994 to 1998 and during this period the company progressed from a technology-based start up company, through flotation to a FTSE 250 company Prior to this, Mr Taylor was Chief Executive Officer of Schneider Inc, a Swiss interventional cardiology/radiology device company and during this time the company's turnover grew to $100 million Schneider was subsequently sold by Pfizer Inc., its parent for over $2 billion Mr Taylor's early career included the Chief Accountant role at Beecham Pharmaceuticals He is also Chairman of Starbridge Systems Limited

2 Dr Daryl Rees
Chief Executive Officer
Dr Rees has an MSc in Pharmacology and a PhD in Clinical Pharmacology He joined Phytopharm in June 1999 from University College London where he was a senior lecturer in Clinical Pharmacology Prior to this Dr Rees gained ten years' experience in the discovery and clinical development of medicines as a senior scientist at Wellcome and was part of a multidisciplinary team involved in the discovery of the L-arginine- NO pathway He is a former editor of the British Journal of Pharmacology and is Chairman of an accredited Research Ethics Committee

3 Mr Piers Morgan
Chief Financial Officer
Mr Morgan has an MA in Law and Management Studies from Cambridge University and is a Chartered Accountant. He worked at Close Brothers Corporate Finance on a wide variety of equity capital market and mergers and acquisitions transactions and was a founding director of the Life Sciences Mergers & Acquisitions team at Ernst & Young In 2000, he joined Arrow Therapeutics Limited (acquired by AstraZeneca for $150m) as Finance Director raising significant finance through private equity debt and grants In 2005, he moved to Paris to become Chief Financial Officer of BioAlliance Pharma SA where he led the successful flotation of the company on Euronext Paris

4 Mr Alexander Morrison
Non-Executive Director
Mr Morrison has a BSc (Hons) in applied chemistry (Strathclyde) and has over 20 years experience in general and international management, global supply chain and R&D He was Chief Executive Officer of Lipton Ltd the global tea sourcing organization for Unilever with operations in six countries from 2000 to 2006 During Mr Morrison's period as CEO, substantial operational and financial improvements were made to the Unilever global tea supply chain and he also played a significant part in addressing issues in the international tea trade In the immediate years prior to 2000, Mr Morrison had senior international food and beverage roles for Unilever outside the UK in the supply chain and in R&D, both at the Rotterdam head office and in the Unilever food and beverage subsidiary in Australia

5 Dr Peter Blower
Non-Executive Director
Dr Blower has over 30 years experience in medicinal research and development with a strong background in the field of neuroscience He joined Beecham Research Laboratories in 1969 and rose to the position of Director of New Neuroscience products in 1996 before leaving in 2000 to form his own consultancy company He has been elected to Fellowship of the Royal Society of Medicine and the Institute of Biology and has authored over 50 scientific publications He has a M I Biol from the Institute of Biology (1972) a PhD in Pharmacology from the University of Aston (1977) and a DSc from the University of East London (1997)

Directors' report for the thirteen month period ended 30 September 2007

The Directors present their report together with the financial statements and auditors report for the thirteen month period ended 30 September 2007

Principal activities

Phytopharm is a pharmaceutical development and functional food company whose products are generated from medicinal plants.

Review of the business and future developments

The Group is required to set out in this Directors report a fair review of the business of the Group and a description of the principal risks and uncertainties facing the Group (known as a Business Review) The Business Review is required to set out a balanced and comprehensive analysis of the development and performance of the Group s business during the thirteen month period ended 30 September 2007 and of the position of the Group at the end of that financial period The information that fulfils the requirements of the Business Review can, in addition to that set out below, be found on pages 10 to 19

The Directors are satisfied with the progress made across the product portfolio and with the period end position

Principal risks and uncertainties

Industry risk

In common with other research and development stage businesses, Phytopharm s business risks relate principally to the success of its development programmes and to the need to fund its operations through these The progress of the development programmes therefore represents the best indicator of the Group s performance and a full review of the programmes is given in the Business Review on pages 10 to 19

Financial risk

The Group has one product, Phytopica®, on the market. However the revenues currently being generated by this programme are not yet sufficient to offset the Company s research and development expenditure, and the Group expects to continue to make losses until it is able to increase its revenues sufficiently This may require commercialisation of additional products. Until this can be achieved the Group may remain dependant on the continuing support of its investors.

Clinical and regulatory risk

Successful commercialisation of the Group s products is likely to depend on continuing successful progress through clinical and consumer studies, and registration as applicable Development of product candidates involves a lengthy and complex process, and products may not meet the necessary requirements in terms of toxicity, efficacy or safety, or the relevant regulators may not agree with the results of the Group s research and may require further testing or withhold approval altogether

Competition risk

The Group s success depends on acceptance of the Group s products by the markets, including physicians and third party payers, and consequently the Group s progress may be adversely affected if it is unable to achieve market acceptance of its products. Factors which may affect the rate and level of market acceptance of any of the Group s products will include the existence or entry on to the market of superior competing products or therapies and the price of the Groups products compared to competing products.

Intellectual property risk

The Group s success depends in part on its ability to obtain and maintain protection for its intellectual and proprietary information, so that it can stop others from making, using or selling its inventions or proprietary rights. The Group s patent applications may not be granted and its existing patent rights may be successfully challenged and revoked

Economic risk

As a consequence of the international nature of its business, the Group is exposed to risks associated with changes in foreign currency rates. The Group is headquartered in the United Kingdom, and substantially all its cash resources are in pounds sterling An adverse change in exchange rates may lead to either an increase in certain of the Group s costs or a decrease in the pounds sterling value of its revenues, and hence a significant impact on the Group s reposted results of operations, financial position and cash flow

[redacted]

Counterparty risk
The Group relies on third party organisations to conduct its clinical trials and to manufacture its products. If the relationship with or performance of any of these partners is adversely affected the Group s results of operations may be adversely impacted

The Group also derives revenue or financial support from its collaborators and expects to derive additional support from partnering with certain charitable organisations. If these relationships are adversely affected, or if the products involved fail to continue to make satisfactory progress, the Group s results of operations may be adversely impacted

Post balance sheet events
There are no post balance sheet events of significance

Results and Dividends
The Group s results for the period ended 30 September 2007 are presented on page 44. The Group s net loss after taxation was £5,813,249 (2006 £5,638,613) The Group is not yet in a position to pay a dividend and the loss for both periods has been added to the accumulated deficit on reserves.

Group research and development activities
The Group continues to develop pharmaceutical products and functional foods from product leads generated from medicinal plants

Directors
The Directors of the Company, all of whom have been Directors for the whole of the period except as noted below, are as follows

Executive Directors
Dr D D Rees – Chief Executive
Mr P J Morgan – Chief Financial Officer (appointed 9 January 2007)
Dr R P Dixey (resigned 31 January 2007)

Non-Executive Directors
Mr A H Taylor – Non-Executive Chairman (appointed 18 July 2007)
Mr A D Morrison – Senior Independent Director
Dr P R Blower
Dr P M Whitney (resigned 18 July 2007)
Mr G K G Stevens (resigned 5 September 2006)
Dr T H Flanagan (resigned 5 September 2006)

Company Secretary
Mrs Z K McGowan

Biographical details of the current Directors are shown on page 23.

There were no contracts of significance with the Company or any of its subsidiaries subsisting during or at the end of the financial period in which a Director of the Company was materially interested

The interests of Directors in the shares and share options of the Company at 30 September 2007 are disclosed in the report of the Board on remuneration on pages 30 to 36

Directors' report for the thirteen month period ended 30 September 2007

Substantial shareholdings

The Directors have been advised of the following substantial holdings as at 19 December 2007 in the Company's issued share capital

Name of shareholder	% holding
Material interest	
Invesco Perpetual Investment Series	14 77
Chakra Ltd	14 26
AXA S.A.	6 00
Henderson Global Investors	5 64
Non-material interest	
Amvescap plc	26 94

The material holding by Invesco Perpetual Investment Series is included within the non-material holding by Amvescap plc

Save for the above, the Company has not been notified, as at 19 December 2007 of any material interest of 3% or more or any Non-material interest exceeding 10% of the issued share capital of the Company

Authority to purchase shares

At the Company's Annual General Meeting held on 27 March 2007, shareholders approved authority, for the purposes of Section 166 of the Companies Act 1985 (the Act), to make market purchases (within the meaning of Section 163(3) of the Act) of any of its ordinary shares of 1p each in the capital of the Company on such terms and in such manner as the Directors may from time to time determine, and where such shares are held as treasury shares, the Company may use them for the purposes of its employee share scheme provided that

(a) the maximum number of ordinary shares which may be purchased is 5,560,631, representing approximately 10% of the ordinary share capital issued at the date of the meeting,

(b) the minimum price which may be paid for each ordinary share is 1p which shall be exclusive of all expenses, if any,

(c) the maximum price which may be paid for each ordinary share is an amount equal to 105% of the average middle market quotations for the ordinary shares of the Company as derived from the Official List of the London Stock Exchange plc for the five business days immediately preceding the day on which such share is contracted to be purchased,

(d) unless previously renewed, revoked or varied this authority shall expire at the conclusion of the annual general meeting in 2008, and

(e) under this authority the Company may make a contract to purchase ordinary shares which would or might be executed wholly or partly after the expiry of this authority, and may make purchases of ordinary shares pursuant to it as if this authority had not expired

As at 30 September 2007 this authority had not been utilised

Creditor payment policy

The Group s current policy concerning the payment of the majority of its trade creditors is to follow the CBI s Prompt Payers Code (copies are available from the CBI, Centre Point, 103 New Oxford Street, London WC1A 1DU) For other suppliers, the Group s policy is to

(a) agree the terms of payment with those suppliers when negotiating the terms of each transaction,

(b) ensure that those suppliers are made aware of the terms of payment by inclusion of the relevant terms in contracts, and

(c) pay in accordance with its contractual and other legal obligations

The payment policy applies to all payments to creditors for revenue and capital supplies of goods and services without exception The average credit period (expressed as creditor days) taken during the period was 21 days (2006 38 days) for the Group and nil days for the Company in both periods. The average credit period is calculated using purchases for the period and the closing trade creditors figure

Employees

The Board of Directors is committed to continuing communication and involvement with all the Group s employees Further details of the Group s policies towards its employees are given in the corporate social responsibility review on pages 20 to 22

Health and Safety

The Directors are committed to ensuring the highest standards of health and safety Further details of the Group s policies towards its employees are given in the Corporate Social Responsibility review on pages 20 to 22.

Charitable donations

Phytopharm has established a Charity Committee to facilitate charitable donations to community programmes and local charities. During the period the Group made charitable donations of £nil (2006 £50)

Financial risk management policies

The Group s policies in relation to financial risk management are described in the financial review on pages 18 to 19 and in note 19 to the financial statements.

Statement of Directors' responsibilities

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

Company law requires the Directors to prepare financial statements for each financial period Under that law the Directors have prepared the Group and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union The financial statements are required by law to give a true and fair view of the state of affairs of the Company and the Group and of the profit or 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,
- state whether the financial statements comply with IFRSs as adopted by the European Union , and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business, in which case these should be supporting assumptions or qualifications as necessary

Directors' report
for the thirteen month period ended 30 September 2007

The Directors confirm that they have complied with the above requirements in preparing the financial statements.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the financial statements and the Directors Remuneration Report comply with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the Group s website and legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Audit information

In the case of each of the persons who are Directors of the Company at the date when this report is approved

- so far as each of the Directors is aware, there is no relevant audit information (as defined in the Companies Act 1985) of which the Company s auditors are unaware, and
- each of the Directors has taken all steps that he ought to have taken as a Director to make himself aware of any relevant audit information (as defined) and to establish that the Company s auditors are aware of that information

This confirmation is given and should be interpreted in accordance with the provisions of s243ZA of the Companies Act 1985

Auditors

A resolution to reappoint PricewaterhouseCoopers LLP as auditors to the Company will be proposed at the next annual general meeting

Dr D D Rees
Chief Executive
19 December 2007

Remuneration report of the Board of Directors

This report has been prepared in accordance with the Directors' Remuneration Regulations 2002 which introduced statutory requirements for the disclosure of Directors' remuneration in respect of periods ending on or after 31 December 2002 of the UK Listing Authority and describes how the Board has applied the principles of the Combined Code published in June 2006 relating to Directors' remuneration. A resolution to approve this report will be proposed to shareholders at the Annual General Meeting in 2008

The regulations require the auditors to report to the Company's members on certain parts of the Directors' remuneration report and to state whether in their opinion those parts of the report have been properly prepared in accordance with the Companies Act (as amended by the Regulations). The report has therefore been divided into separate sections for audited and unaudited information

Unaudited information

Remuneration committee

The Remuneration Committee ('the Committee') is comprised exclusively of independent Non-Executive Directors. The Directors who have served on the Committee during the period are as follows

Dr P R Blower (Chairman) (appointed 5 September 2006)
Mr A D Morrison (appointed 5 September 2006)
Mr A H Taylor (appointed 18 July 2007)
Dr P M Whitney (resigned 18 July 2007)
Mr G K G Stevens (resigned 5 September 2006)
Dr T H Flanagan (resigned 5 September 2006)

The Committee decides the remuneration policy that applies to Executive Directors and all of the Group's employees including other senior management. This comprises the setting of salaries for the Executive Directors, the setting of salary scales for other employees, approving the format and range of all performance-related arrangements (both annual and long term equity incentive arrangements), and determining the extent to which the elements of variable pay vest.

To assist the Committee in establishing its policy the Group has retained the services of New Bridge Street Consultants, who are experts in advising on remuneration in the biotech industry. The Chief Executive is invited to attend the Committee meetings to make recommendations on compensation levels for employees.

During the period ended 30 September 2007 the Committee met six times and there was full attendance at each meeting except for one occasion as noted on page 38

Remuneration of Non-Executive Directors

The Non-Executive Directors each receive a fee for their services, which is agreed by the Board following recommendation by the Committee in respect of the Chairman and by the Chairman in respect of the other Non-Executive Directors with the assistance of independent advice, where necessary, concerning comparable organisations and appointments.

Neither the Chairman nor the other Non-Executive Directors receive any pension or other benefits from the Company

Remuneration policy for Executive Directors

The Company's remuneration policy for Executive Directors is to

- have regard to the Directors' experience and the nature and complexity of their work, and regard to Directors' remuneration in comparable companies, in order to pay a competitive salary, including a performance related cash bonus that attracts and retains management of the highest quality,
- link individual remuneration packages to the Group's long-term performance through the award of share options via the Phytopharm Share Option Plan 2007 and the Phytopharm Long Term Incentive Plan 2007, and
- provide post retirement benefits through the Group's pension schemes.

Remuneration report of the Board of Directors continued

Consistent with the above policy, compensation awarded to Executive Directors comprises four main performance and non-performance related elements

- basic salary and bonuses,
- benefits in kind,
- share options and performance share awards (awarded by reference to annual performance), and
- pension arrangements.

Basic salary
The Committee sets the annual salaries for Executive Directors, having regard to personal performance and responsibilities of each Director and their expected future contribution.

Share schemes
The Group operates incentive schemes to assist in attracting and retaining high calibre employees and to focus the performance of senior Executives on creating long-term shareholder value The awards to individuals are linked to the performance targets of the Group and the individual. The Group targets and those for Executive Directors are approved by the Board

During the period the Remuneration Committee reviewed the effectiveness and appropriateness of the existing long-term incentive and share option schemes. As a result of this review, new incentive arrangements were approved by shareholders at a general meeting in June 2007 Subsequently, employees and Executive Directors surrendered existing options and received grants under the new arrangements. The previous schemes have been retained to allow former employees under "good leaver status to retain their options for the periods agreed by the Remuneration Committee Details of the numbers of options outstanding and the remaining exercise periods are shown in note 22. No further grants of options will be made under these schemes.

The total number of unissued Ordinary Shares in the capital of the Company which may be placed under option on any day under the Phytopharm share option schemes may not exceed, when added to the aggregate number of shares that have been or may be issued pursuant to rights granted for the past ten years, 10 per cent of the issued ordinary share capital of the Company immediately prior to that day

Share option schemes
Share options are granted under the Phytopharm Share Option Plan 2007 and the Phytopharm Sharesave Plan 2007, which are open to all employees. The Phytopharm Share Option Plan 2007 complies with the tax favoured Enterprise Management Incentive Legislation Where possible the Company will grant tax advantaged options. The Remuneration Committee determines the level of awards. To provide maximum flexibility, the Committee has discretion to make awards up to an annual 400% of salary individual limit although the Committee would only envisage making an award at such a level in very exceptional circumstances. Performance share awards will normally vest three years after the date of grant subject to continued employment and the extent to which a performance target has been satisfied The actual grants made in the period were significantly lower than this limit and are specified for each Executive Director in the table on page 34

The vesting of a share option will depend on total shareholder return (TSR) performance conditions being met. The Company s TSR will be compared to that of the companies making up the FTSE Small Cap Index at or within three months of the vesting date No option or award can be exercised for below median performance

The Committee considers TSR to be the most appropriate method of measuring performance at this stage of the Group s development where income streams have not stabilised and the Group has not yet made a profit. The Committee seeks independent verification of the TSR conditions before confirming that a share option has vested

The Phytopharm Sharesave Plan 2007 is an HMRC approved scheme and the first offer was made to employees and Executive Directors on 13 August 2007 and vests on 30 September 2010

Long-term incentives

The Group operates the Phytopharm Long Term Incentive Plan 2007 under which performance share awards can be made to selected senior managers of the Company and its subsidiaries. The Committee determines the level of awards to provide maximum flexibility The Committee has discretion to make awards up to an annual 400% of salary individual limit although the Committee would only envisage making an award at such a level in very exceptional circumstances. Performance share awards will normally vest three years after the date of grant subject to continued employment and the extent to which a performance target has been satisfied The actual grants made in the period were significantly lower than this limit and are specified for each Executive Director in the table on page 36

The Committee s policy is that the same TSR performance condition as described above for share options will apply to the vesting of performance share awards. This is for the same reasons as given above The relevant distinction is that the grant of share options depends on annual performance whereas it is envisaged that performance share awards will be granted each period in order to ensure that there is a continual and material long term incentive element to the Executives remuneration packages

Share purchase Scheme

The Group operates the Phytopharm Share Incentive Plan 2007 which will provide matching shares to employees on a one for one basis. This scheme was not active in the period to 30 September 2007

Pensions

All the Executive Directors have money purchase pension schemes to which the Group contributes 16% (8% for the period to 30 June 2007) of basic salary

Fees retained for Non-Executive Directorships in other companies

The Committee recognised that Executive Directors may be invited to take up Non-Executive Directorships and that these can broaden the experience and knowledge of the Director, from which the Company would benefit. Accordingly, subject to Board approval, they may accept Non-Executive appointments, as long as they are not likely to lead to a conflict of interest. They are also allowed to retain any fees paid under such appointments.

Performance graph

The following shows the Company s performance, measured by total shareholder return compared with the performance of the FTSE SmallCap Index also measured by total shareholder return Total shareholder return looks at the value at 30 September 2007 of £100 invested in the Company on 1 September 2002 compared with the value of £100 invested in the FTSE SmallCap Index over the same period This index has been selected for this comparison because, in the opinion of the Directors, it is the most appropriate index against which the total shareholder return of the Company should be measured

The graph looks at the value by 30 September 2007 of £100 invested in Phytopharm on 1 September 2002 compared with the value of £100 invested in the FTSE Small Cap Index The other points plotted are the values at intervening financial year-ends

Remuneration report of the Board of Directors continued

Executive Directors' contracts

It is the Group's policy that Executive Directors should have contracts with an indefinite term but which provide for a maximum period of notice to be served by the Company or by the Director. The details of the Directors' contracts are summarised in the table below:

	Date of Contract	Notice period
Dr D D Rees	22 September 2000	6 months
Mr P J Morgan	9 January 2007	6 months

In the event of termination, the Executive Directors' contracts provide for compensation up to a maximum of basic salary for the notice period.

Non-Executive Directors' contracts

The terms of service for Non-Executive Directors are specified in letters of appointment. Currently appointments are for a period of 12 months, which may be renewed, and are summarised in the table below:

	Date of Contract	Notice period
Mr A H Taylor	18 July 2007	3 months
Mr A D Morrison	1 June 2007	3 months
Dr P R Blower	21 July 2007	3 months

In addition, one third of all Directors are required under the Articles of Association to resign and offer themselves for re-election at each annual general meeting.

Directors' interests in shares

The interests of the Directors in the shares of the Company at 30 September 2007 and 31 August 2006 (or date of appointment) were:

	Ordinary shares of 1 pence	
	30 September 2007	31 August 2006
Dr P R Blower	**9,494**	–
Dr R P Dixey[i]	–	543,964
Mr P J Morgan	**18,989**	–
Mr A D Morrison	**9,494**	–
Dr D D Rees	**18,989**	–
Mr A H Taylor[ii]	–	–
Dr P M Whitney[iii]	–	–

All Directors' interests are beneficially held.

(i) Dr R P Dixey resigned on 31 January 2007
(ii) Mr A H Taylor was appointed on 18 July 2007
(iii) Dr P M Whitney resigned on 18 July 2007

Apart from the interests disclosed above no Directors were interested at any time during the period in the share capital of the Company or other Group companies.

Audited information

Directors' detailed emoluments and compensation

Details of individual Directors emoluments for the period are as follows

	2007						2006	
Executive	**Salary & fees £**	**Compensation for loss of office £**	**Bonus £**	**Monetary value of benefits £**	**Total excluding pensions £**	**Pension contributions £**	Total excluding pensions £	Pension contributions £
Dr D D Rees	**181,401**	**–**	**77,000**	**16,778**	**275,179**	**14,029**	215,734	11,499
Mr P J Morgan[i]	**91,954**	**–**	**48,125**	**15,378**	**155,457**	**9,856**	–	–
Dr R P Dixey[iii]	**78,850**	**37,109**	**–**	**9,158**	**125,117**	**186,308**	485,067	14,899
Dr G W Chong[iii]	**–**	**–**	**–**	**–**	**–**	**–**	80,813	2,459
	352,205	**37,109**	**125,125**	**41,314**	**555,753**	**210,193**	781,614	28,857
Non-executive								
Mr A H Taylor[iv]	**7,174**	**–**	**–**	**–**	**7,174**	**–**	–	–
Mr A D Morrison	**25,833**	**–**	**–**	**472**	**26,305**	**–**	5,156	–
Dr P R Blower	**25,833**	**–**	**–**	**318**	**26,151**	**–**	2,203	–
Dr P W Whitney[v]	**29,497**	**–**	**–**	**–**	**29,497**	**–**	20,000	–
Mr G K G Stevens[vi]	**345**	**–**	**–**	**–**	**345**	**–**	30,000	–
Dr T H Flanagan[vii]	**230**	**–**	**–**	**–**	**230**	**–**	20,000	–
	88,912	**–**	**–**	**790**	**89,702**	**–**	77,359	–
Total	**441,117**	**37,109**	**125,125**	**42,104**	**645,455**	**210,193**	858,973	28,857

(i) From 9 January 2007
(ii) From 1 September 2006 to 31 January 2007
(iii) From 1 September 2005 to 2 December 2005
(iv) From 18 July 2007
(v) From 1 September 2006 to 18 July 2007
(vi) From 1 September 2006 to 5 September 2006
(vii) From 1 September 2006 to 5 September 2006

The Directors receive certain benefits in kind The benefits provided to the Chief Executive are the provision of a fully expensed company car, life insurance and private medical insurance The benefits provided to the Chief Financial Officer are the provision of a car allowance, life assurance and permanent health insurance

No Directors waived emoluments in the financial period ended 30 September 2007 (2006 nil)

There were no gains made by individual Directors from the exercise of share options for the period ended 30 September 2007 (2006 nil)

Remuneration report of the Board of Directors continued

Directors' interest in share options

Details of options over shares of the Company held by Directors, all of which have been granted at no cost to the Directors, are set out below:

	At 31 August 2006	Number of options surrendered during the year	Number of options granted during the year	Number of options exercised in the year	Number of options lapsed in the year	At 30 September 2007	Note*	Exercise price	Date from which exercisable	Expiry date
Dr D D Rees	13,043	13,043	–	–	–	–	1a	£2 30	24 June 2002	23 June 2009
	10,000	–	–	–	10,000	–	1b	£3 89	15 December 2002	14 December 2006
	10,000	–	–	–	10,000	–	2b	£3 89	15 December 2002	14 December 2006
	20,000	–	–	–	20,000	–	3	£3 89	15December 2004	14 December 2006
	5,704	5,704	–	–	–	–	1b	£6 575	7 December 2003	6 December 2007
	5,703	5,703	–	–	–	–	2b	£6 575	7 December 2003	6 December 2007
	11,406	11,406	–	–	–	–	3	£6 575	7 December 2005	6 December 2007
	7,500	7,500	–	–	–	–	1b	£4 60	2 August 2004	1 August 2008
	7,500	7,500	–	–	–	–	2b	£4 60	2 August 2004	1 August 2008
	15,000	15,000	–	–	–	–	3	£4 60	2 August 2006	1 August 2008
	13,215	13,215	–	–	–	–	1b	£4 775	21 May 2005	20 May 2009
	13,214	13,214	–	–	–	–	2b	£4 775	21 May 2005	20 May 2009
	26,430	26,430	–	–	–	–	3	£4 775	21 May 2007	20 May 2009
	33,342	33,342	–	–	–	–	4b	£1 425	2 May 2006	1 May 2013
	10,582	10,582	–	–	–	–	4b	£2 125	9 December 2006	8 December 2013
	51,722	51,722	–	–	–	–	4c	£2 125	9 December 2006	8 December 2013
	20,000	20,000	–	–	–	–	4c	£1 85	5 May 2007	4 May 2014
	400,000	400,000	–	–	–	–	4c	£0 545	14 December 2008	13 December 2015
	25,864	25,864	–	–	–	–	4c	£0 56	8 May 2009	7 May 2016
	–	–	52,724	–	52,724	–	4c	£0 4675	8 November 2009	7 November 2016
	–	–	350,000	–	–	**350,000**	6	£0 45	9 January 2010	8 January 2017
	–	–	712,949	–	–	**712,949**	7	£0 445	3 August 2009	2 August 2017
	–	–	19,585	–	–	**19,585**	10	£0 4825	1 October 2010	31 March 2011
	700,225	660,225	1,135,258	–	92,724	**1,082,534**				
Mr P J Morgan	–	–	250,000	–	–	**250,000**	6	£0 45	9 January 2010	8 January 2017
	–	–	19,585	–	–	**19,585**	10	£0 4825	1 October 2010	31 March 2011
	–	–	269,585	–	–	**269,585**				

*Further details of the terms of the share option schemes are contained in note 22 to the financial statements under the note reference in the above table

During the period the Remuneration Committee reviewed the effectiveness and appropriateness of the existing long-term incentive and share option schemes. As a result of this review, new incentive arrangements were approved by Shareholders at a general meeting in June 2007. Subsequently the Executive Directors surrendered existing options and received grants under the new arrangements.

	At 31 August 2006	Number of options surrendered during the year	Number of options granted during the year	Number of options exercised in the year	Number of options lapsed in the year	At 30 September 2007	Note*	Exercise price	Date from which exercisable	Expiry date
Dr R P Dixey[i]	8,564	–	–	–	8,564	–	1b	£3 89	15 December 2002	14 December 2006
	8,563	–	–	–	8,563	–	2b	£3 89	15 December 2002	14 December 2006
	17,127	–	–	–	17,127	–	3	£3 89	15 December 2004	14 December 2006
	8,555	–	–	–	8,555	–	1b	£6 575	7 December 2003	6 December 2007
	8,555	–	–	–	8,555	–	2b	£6 575	7 December 2003	6 December 2007
	17,110	–	–	–	17,110	–	3	£6 575	7 December 2005	6 December 2007
	9,816	–	–	–	9,816	–	1b	£4 775	7 December 2004	6 December 2008
	9,817	–	–	–	9,817	–	2b	£4 775	7 December 2004	6 December 2008
	19,634	–	–	–	19,634	–	3	£4 775	7 December 2006	6 December 2008
	24,746	–	–	–	24,746	–	1b	£1 165	6 December 2005	5 December 2009
	24,745	–	–	–	24,745	–	2b	£1 165	6 December 2005	5 December 2009
	49,490	–	–	–	49,490	–	3	£1 165	6 December 2007	5 December 2009
	48,649	–	–	–	48,649	–	4b	£1 425	2 May 2006	1 May 2013
	14,435	–	–	–	14,435	–	4b	£2 125	9 December 2006	8 December 2013
	36,814	–	–	–	36,814	–	4c	£2 125	9 December 2006	8 December 2013
	20,000	–	–	–	20,000	–	4c	£1 85	5 May 2007	4 May 2014
	35,175	–	–	–	35,175	–	4c	£0 56	8 May 2009	7 May 2016
	361,795	–	–	–	361,795	–				
Total	1,062,020	–	1,404,843	–	454,519	**1,352,119**				

*Further details of the terms of the share option schemes are contained in note 22 to the financial statements under the note reference in the above table
(i) Dr R P Dixey left the Group on 31 January 2007 and subsequently his options lapsed on 31 July 2007

During the period the Remuneration Committee reviewed the effectiveness and appropriateness of the existing long-term incentive and share option schemes. As a result of this review, new incentive arrangements were approved by Shareholders at a general meeting in June 2007. Subsequently the Executive Directors surrendered existing options and received grants under the new arrangements.

Remuneration report of the Board of Directors continued

Directors' interests in long-term incentive plans

	At 31 August 2006	Number of awards surrendered during the year	Number of awards awarded during the year	Number of awards vested in the year	Number of awards lapsed in the year	At 30 September 2007	Note*	Market price at date of grant	Exercise price	Date from which vesting	Expiry date
Dr D D Rees	41,463	41,463	–	–	–	–	5	£1 82	£0 01	3 December 2007	2 June 2008
	16,952	16,952	–	–	–	–	5	£1 26	£0 01	11 May 2007	10 December 2007
	47,610	47,610	–	–	–	–	5	£0 48	£0 01	3 November 2008	2 May 2009
	–	–	106,025	–	–	**106,025**	8	£0 45	£0 01	3 August 2009	**
	–	–	90,000	–	–	**90,000**	9	£0 45	£0 01	3 August 2010	**
	106,025	106,025	196,025	–	–	**196,025**					
Mr P J Morgan	–	–	65,000	–	–	**65,000**	8	£0 45	£0 01	3 August 2010	**
	–	–	65,000	–	–	**65,000**					
Dr R P Dixey[i]	56,389	–	–	–	56,389	–	5	£1 82	£0 01	3 December 2007	2 June 2008
	23,055	–	–	–	23,055	–	5	£1 26	£0 01	11 May 2007	10 December 2007
	32,375	–	–	–	32,375	–	5	£0 48	£0 01	3 November 2008	2 May 2009
	111,819	–	–	–	111,819	–					
Total	217,844	106,025	261,025	–	111,819	**261,025**					

*Further details of the terms of the long term incentive plan are contained in note 22 to the financial statements under the note reference in the above table
** These shares shall be transferred to the participant at the end of the performance period to the extent that any performance conditions have been satisfied
[i] Dr R P Dixey left the Group on 31 January 2007 and subsequently his options lapsed on 31 July 2007

During the period the Remuneration Committee reviewed the effectiveness and appropriateness of the existing long-term incentive and share option schemes. As a result of this review, new incentive arrangements were approved by Shareholders at a general meeting in June 2007 Subsequently the Executive Directors surrendered existing options and received grants under the new arrangements.

The market price of the Company s shares at the end of the financial period was 40 pence (31 August 2006 58 pence) and the range of market prices during the period was between 38 25 pence and 62.75 pence

Approval

This report was approved by the Board of Directors on 19 December 2007 and signed on its behalf by

Dr P R Blower
Chairman of the Remuneration Committee

Corporate governance

The Combined Code

The Directors are accountable to shareholders for the good corporate governance of the Group and seek to uphold and report on compliance with current best practice in Corporate Governance

The Directors are satisfied that the Group has complied throughout the period with the best practice provisions of the 2003 FRC Combined Code on corporate governance in effect for the financial period to 30 September 2007 The new Combined Code published in June 2006, becomes effective for the financial period commencing 1 October 2007 This report together with the Report of the Board on remuneration sets out the manner in which the Group has applied all the principles contained in the 2003 Combined Code

See page 27 for the statement of Directors responsibilities in respect of the Annual Report, the Directors Remuneration Report and the financial statements.

Compliance statement

The Board has carried out a review of its corporate governance procedures (including internal controls) during the period and is pleased to confirm that the Group has complied throughout the period with the provisions of the Combined Code

The principles set out in the Combined Code cover four areas the Board, Directors remuneration, accountability and audit and relations with shareholders. With the exception of Directors remuneration (which is dealt with separately in the remuneration report) the following section sets out how the Board has applied such principles.

The Board

The Board is chaired by Mr A H Taylor (appointed 18 July 2007) and met for regular business nine times during the period under review It was chaired by Dr P M Whitney eight times in the period to 18th July 2007 and by Mr A H Taylor once in the period since 18th July 2007 Of these, apologies for Board meetings were received from Mr A D Morrison on 18 July 2007 Otherwise, all meetings were attended by all members. In addition, further meetings are held when circumstances and urgent business dictate

The Board has agreed a schedule of items that are specifically reserved for its consideration, which is reviewed on an annual basis. This schedule includes business strategy, financing arrangements, material acquisitions and divestments, approval of budgets, major capital expenditure projects, risk management, treasury policies, and establishing and monitoring internal controls. The Board is responsible for the overall direction and strategy of the Group and for securing the optimum performance from Group assets. At each meeting, the Board reviews strategy and progress of the Group towards its objectives, particularly in respect of research and development projects, and monitors financial progress against budget

The Board of Directors consists of two Executive and three independent Non-Executive Directors. Mr A D Morrison is the Senior Non-Executive Director Biographies of the Directors are set out on page 23 Details of the Directors shareholdings are shown on page 32

All Directors are required to retire and submit themselves for re-election at the first Annual General Meeting after appointment and, thereafter, at least every three years. Subject to their re-election and Companies Act provisions, the Non-Executive Directors are appointed for specified terms.

There is clear separation of the roles of Chairman and Chief Executive on terms which have been agreed by the Board and reviewed on an annual basis. The Chairman is responsible for overseeing the running of the Board, encouraging all Directors to participate fully in discussions with the aim of reaching a consensus and ensuring that the Non-Executive Directors are properly briefed on matters. The Chief Executive has responsibility for implementing the Board s strategy and managing day to day business activities of the Group with the Executive Directors and senior managers. The Company Secretary, through the Chairman, is responsible for advising the Board on all governance matters.

The Board has agreed procedures to allow individual Directors to seek independent professional advice at the Company s expense for the furtherance of their duties, and all Directors have access to the services of the Company Secretary The Company Secretary is accountable to the Board through the Chairman on governance matters. It is the responsibility of the Company Secretary to ensure that Board procedures are followed and all rules and regulations are complied with. Newly appointed Directors receive a comprehensive, formal and tailored introduction to the Group s business as well as information on their responsibilities and roles as a Director of the Company

The Board is mindful of the requirement to undertake annual evaluation of its performance and that of its Committees and individual Directors. All Directors have conducted a self assessment of the performance of the Board during the period by reference to an evaluation checklist provided by the Group s external auditors. The results were compiled and analysed by the Company Secretary Areas for improvement identified by the assessment will be addressed accordingly

Corporate governance continued

Board Committees

In accordance with best practice, the Company has established Audit, Remuneration and Nominations Committees with written terms of reference for each that deal with their authorities and duties. The full terms of reference of all the Committees have been published on the Company's website

Audit Committee

The Audit Committee comprises the independent Non-Executive Directors, Mr A D Morrison, Dr P R Blower and Mr A H Taylor (appointed 18 July 2007), who the Board considers has recent and relevant financial experience and is chaired by Mr A D Morrison. Dr P M Whitney resigned on 18 July 2007. The Committee met two times during the period under review, with the Group's external auditors and Executive Directors attending where appropriate. All meetings were fully attended.

The Committee assists the Board in ensuring that the Group's published financial statements give a true and fair view and in securing reliable internal financial information for decision making. The Committee reviews the findings of the external auditors and reviews key accounting policies and judgments. The Audit Committee is also responsible for monitoring the effectiveness of the external audit process and the independence of the external auditors, recommending audit fee proposals to the Board and considering the scale and nature of non-audit work. Non-audit services provided by the external auditors are discussed to ensure the Committee is satisfied regarding the objectivity and independence of the external audit, including any relevant safeguards. Any material non-audit fees are approved by the Committee before being committed.

The Group has a Quality Assurance manager but does not have an internal financial audit function. The Audit Committee considers that this is appropriate at this time given the size of the Group. The Audit Committee reviews the Company's Protected Disclosure policy and procedure on an annual basis to ensure that adequate arrangements are in place by which members of staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other areas. The Committee considers that appropriate arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow up action.

The Audit Committee conducted a self-assessment of its performance during the period by reference to an evaluation checklist provided by the Group's external auditors. The results were compiled and analysed by the Company Secretary. Areas for improvement identified by the assessment will be addressed accordingly.

The terms of reference of the Audit Committee include the following responsibilities:

- to monitor the integrity of the Group's financial statements,
- to review annually the need for an internal audit function,
- to review the effectiveness of the Group's internal control and risk management systems, and
- to consider and make recommendations to the Board regarding the appointment of the Group's external auditors.

Remuneration Committee

The Remuneration Committee comprises the independent Non-Executive Directors Mr A D Morrison, Dr P R Blower and Mr A H Taylor (appointed 18 July 2007) and is chaired by Dr Blower. Dr P M Whitney resigned on 18 July 2007. The Committee met six times during the period under review. Of these, apologies for Remuneration Committee meetings were received from Mr A D Morrison on 18 July 2007. Otherwise, all meetings were attended by all members.

The Committee is responsible for making recommendations to the Board on remuneration policy for all members of staff and Executive Directors. The policy recommendations include setting salary scales, and approving the format and range of incentive payments and share option grants to all staff. Remuneration of Non-Executive Directors is under the control of the Executive Directors.

The Remuneration Committee conducted a self-assessment of its performance during the period by reference to an evaluation checklist provided by the Group's external auditors. The results were compiled and analysed by the Company Secretary. Areas for improvement identified by the assessment will be addressed accordingly.

The terms of reference of the Remuneration Committee include the following responsibilities

- to determine and agree with the Board the framework and policy for the remuneration of the Executive Directors and other members of the Executive Team,
- to determine targets for any performance related pay scheme,
- to approve overall remuneration structure, and
- to review employee benefit structures.

The remuneration report, which includes details of the Group s remuneration policy, is set out on pages 29 to 36

Nomination Committee

The Nomination Committee comprises Mr A D Morrison, Dr P R Blower and Mr A H Taylor (appointed 18 July 2007) and is chaired by Dr P R Blower Dr P M Whitney resigned on 18 July 2007 It met four times during the period under review, with all meetings being fully attended Both Mr P J Morgan and Mr A H Taylor, who were appointed to the Board during the period, were selected from a list of potential candidates provided by the Company s advisors and contacts and interviewed by the Committee members prior to their appointment.

The Committee is responsible to the Board for determining the qualities and experience required of the Company s Executive and Non-Executive Directors and for identifying suitable candidates. In appropriate cases, recruitment consultants assist in the process. The Committee is also responsible for succession planning

The terms of reference of the Nomination Committee include the following responsibilities

- to identify and nominate candidates to fill Board positions as they arise,
- to prepare a description of the role and capabilities required for a particular appointment, and
- to give full consideration to succession planning

Relationship with shareholders

The Group is committed to maintaining good relations with its institutional and private shareholders and reports formally to shareholders on a six monthly basis through the provision of interim and annual reports. In addition, the Group keeps shareholders informed of significant events for the Group during the period by issuing press releases which are immediately made available on the Group s website www phytopharm com The Group s website also provides an overview of the business including its strategy, products and objectives.

The Group also maintains communication by making presentations during the period to institutional shareholders on request and to all shareholders through the Group s website www phytopharm com This contains information on all of the Group s products and all financial reports and press releases issued by the Group Details of the current share price and historic share price performance are also included

The Board is kept up to date at its regular meetings with the views of shareholders and analysts by the Chairman and Chief Executive

Annual general meeting

The principal forum for discussion with shareholders is the annual general meeting and their participation is encouraged Formal notification together with an explanation of each proposed resolution is sent to shareholders at least twenty working days in advance of the meeting At the meeting the Board provides a summary of the period s events after which all the Directors are available to answer questions from shareholders.

In accordance with the Combined Code recommendations, the Company counts all proxy votes. On each resolution which is voted on a show of hands, the Company indicates the level of proxies lodged, the number of proxy votes for and against each resolution and the number of abstentions. The Chairs of the Audit, Remuneration and Nomination Committees attend to answer questions.

Corporate social responsibility

Details of the Group s activities in the area of corporate social responsibility are set out on pages 20 to 22

Corporate governance continued

Internal controls
The Board acknowledges that it is responsible for the Group s system of internal control and for reviewing its effectiveness at least annually However, the Board acknowledges that such a system can only provide reasonable and not absolute assurance against material misstatement or loss, as it is designed to manage rather than eliminate the risk of failure to achieve business objectives.

The key procedures that the Board has established are designed to provide effective internal controls within the Group and comply with the Internal Control Guidance for Directors on the Combined Code issued by the Financial Reporting Council. There is an ongoing process for identifying and managing significant risks faced by the Group which has been in place throughout the period and the effectiveness of all the Group s internal controls in effect during the period has been reviewed by the Board

The Group s key internal control procedures include the following

Control environment
The Group s control environment is the responsibility of the Group s Directors and managers at all levels. The Group s organisational structure has clear lines of reporting and responsibility Regular research and development programme reviews are held to review progress against plan for each programme The information from these meetings is reported on a regular basis to a management group comprising the Executive Directors and key senior managers to compare progress against plan for the business as a whole Overall control of the business rests with the Board of Directors.

Risk identification and evaluation
Regular assessments of ongoing risks facing the business are undertaken as part of the operational reviews and regular management group meetings in the key areas such as management of working capital, compliance, legal and operational issues.

Operational controls
Quality. Investigational medicinal products and the Group s marketed functional food product (Phytopica®) are manufactured on behalf of Phytopharm and are produced in accordance with Good Manufacturing Practice (GMP) to ensure that the products are manufactured consistently to the appropriate quality standards. The Company also has agreements with a number of plantations operating under the principles of Good Agricultural Practice (GAP) to ensure that raw material supply is consistently controlled and of appropriate quality

Non-clinical studies. Key non-clinical studies to determine the safety and efficacy of new products are conducted in accordance with Good Laboratory Practice (GLP) at contractors who operate under those regulations. Each contractor is audited to assess compliance with GLP prior to initiation of studies.

Clinical studies. All clinical studies carried out by the Group are in accordance with Good Clinical Practice (GCP) This ensures that the health and well being of the subjects is carefully monitored during the study and that the data gathered is complete and reliable All studies are audited for compliance under the management of Phytopharm's quality assurance group

Financial controls
Financial reporting Budgets and long term forecasts are normally prepared twice a year to allow management to monitor the key business and financial risks. Further, more frequent, forecasts are prepared if circumstances require The budgets are reviewed and approved by the Board prior to adoption by the Company Management accounts are prepared on a monthly basis and performance against budget is analysed in detail and reported on monthly

Control procedures. The Group has established detailed policies, and accounting and administrative procedures are in place covering all significant areas and key systems. These include formal authorisation procedures for the transfer of funds, capital expenditure and recruitment. Any commitment of expenditure requires documentary approval which is subject to prescribed limits of authority Any major expenditure or commitment including the appointment of senior members of staff requires Board approval.

Compliance
The Group has established policies and standard operating procedures (SOPs) that provide instruction on all aspects of the operation of the business. These SOPs are designed to ensure compliance with the quality management requirements of the Group and external regulations where appropriate All SOPs are reviewed on a regular basis and updated where necessary

Insurance
The Group has reviewed its portfolio of insurance policies with its insurance broker to ensure that the policies are appropriate to the Group s activities.

Announcements

All announcements are approved by the Board of Directors prior to issue The Group also has internal and external checks to guard against unauthorised release of information

Human Resources

The Group endeavours to appoint employees with appropriate skills, experience and knowledge for the roles they undertake The Group has a range of polices which are aimed at retaining and incentivising key staff. Employees have clear objectives based on the Group s business objectives.

Going concern

The Directors have a reasonable expectation that the Group and the Company have adequate resources to continue in operational existence for the foreseeable future For this reason, they continue to adopt the going concern basis in preparing the Group s financial statements.

The BioIndustry Association (BIA) Code of Practice.

Phytopharm is a member of the BIA who have published a code of eight principles which are broad statements of best practice for information communication and management for its members. The Group has complied with the Code for the period under review

By order of the Board
Dr D D Rees
Chief Executive
19 December 2007

Independent auditors' report to the members of Phytopharm plc

We have audited the Group and parent company financial statements (the financial statements) of Phytopharm plc for the period ended 30 September 2007 which comprise the Consolidated Income Statement, the Consolidated and Company Balance Sheets, the Group and Company Statements of Changes in Shareholders Equity, the Consolidated and Company Cash Flow Statements and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors Remuneration Report that is described as having been audited

Respective responsibilities of Directors and auditors

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

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

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation We also report to you whether in our opinion the information given in the Directors Report is consistent with the financial statements The information given in the Directors Report includes that specific information presented in the Business review· Pharmaceutical products and the Business review Functional foods that is cross referred from the Review of the business and future developments section of the Directors Report

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors remuneration and other transactions is not disclosed

We review whether the Corporate Governance Statement reflects the Company s compliance with the nine provisions of the Combined Code 2005 specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board s statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group s corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Chairman s Statement and Chief Executive s review, the other preliminary sections (Business Highlights, Our strategic objectives, Our business strategy, Our pipeline), the Business review Pharmaceutical products and the Business review Functional foods, the Financial review, the Corporate social responsibility review, the Board of Directors section and the Directors report, the unaudited part of the Directors remuneration report and the Corporate Governance Statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements Our responsibilities do not extend to any other information

Basis of audit opinion

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

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

[redacted]

Opinion

In our opinion

- the Group financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union, of the state of the Group s affairs as at 30 September 2007 and of its loss and cash flows for the period then ended,
- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company s affairs as at 30 September 2007 and of its cash flows for the period then ended,
- the financial statements and the part of the Directors Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation, and
- the information given in the Directors Report is consistent with the financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Cambridge
19 December 2007

Consolidated income statement for the thirteen month period ended 30 September 2007

	Note	Thirteen months to 30 September 2007 £	Twelve months to 31 August 2006 £
Revenue	2	**3,121,018**	1,882,501
Cost of sales		**(250,057)**	(341,067)
Gross profit		**2,870,961**	1,541,434
Net operating expenses	3	**(9,422,744)**	(8,164,952)
Operating loss		**(6,551,783)**	(6,623,518)
Interest receivable and similar income		**217,396**	380,484
Interest payable and similar charges	6	**(30)**	–
Loss on ordinary activities before taxation	7	**(6,334,417)**	(6,243,034)
Tax on loss on ordinary activities	8	**521,168**	604,421
Loss for the period		**(5,813,249)**	(5,638,613)
Basic and diluted loss per ordinary share (pence)	10	**(10.9)**	(11.0)

All revenues and expenses shown above were generated from continuing operations.

Consolidated and Company balance sheets at 30 September 2007

	Note	Group		Company	
		30 September 2007 £	31 August 2006 £	**30 September 2007** £	31 August 2006 £
Non-current assets					
Property, plant and equipment	11	**199,832**	201,521	**–**	–
Investments	12	**–**	–	**2,330,855**	1,767,653
Amounts due from subsidiary undertaking	13	**–**	–	**43,922,738**	39,684,675
Non-current assets		**199,832**	201,521	**46,253,593**	41,452,328
Current assets					
Inventories	14	**683,483**	842,899	**–**	–
Trade and other receivables	15	**508,613**	568,882	**50,348**	21,996
Current tax receivable	8	**521,168**	604,421	**–**	–
Cash and cash equivalents	16	**2,240,947**	5,997,428	**1,980,557**	5,520,988
Current assets		**3,954,211**	8,013,630	**2,030,905**	5,542,984
Current liabilities					
Trade and other payables	17	**(1,353,381)**	(1,737,547)	**(96,607)**	(92,501)
Net current assets		**2,600,830**	6,276,083	**1,934,298**	5,450,483
Net assets		**2,800,662**	6,477,604	**48,187,891**	46,902,811
Equity					
Share capital	21	**556,063**	511,809	**556,063**	511,809
Share premium		**48,685,559**	47,156,708	**48,190,152**	46,661,301
Other reserves (deficit)		**(204,211)**	(204,211)	**–**	–
Profit and loss account (deficit)		**(46,236,749)**	(40,986,702)	**(558,324)**	(270,299)
Shareholders' funds		**2,800,662**	6,477,604	**48,187,891**	46,902,811

The financial statements comprising the consolidated income statement, the consolidated and company balance sheets, the Group and Company statements of changes in equity, the consolidated and company cash flow statements and the related notes, were approved by the Board of Directors on 19 December 2007 and were signed on its behalf by

Mr P J Morgan
Chief Financial Officer

Statements of changes in shareholders' equity

Group	Share capital £	Share premium £	Other reserves (deficit) £	Profit and loss account (deficit) £	Total £
Balance at 1 September 2005	511,809	47,156,708	(204,211)	(35,650,581)	**11,813,725**
Loss for the period	–	–	–	(5,638,613)	**(5,638,613)**
Equity share options charge	–	–	–	302,492	**302,492**
Balance at 31 August 2006	511,809	47,156,708	(204,211)	(40,986,702)	**6,477,604**
Loss for the period	–	–	–	(5,813,249)	**(5,813,249)**
Issue of equity share capital	44,254	1,489,287	–	–	**1,533,541**
Share issue costs recovered	–	39,564	–	–	**39,564**
Equity share options charge	–	–	–	563,202	**563,202**
Balance at 30 September 2007	556,063	48,685,559	(204,211)	(46,236,749)	**2,800,662**

Company	Share capital £	Share premium £	Profit and loss account (deficit) £	Total £
Balance at 1 September 2005	511,809	46,661,301	11,146	**47,184,256**
Loss for the period	–	–	(583,937)	**(583,937)**
Equity share options charge	–	–	302,492	**302,492**
Balance at 31 August 2006	511,809	46,661,301	(270,299)	**46,902,811**
Loss for the period	–	–	(851,227)	**(851,227)**
Issue of equity share capital	44,254	1,489,287	–	**1,533,541**
Share issue costs recovered	–	39,564	–	**39,564**
Equity share options charge	–	–	563,202	**563,202**
Balance at 30 September 2007	556,063	48,190,152	(558,234)	**48,187,891**

Consolidated and Company cash flow statements for the thirteen month period ended 30 September 2007

	Group		Company	
	Thirteen months to 30 September 2007 £	Twelve months to 31 August 2006 £	**Thirteen months to 30 September 2007** £	Twelve months to 31 August 2006 £
Cash flow from operating activities				
Operating loss	**(6,551,783)**	(6,623,518)	**(1,055,543)**	(939,369)
Depreciation	**97,164**	108,259	**–**	–
(Gain)/loss on disposal of property, plant and equipment	**(4,576)**	10,068	**–**	–
Share option charge	**563,202**	302,492	**–**	–
	(5,895,993)	(6,202,699)	**(1,055,543)**	(939,369)
Changes in working capital				
Decrease/(increase) in trade and other receivables	**60,269**	96,207	**(28,352)**	(9,817)
(Decrease)/increase in trade and other payables	**(384,166)**	(520,725)	**4,105**	4,081
Decrease in inventories	**159,416**	104,325	–	–
Cash used in operations	**(6,060,474)**	(6,522,892)	**(1,079,790)**	(945,105)
Taxation received	**604,421**	674,341	**–**	–
Interest paid	**(30)**	–	**(30)**	–
Net cash used in operating activities	**(5,456,083)**	(5,848,551)	**(1,079,820)**	(945,105)
Cash flows from investing activities				
Purchase of tangible fixed assets	**(127,760)**	(234,596)	**–**	–
Sale of property, plant and equipment	**36,861**	60,750	**–**	–
Interest received	**217,396**	380,484	**204,347**	355,432
Net cash generated from investing activities	**126,497**	206,638	**204,347**	355,432
Cash flows from financing activities				
Issue of shares	**1,681,659**	–	**1,681,659**	–
Share issue costs	**(148,118)**	–	**(148,118)**	–
Share issue costs recovered	**39,564**	–	**39,564**	–
Change in financing of Group company	**–**	–	**(4,238,063)**	(5,504,938)
Capital element of finance leases	**–**	(1,398)	**–**	–
Net cash generated from/(used in) financing activities	**1,573,105**	(1,398)	**(2,664,958)**	(5,504,938)
Movements in cash and cash equivalents in the period	**(3,756,481)**	(5,643,311)	**(3,540,431)**	(6,094,611)
Cash and cash equivalents at the beginning of the period	**5,997,428**	11,640,739	**5,520,988**	11,615,599
Cash and cash equivalents at end of period	**2,240,947**	5,997,428	**1,980,557**	5,520,988

Notes to the financial statements

1 Accounting policies and basis of preparation

The principal accounting policies adopted in the preparation of these financial statements are set out below These policies have been consistently applied to both periods presented

Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards and IFRIC interpretations endorsed by the EU and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS The financial statements have been prepared on a historical cost basis.

The Company changed its year end to 30 September during the period for administrative reasons. The financial results therefore comprise thirteen months of trading for the period ended 30 September 2007, results for the comparative period comprise trading for the twelve months ended 31 August 2006

Accounting policies

Basis of consolidation

The acquisition by the Company s subsidiary, Phytotech Limited (formerly Phytopharm Limited), of Phytodevelopments Limited on 21 March 1996 has been accounted for as a merger in the consolidated financial statements, and all transactions between the two companies have been eliminated

On 3 April 1996 the Group structure was reorganised and a new holding Company established by way of a share exchange This has been accounted for as a merger in the consolidated accounts, and all transactions within the Group have been eliminated

There has been no change to the basis set out as a result of the implementation of IFRS, as permitted by IFRS1

Critical accounting judgements

The preparation of the consolidated financial statements requires the Directors to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The main accounting judgements relate to inventory valuation, the share option charge and the underlying assumptions The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making judgements about carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of revision and future periods if the revision affects both current and future periods.

Share-based payments

The Group makes equity-settled share-based payments to its employees and Directors. Equity-settled share-based payments are measured at fair value at the date of grant and are expensed on a straight line basis over the vesting period of the award At each balance sheet date, the Group revises its estimate of the number of options that are expected to become exercisable The share-based payment charge is allocated to research and development expenses and selling, general and administrative expenses on the basis of staff numbers with a corresponding adjustment to equity

Employee benefits

All employee benefit costs, notably holiday pay and contributions to Group or personal defined contribution plans, are charged to the income statement on an accruals basis. The Group operates a defined contribution pension scheme The assets of this scheme are held separately from those of the Group in independently administered funds The Group does not offer any other post retirement benefits.

Cash and cash equivalents

Cash and cash equivalents include cash in hand, bank deposits repayable on demand and other short-term highly liquid investments with original maturities at inception of 90 days or less.

Property, plant & equipment

The cost of property, plant & equipment is its purchase cost, together with any incidental expenses of acquisition Depreciation is calculated so as to write off the cost of property, plant & equipment, less its estimated residual value, on a straight line basis over the expected useful economic lives of the assets concerned

1 Accounting policies and basis of preparation continued

The principal rates used for this purpose are
Plant and machinery 20%
Computer equipment 33%
Fixtures and fittings 20%
Motor vehicles 25%

Leasehold improvements are amortised over the shorter of the lease term and the asset s useful economic life

Impairment of assets

Non-current assets are reviewed for impairment at each reporting date An impairment loss is recognised for the amount by which the asset s carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset s fair value less costs to sell and its value in use

Investments in subsidiary

The investment in Phytotech Limited was originally recorded at the nominal value of the shares issued at the time of the share for share exchange on 3 April 1996 The fair value of the options granted after 7 November 2002 by Phytopharm plc to the employees of Phytotech Limited which had not vested by 1 September 2005 is now also included in the value of the investment

Research and development expenditure

All on-going research expenditure is currently expensed in the period in which it is incurred Due to the regulatory and other uncertainties inherent in the development of the Group s products, the criteria for development costs to be recognised as an asset, as prescribed by IAS 38 "Intangible assets , are not met until the product has been submitted for regulatory approval, and such approval has been received, and it is probable that future economic benefit will flow to the Group The Group does not currently have any such internal development costs that qualify for capitalisation as intangible assets.

Operating leases

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

Foreign currencies

Transactions denominated in foreign currencies are translated into sterling, being the functional currency of the Company, at actual rates of exchange ruling at the date of transaction Monetary assets and liabilities expressed in foreign currencies are translated into sterling at rates of exchange ruling at the end of the financial period All foreign currency exchange differences are taken to the income statement in the period in which they arise

Revenue

Revenue, which excludes value added tax, represents the invoiced value of goods and services supplied, net of certain promotional activity

Amounts received or receivable in respect of research and development contracts, collaborative research agreements, licence fees or milestone payments are recognised as revenue when the licence rights are granted or the specific conditions stipulated in the agreements have been satisfied These amounts are shown gross of any withholding tax.

Cost of sales and operating expenses

Cost of sales comprises the proportion of milestone and royalty income earned by the Group and due to third parties under licence agreements and the direct cost of goods sold, including distribution costs. All research and development costs, whether funded by third parties under licence and development agreements or not, are included within operating expenses and classified as research and development costs.

Deferred taxation

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements in accordance with IAS 12 "Income taxes" Deferred tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither the accounting nor taxable profit or loss. A deferred tax asset is recognised only to the extent that it is probable that sufficient taxable profit will be available in future periods to utilise the temporary difference

Inventory

Inventory including raw materials, work in progress and finished goods is stated on a first in first out basis at the lower of cost and net realisable value Cost represents direct materials and where applicable production overheads. Where necessary, provision is made for obsolete, slow-moving or defective inventory

Notes to the financial statements continued

Equity instruments
Equity instruments issued by the Group are recorded at the proceeds received, net of direct issue costs.

Trade receivables
Trade receivables are non-interest bearing and are stated at their nominal value, as reduced by appropriate allowances for estimated irrecoverable amounts.

Trade payables
Trade payables are non-interest bearing and are stated at their nominal value

Basis for segments
A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns which are different from those segments operating in other economic environments.

New IFRS standards and interpretations not applied
The IASB and IFRIC issued additional standards and interpretations which are effective for periods starting after the date of these financial statements. The following standards and interpretations have yet to be adopted by the Group

International Financial Reporting Standards (IFRS/IAS)	Effective date
IFRS7 – Financial Instruments disclosures	1 January 2007
IFRS8 – Operating Segments	1 January 2009
IAS1 – Presentation of Financial Statements, comprehensive revision requiring a statement of comprehensive income	1 January 2009
International Financial Reporting Interpretations Committee (IFRIC)	
IFRIC12 – Service Concession Agreements	1 January 2008
IFRIC13 – Customer Loyalty Programmes	1 July 2008
IFRIC14 – IAS19 – The Limit of a Defined Benefit Asset	1 January 2008

The Group does not anticipate that these standards and interpretations will have a material effect on its financial statements on initial adoption

2. Business and geographical segments

The Group s development and other functions operate across both pharmaceutical products and functional foods, are managed centrally and are reported internally as a single business. This also applies to the Group s marketed products. Accordingly, the Directors consider that there is only one primary reporting segment. Geographic segments are secondary as neither geographical origin nor destination is central to management s assessment of risk and return

	Thirteen months to 30 September 2007 £	Twelve months to 31 August 2006 £
By geographical area by destination		
United Kingdom	**163,822**	218,229
Europe	**2,957,196**	1,653,751
Asia	**–**	10,521
	3,121,018	1,882,501

All the Group s turnover, loss before taxation and net assets arose in the United Kingdom

3. Net operating expenses

	Thirteen months to 30 September 2007 £	Twelve months to 31 August 2006 £
Continuing operations		
Research and development	**7,500,404**	6,540,173
Administrative expenses	**1,922,340**	1,624,779
	9,422,744	8,164,952

4. Directors' emoluments

	Thirteen months to 30 September 2007 £	Twelve months to 31 August 2006 £
Aggregate emoluments	**608,346**	815,499
Compensation for loss of office	**37,109**	43,474
Contributions to money purchase pension schemes	**210,193**	28,857
	855,648	887,830

There were no gains made by individual Directors from the exercise of share options for the period ended 30 September 2007 (2006 nil)

Detailed disclosures of Directors individual remuneration and share options are given in the report of the Board on remuneration on pages 29 to 36

All the Executive Directors, comprising three this period (2006 two) had retirement benefits accruing to them from money purchase pension schemes in respect of qualifying services.

5. Employee information

The average monthly number of persons (including Executive Directors) employed during the period was

	Thirteen months to 30 September 2007 Number	Twelve months to 31 August 2006 Number
Administration	**10**	10
Research and development	**27**	27
	37	37

	Thirteen months to 30 September 2007 £	Twelve months to 31 August 2006 £
Staff costs (for the above persons):		
Wages and salaries	**1,691,278**	1,942,058
Social security costs	**192,276**	233,677
Other pension costs	**278,383**	82,880
Share option charge	**563,202**	302,492
	2,725,139	2,561,107

Notes to the financial statements continued

5. Employee information continued

Key management compensation

	Thirteen months to 30 September 2007 £	Twelve months to 31 August 2006 £
Wages and salaries	**893,616**	1,119,562
Social security costs	**114,447**	142,849
Other pension costs	**224,212**	44,565
Share option charge	**272,034**	186,476
	1,508,309	1,493,452

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including all Executive Directors and Non-Executive Directors. The number of management personnel whose remuneration is included above is 10 (2006 11)

The Company has no employees.

6. Interest payable and similar charges

	Thirteen months to 30 September 2007 £	Twelve months to 31 August 2006 £
Other interest payable	**30**	–

7. Loss on ordinary activities before taxation

	Thirteen months to 30 September 2007 £	Twelve months to 31 August 2006 £
Loss on ordinary activities before taxation is stated after charging		
Depreciation charge for the period		
Owned property, plant and equipment	**97,164**	108,259
(Gain)/loss on disposal of property, plant and equipment	**(4,576)**	10,068
Fees payable to the Company s auditors for the audit of the parent company and consolidated financial statements	**25,000**	19,000
Fees payable for other services supplied pursuant to legislation	**8,900**	8,500
Fees payable for the audit of the Company s subsidiaries pursuant to legislation	**6,000**	5,000
Tax services	**12,530**	10,290
Other services	**950**	–
Operating lease charges		
Plant and machinery	**7,573**	31,136
Other assets	**91,975**	84,900

8. Tax on loss on ordinary activities

	Thirteen months to 30 September 2007 £	Twelve months to 31 August 2006 £
Current tax		
Current UK corporation tax credit on loss for the period	**521,168**	604,421

There is no corporation tax charge because of the incidence of tax losses (2006 £nil) The Company has taken advantage of the Research and Development corporation tax credits introduced in the Finance Act 2000 whereby a company may surrender corporation tax losses incurred on research and development expenditure for a corporation tax refund at the rate of 24 pence in the pound of actual spend

Factors affecting the current tax credit for the year

	Thirteen months to 30 September 2007 £	Twelve months to 31 August 2006 £
Loss on ordinary activities before tax	**(6,334,417)**	(6,243,034)
Loss on ordinary activities multiplied by the standard rate for research and development tax credits of 16% (2006 16%)	**(1,013,507)**	(998,885)
Effect of		
Difference between depreciation and capital allowances	**11,950**	15,221
Short term timing differences	**(1,211)**	250
Expenses not deductible for tax purposes	**776**	2,084
Effect of share option compensation charge	**90,112**	48,399
Enhanced research & development expenditure	**(173,722)**	(201,474)
Carried forward losses	**564,434**	529,984
Tax credit for the period	**(521,168)**	(604,421)

9. Loss for the financial year

As permitted by section 230 of the Companies Act 1985, the parent Company's profit and loss account has not been included in these financial statements. The parent Company's loss for the period to 30 September 2007 was £ 851,227 (2006 £583,937)

10. Loss per ordinary share

The calculation of basic and diluted loss per share on the net basis is based on the loss on ordinary activities after taxation, namely £5,813,249 (2006 £5,638,613) and on 53,567,257 (2006 51,180,893) ordinary shares, being the weighted average number of ordinary shares in issue and ranking for dividend during the period

The Company has no dilutive potential ordinary shares in issue because it is loss making

Notes to the financial statements continued

11. Property, plant and equipment

	Short leasehold £	Computer equipment £	Motor vehicles £	Plant and machinery £	Fixtures and fittings £	Total £
Cost						
At 1 September 2006	3,363	278,994	168,471	24,739	175,588	651,155
Additions	–	31,194	76,616	–	19,950	127,760
Disposals	–	(3,477)	(54,760)	–	(5,047)	(63,284)
At 30 September 2007	**3,363**	**306,711**	**190,327**	**24,739**	**190,491**	**715,631**
Depreciation						
At 1 September 2006	3,363	235,586	59,419	19,588	131,678	449,634
Charge for year	–	33,634	43,494	2,148	17,888	97,164
Disposals	–	(2,392)	(23,710)	–	(4,897)	(30,999)
At 30 September 2007	**3,363**	**266,828**	**79,203**	**21,736**	**144,669**	**515,799**
Net book value						
At 30 September 2007	**–**	**39,883**	**111,124**	**3,003**	**45,822**	**199,832**
Net book value						
At 31 August 2006	–	43,408	109,052	5,151	43,910	201,521

Company

The Company has no property, plant and equipment.

12. Investments

	Group		Company	
Investment in group undertakings	**2007 £**	2006 £	**2007 £**	2006 £
At 1 September	**–**	–	**1,767,653**	1,465,161
Share option charge			**563,202**	302,492
At 30 September	**–**	–	**2,330,855**	1,767,653
Other investments				
Cost at 1 September and 31 August	**30,098**	30,098	**30,098**	30,098
Provision for impairment in value at 1 September and 31 August	**(30,098)**	(30,098)	**(30,098)**	(30,098)
Carrying value at 1 September and 30 September	**–**	–	**–**	–
Total fixed asset investments	**–**	–	**2,330,855**	1,767,653

The other investment shown above is in equity shares of Saklaspur Bio Tech Limited (formerly Tumkur Chemicals Limited), a private company incorporated in India. This investment represents 10% of the voting rights and nominal value of issued shares. The investment was fully impaired as at 31 August 2002. The operations of Saklaspur Bio Tech Limited ceased in 2002 and the entity has since then not generated revenues and it is not likely that the investment value will be recovered

12. Investments continued

Interests in Group undertakings

Name of undertaking	Country of incorporation	Description of shares held	Proportion of voting rights and nominal value of issued shares held by Group %	Company %
Phytotech Limited	England and Wales	Ordinary 10 pence shares	100	100
Phytodevelopments Limited	England and Wales	Ordinary €1 shares	100	–

Both the above companies have been included in these financial statements and operated principally in their country of incorporation or registration

The principal business activities of these subsidiary undertakings are
Phytotech Limited – development of pharmaceutical products and functional foods
Phytodevelopments Limited – dormant

13. Amounts due from subsidiary undertaking

	Group		Company	
	30 September 2007 £	31 August 2006 £	30 September 2007 £	31 August 2006 £
Amounts due from subsidiary undertaking	–	–	**43,922,738**	39,684,675

There are no fixed terms in respect of amounts owed by subsidiary undertakings. These are non-interest bearing, unsecured and not payable on demand

14. Inventories

	30 September 2007 £	31 August 2006 £
Raw materials and consumables	**433,595**	482,056
Work in progress	**249,888**	360,843
	683,483	842,899

In the period ended 30 September 2007, finished goods to the value of £215,453 have been recognised as an expense in cost of sales (2006 £149,946), £107,516 of raw materials and finished goods near to or past their expiry date have been written off (2006 £104,636) and no provision has been made against obsolete raw materials, work in progress and finished goods (2006 £79,266)

The Company has no inventories.

15. Trade and other receivables

	Group		Company	
	30 September 2007 £	31 August 2006 £	30 September 2007 £	31 August 2006 £
Trade receivables	**227,568**	324,396	–	–
Other receivables	**96,477**	34,740	**25,950**	489
Prepayments and accrued income	**184,568**	209,746	**24,398**	21,507
	508,613	568,882	**50,348**	21,996

Notes to the financial statements continued

16. Cash and cash equivalents

	Group		Company	
	30 September 2007 £	31 August 2006 £	30 September 2007 £	31 August 2006 £
Cash and cash equivalents	**2,240,947**	5,997,428	**1,980,557**	5,520,988

The Company holds its excess cash reserves in a combination of fixed interest accounts and fixed term money market deposits. At 30 September 2007 and 31 August 2006 these did not exceed three months in duration

17. Trade and other payables

	Group		Company	
	30 September 2007 £	31 August 2006 £	30 September 2007 £	31 August 2006 £
Trade payables	**242,839**	522,222	**44,551**	2,440
Other payables	**15,064**	73	**-**	-
Other taxation and social security	**48,165**	61,598	**-**	-
Accruals and deferred income	**1,047,313**	1,153,654	**52,056**	90,061
	1,353,381	1,737,547	**96,607**	92,501

Included within other payables for the Group is an amount of £15,032 (2006 £73) relating to pensions

18. Provisions

Provision for employer's National Insurance on share option gains

There is no provision for employer s National Insurance on share option gains at the period end as the option price of the share options granted after 5 April 1999 (but before 7 November 2002) under the 1996 share option scheme, which have not vested at 30 September 2007, is greater than the market value of the shares under option Options granted after 18 September 2000 under the 1996 share options schemes and all options granted under the 2003 and the 2007 share option schemes have transferred the liability for National Insurance to the employee

Deferred taxation

The Group and Company have the potential assets shown below, which are not recognised due to uncertainty as to the timing of their utilisation

	Group		Company	
	30 September 2007 £	31 August 2006 £	30 September 2007 £	31 August 2006 £
Tax effect of timing differences				
Excess of tax allowances over depreciation	**292,026**	290,404	**3,073**	3,293
Accumulated losses	**9,642,553**	9,322,398	**746,389**	546,611
Other	**-**	2,271	**-**	-
	9,934,579	9,615,073	**749,462**	549,904

19. Financial instruments and financial risk management

The Group s financial instruments comprise primarily cash and liquid resources, and various items such as trade receivables and trade payables, which arise directly from its operations. The Group does not enter into derivative transactions

The Group s ongoing objectives in using financial instruments are to maximise the returns on funds held on deposit, to minimise exchange rate risk where appropriate, and to generate additional cash resources through the issue of shares when market conditions are appropriate In addition, the Group has from time to time conserved cash resources by entering into financing arrangements for the acquisition of major capital assets

The balance sheet positions at 30 September 2007 and 31 August 2006 are not representative of the positions throughout the period as cash and short-term investments fluctuate considerably depending on when milestone receipts have occurred and on the timing of share issues.

Interest rate risk profile of the Group's financial assets

The Group held all cash, bank and deposits in Sterling accounts with UK banks. Interest rates on current accounts are floating and are based on LIBID, while interest rates on term deposits are fixed for the duration of deposit and earned interest between 5 % and 5 75% in the period ended 30 September 2007 (2006 between 4 65% and 4.91%)

Interest rate risk profile of the Group's financial liabilities

The Group s liabilities were all in Sterling at fixed rates of interest and are in respect of lease agreements for the purchase of capital assets, or were non interest-bearing

Currency risk profile

The Group had no significant commitments in foreign currencies throughout the period

Borrowing facilities

The Group had no borrowing facilities at 30 September 2007 (2006 £nil)

Fair values

There is no material difference between the fair value and the carrying values of the financial instruments referred to above, because of the short maturity period of these financial instruments or their intrinsic size and risk.

Credit risk

Other than trade receivables, the financial instruments that subject the Group to a potential credit risk comprise principally of cash and short term investments and the funds advanced to suppliers of inventory The Group s policy is to minimise the risks associated with cash and short term investments by placing these deposits with institutions with a recognised high rating, or with one of the major clearing banks. Trade receivables are largely with highly reputable, creditworthy trading partners

20. Pensions and similar obligations

The Group operates a number of defined contribution pension schemes for employees. The assets of the schemes are held separately from those of the Group in independently administered funds. The pension cost represents contributions paid and payable by the Group to the funds and amounted to £278,383 (2006 £82,880)

21. Called-up share capital

	30 September 2007 £	31 August 2006 £
Authorised		
100,000,000 (2006 100,000,000) ordinary shares of 1pence each	**1,000,000**	1,000,000
Allotted, called-up and fully paid		
55,606,309 (2006 51,180,893) ordinary shares of 1pence each	**556,063**	511,809

During the period 4,425,416 shares were issued for cash consideration of £1,681,659 The nominal amount of these shares was £44,254 In the year ended 31 August 2006, no shares were issued for cash.

Notes to the financial statements continued

22. Options over shares of Phytopharm plc

Potential issues of shares

The Company may grant share options to selected employees on joining the Company and any such grants are made following the preliminary and interim announcements together with performance related grants to all employees. Performance criteria must be satisfied before share options can be exercised and these are detailed below In addition the Company has a long-term incentive scheme under which long-term share incentives may be granted to selected Senior Executives. During the period the Remuneration Committee reviewed the effectiveness and appropriateness of the existing long-term incentive and share option schemes. As a result of this review, new incentive arrangements were approved by Shareholders at a general meeting in June 2007 Subsequently employees and Executive Directors surrendered existing options and received grants under the new arrangements

The outstanding share scheme options and long-term incentive awards at 30 September 2007 are shown below analysed according to the exercise criteria Other than those described in notes 6 to 10 below, all options were originally granted under the 1996 and 2003 plans. The conditions attaching to these were not affected by the surrender and replacement described above

Number outstanding 30/092007	Exercise price	Note	Date granted	Exercisable From	Exercisable To	Currently vested 30/092007	Currently exercisable 30/092007
450	£4 50	1a	02/07/2002	02/07/2005	01/07/2012	450	–
1,304	£1 165	1b	06/12/2002	06/12/2005	05/12/2012	1,304	–
1,754						1,754	–
450	£4 50	2a	02/07/2002	02/07/2005	01/07/2012	450	–
1,304	£1 165	2b	06/12/2002	06/12/2005	05/12/2012	1,304	–
1,754						1,754	–
900	£4 50	3	02/07/2002	02/07/2007	01/07/2009	900	–
2,607	£1 165	3	06/12/2002	06/12/2007	05/12/2009	–	–
3,507						900	–
15,426	£1 815	4b	03/12/2004	03/12/2007	02/12/2014	–	–
5,612	£1 255	4b	11/05/2005	11/05/2008	10/05/2015	–	–
7,881	£0 48	4b	03/11/2005	03/11/2008	02/11/2015	–	–
7,524	£0 56	4b	08/05/2006	08/05/2009	07/05/2016	–	–
21,464	£0 4675	4b	08/11/2006	08/11/2009	07/11/2016	–	–
57,907						–	–
600,000	£0 45	6	09/01/2007	09/01/2010	08/01/2017	–	–
600,000						–	–
2,532,484	£0 445	7	03/08/2007	03/08/2009	02/08/2017	–	–
2,532,484						–	–
151,136	£0 01	8	03/08/2007	03/08/2009	*	–	–
155,000	£0 01	9	03/08/2007	03/08/2010	*	–	–
306,136						–	–
121,817	£0 4825	10	12/09/2007	01/10/2010	30/09/2011	–	–
121,817						–	–

* these shares shall be transferred to the participant at the end of the performance period to the extent that any performance conditions have been satisfied

22. Options over shares of Phytopharm plc continued

Note

1a These options vest in tranches of one third on each of the first, second and third anniversaries of the date of grant, and have been granted under a scheme approved by HMRC Each option is subject to the following condition which must be satisfied before it can be exercised, namely that the increase between an amount equal to 91% of the option price for those options originally granted on 24 April 1996 or the option price for later grants and the middle market quotation of a share on a date falling no earlier than the third anniversary of the date of grant of that option shall be at least one and a half times the increase over the period from the date of grant to such date in the FT Actuaries All Share Index The options remain exercisable until the tenth anniversary of the date of grant

1b These options vest in the same way and must satisfy the same conditions as those under 1a above However, these options remain exercisable until the seventh anniversary of the date of grant and have not been submitted to HMRC for approval.

2a These options vest in tranches of one third on each of the first, second and third anniversaries of the date of grant and have been granted under a scheme approved by HMRC Each option is subject to the following condition which must be satisfied before it can be exercised, namely that the increase between an amount equal to 91% of the option price for those options originally granted on 24 April 1996 or the option price for later grants and the middle market quotation of a share on a date falling no earlier than the third anniversary of the date of grant of that option shall be at least twice the increase over the period from the date of grant to such date in the FT Actuaries All Share Index. The options remain exercisable until the tenth anniversary of date of the grant.

2b These options vest in the same way and must satisfy the same conditions as those under 2a above However, these options remain exercisable until the seventh anniversary of the date of grant and have not been submitted to HMRC for approval.

3 These options vest in tranches of one fifth on each of the first, second, third, fourth and fifth anniversaries of the date of grant Each option is subject to the following condition which must be satisfied before it can be exercised, namely that the increase between an amount equal to 91% of the option price for those options originally granted on 24 April 1996 or the option price for later grants and the middle market quotation of a share on a date falling no earlier than the fifth anniversary of the date of grant of that option shall be at least one and a half times the increase over the period from the date of grant to such date in the Pharmaceuticals Index as published by the Financial Times as a constituent part of the FT Actuaries All Share Index. The options remain exercisable until the seventh anniversary of the date of grant

4a These options vest on the third anniversary of the date of grant and have been granted under a scheme approved by HMRC The number of options exercisable will be determined by the Company s Total Shareholder Return (TSR) Two thirds will become exercisable by reference to the Company s performance compared to a group of UK listed biotechnology companies applicable at the time of grant The remaining one third will be exercisable by reference to the Company s performance compared to the constituents of the FTSE Small Cap Index.

The value of options (at date of grant) granted up to 100% of base salary will be exercisable if the Company s TSR in the relevant ranking Group is above the median The value of options (at date of grant) granted in excess of 100% of base salary will be exercisable at 25% for median performance against the comparator Group rising to 100% for upper quartile and above performance The performance of the Company will initially be measured over three years following grant date If the target has not been met after three years, it can be re-tested after years four and five For options originally granted in 2004 there will be only one option to re-test after four years and for options originally granted in 2005 and later there will be no opportunity to re-test.

4b These options vest in the same way and must satisfy the same conditions as those under note 4a above and have been granted under the Enterprise Management Incentive Scheme

4c These options vest in the same way and must satisfy the same conditions as those under note 4a above and have not been submitted to HMRC for approval.

5 These awards made under long-term incentive plans are subject to performance conditions and the benefits are not pensionable The performance conditions are based on TSR over a three year period (with no retesting opportunities) when compared to a peer Group comprising other UK listed biotech and pharmaceutical companies (as above) for two thirds of the shares and compared to the FTSE Small Cap index for the remaining one third In each case 25% of the shares will vest for median performance against the comparator Group rising prorate to 100% for upper decile and above performance None of the shares awarded will vest for below median performance TSR is considered by the remuneration committee to be the most robust method of measuring Company performance over the period The terms of these awards will not be amended to the benefit of Directors without shareholder approval.

Notes to the financial statements continued

22. Options over shares of Phytopharm plc continued

6 On 9 January 2007 the Remuneration Committee made a performance share award of 350,000 ordinary shares to Dr D Rees, and 250,000 ordinary shares to Mr P Morgan at an exercise price of 45 pence per share The Remuneration Committee considered that there was a considerable risk of Dr Rees leaving the Company as his existing share option awards were at option prices significantly in excess of the current share price and this performance share award was granted, as permitted by Listing Rule 9 4 2 (2) to retain the services of Dr Rees. The Remuneration considered that the award to Mr Morgan was necessary and as permitted by Listing Rule 9 4 2 (2), to secure the services of Mr Morgan The awards are subject to performance conditions and the benefits are not pensionable The performance condition is based on TSR over a three year period (with no retesting opportunities) when compared to the FTSE Small Cap Index. 100% of the shares awarded will vest for performance above the comparator group None of the shares awarded will vest for performance below the comparator group TSR is considered by the Remuneration Committee to be the most robust method of measuring company performance over the period The terms of the award will not be amended to the benefit of Dr Rees or Mr Morgan without seeking shareholder approval.

7 These options vest on the second anniversary of the date of grant and have been granted under the Enterprise Management Incentive Scheme The number of options exercisable will be determined by the Company's TSR compared to the constituents of the FTSE Small Cap Index. The value of options (at date of grant) will be exercisable if the Company's TSR in the relevant ranking Group is above the median

8 These options vest on the second anniversary of the date of grant and have been granted under the long-term incentive plan The number of options exercisable will be determined by the Company's TSR compared to the constituents of the FTSE Small Cap Index. The value of options (at date of grant) will be exercisable at 25% if the Company's TSR in the relevant ranking Group is above the median rising to 100% for upper decile performance

9 These options vest on the third anniversary of the date of grant and have been granted under the long-term incentive plan The number of options exercisable will be determined by the Company's TSR compared to the constituents of the FTSE Small Cap Index. The value of options (at date of grant) will be exercisable at 25% if the Company's TSR in the relevant ranking Group is above the median rising to 100% for upper decile performance

10 These options are granted under a save as you earn plan approved by HMRC The last offer under the plan was made to all employees and Executive Directors on 13 August 2007

Option valuations

Options were valued using a stochastic model (also known as a Monte Carlo model) The fair value per option granted and the assumptions used in the calculation for options granted since 6 December 2002 are set out in the tables respectively below The Company's effective date for IFRS2, Share Based Payments implementation is 1 September 2005 and the IFRS has been applied to all options granted after 7 November 2002 which have not vested by this effective date and options granted before this effective date which have been subsequently modified

The fair value per option granted and the assumptions used in the calculation for options granted since 6 December 2002 are set out below

Award	Grant date	Exercise price £	**Number of shares outstanding at 30 September 2007 £**	Fair value per option at grant date £	Modification date	Share price on date of modification £	Number of shares surrendered and replaced £	Incremental fair value of replacement options £
1996 Share Option Plans[11]					03/08/2007	0 445	292,989	0 2030
1996 Share option plan (part 1a)	06/12/2002	1 165	**30,163**	0 6700	03/08/2007	0 445	28,859	0 0636
1996 Share option plan (part 1b)	06/12/2002	1 165	**27,184**	0 6700	03/08/2007	0 445	27,184	0 1971
1996 Share option plan (part 2a)	06/12/2002	1 165	**30,157**	0 6780	03/08/2007	0 445	28,853	0 0708
1996 Share option plan (part 2b)	06/12/2002	1 165	**27,181**	0 6664	03/08/2007	0 445	27,181	0 1998
1996 Share option plan (part 3)	06/12/2002	1 165	**106,951**	0 6641	03/08/2007	0 445	104,344	0 1789
2003 Share option plan	02/05/2003	1 425	**97,449**	0 8137	03/08/2007	0 445	97,449	0 1491
2003 Share option plan	02/05/2003	1 425	**48,725**	0 8137	03/08/2007	0 445	48,725	0 2034
2003 Share option plan	09/12/2003	2 125	**163,564**	1 2559	03/08/2007	0 445	163,564	0 1847
2003 Share option plan	09/12/2003	2 125	**81,782**	1 2559	03/08/2007	0 445	81,782	0 2016

22. Options over shares of Phytopharm plc continued

Award	Grant date	Exercise price £	Number of shares outstanding at 30 September 2007 £	Fair value per option at grant date £	Modification date	Share price on date of modification £	Number of shares surrendered and replaced £	Incremental fair value of replacement options £
2003 Share option plan	05/05/2004	1 85	**37,939**	1 0360	03/08/2007	0 445	37,939	0 1994
2003 Share option plan	05/05/2004	1 85	**18,970**	1 0360	03/08/2007	0 445	18,970	0 2034
2003 Share option plan	05/05/2004	1 85	**15,599**	1 0360	03/08/2007	0 445	15,599	0 1954
2003 Share option plan	05/05/2004	1 85	**7,800**	1 0360	03/08/2007	0 445	7,800	0 2034
2003 Share option plan	03/12/2004	181 5	**103,837**	0 6411	03/08/2007	0 445	88,411	0 1749
2003 Share option plan	03/12/2004	181 5	**44,206**	0 6411	03/08/2007	0 445	44,206	0 1936
2003 Share option plan	11/05/2005	1 255	**124,220**	0 6250	03/08/2007	0 445	118,608	0 1802
2003 Share option plan	11/05/2005	1 255	**59,304**	0 6250	03/08/2007	0 445	59,304	0 2025
2003 Share option plan	03/11/2005	0 48	**162,570**	0 2352	03/08/2007	0 445	154,689	0 0423
2003 Share option plan	03/11/2005	0 48	**77,344**	0 2352	03/08/2007	0 445	77,344	0 1166
2003 Share option plan	14/12/2005	0 545	**266,667**	0 6670	03/08/2007	0 445	266,667	0 0062
2003 Share option plan	14/12/2005	0 545	**133,333**	0 6670	03/08/2007	0 445	133,333	0 1562
2003 Share option plan	08/05/2006	0 56	**100,996**	0 6234	03/08/2007	0 445	93,472	–
2003 Share option plan	08/05/2006	0 56	**46,736**	0 6234	03/08/2007	0 445	46,736	0 0329
2003 Share option plan	08/11/2006	0 4675	**242,448**	0 2436	03/08/2007	0 445	220,984	–
2003 Share option plan	08/11/2006	0 4675	**110,492**	0 2436	03/08/2007	0 445	110,492	0 0156
2003 Share performance plan	03/12/2004	0 01	**57,716**	1 2741	03/08/2007	0 445	57,716	0 2817
2003 Share performance plan	03/12/2004	0 01	**28,858**	1 2741	03/08/2007	0 445	28,858	0 2817
2003 Share performance plan	11/05/2005	0 01	**11,301**	0 8095	03/08/2007	0 445	11,301	0 2750
2003 Share performance plan	11/05/2005	0 01	**5,651**	0 8095	03/08/2007	0 445	5,651	0 2817
2003 Share performance plan	03/11/2005	0 01	**31,740**	0 2741	03/08/2007	0 445	31,740	0 1135
2003 Share performance plan	03/11/2005	0 01	**15,870**	0 2741	03/08/2007	0 445	15,870	0 1135
Exceptional award	09/01/2007	0 45	**600,000**	0 2213	03/08/2007	–	–	–
2007 Share option plan	03/08/2007	0 445	**137,000**	0 2034	03/08/2007	–	–	–
2007 Long term incentive plan	03/08/2007	0 01	**155,000**	0 2801	03/08/2007	–	–	–
2007 Sharesave plan	12/09/2007	0 4825	**121,817**	0 1900	03/08/2007	–	–	–

(i) These awards were awarded prior to the effective date for IFRS2 and were surrendered and replaced on 3 August 2007 Their fair value has been calculated at the date of modification.

Notes to the financial statements continued

22. Options over shares of Phytopharm plc continued

The fair values of the original share options granted but not vested as at 30 September 2007 were calculated using the following assumptions

Award	Grant date	Expected term	Expected dividend yield (note(b))	Expected volatility (note (c))	Risk free rate (note (d))	Performance condition (note)
1996 Share option plan (part 1a)	06/12/2002	See note (a) below	0%	63 0%	5 0%	1a
1996 Share option plan (part 2a)	06/12/2002	See note (a) below	0%	63 0%	5 0%	2a
1996 Share option plan (part 3)	06/12/2002	See note (a) below	0%	63 0%	5 0%	3
2003 Share option plan	03/12/2004	See note (a) below	0%	61 0%	5 0%	4
2003 Share option plan	11/05/2005	3 years	0%	62 0%	4 0%	4
2003 Share option plan	03/11/2005	3 years	0%	64 0%	4 0%	4
2003 Share option plan	08/05/2006	3 years	0%	68 2%	4 8%	4
2007 Share option plan	03/08/2007	2 years	0%	67 5%	5 4%	7
2007 Long term incentive plan	03/08/2007	2 years	0%	71 3%	5 6%	8
2007 Long term incentive plan	03/08/2007	3 years	0%	71 3%	5 6%	9
2007 Sharesave Plan	12/09/2007	3 Years	0%	64 5%	4 9%	10

The fair values of the options surrendered and replaced on 3 August 2007 were calculated using the following assumptions

Award	Grant date	Expected term	Expected dividend yield (note(b))	Expected volatility (note (c))	Risk free rate (note (d))	Performance condition (note)
1996 Share option plan (part 1a)	06/12/2002	See note (a) below	0%	67 9%	5 5%	1a
1997 Share option plan (part 1b)	06/12/2002	See note (a) below	0%	47 5%	5 6%	1b
1996 Share option plan (part 2a)	06/12/2002	See note (a) below	0%	67 9%	5 5%	2a
1997 Share option plan (part 2b)	06/12/2002	See note (a) below	0%	47 5%	5 6%	2b
1996 Share option plan (part 3)	06/12/2002	See note (a) below	0%	53 0%	5 6%	3
2003 Share option plan	02/05/2003	See note (a) below	0%	64 5%	5 5%	4
2003 Share option plan	09/12/2003	See note (a) below	0%	62 8%	5 5%	4
2003 Share option plan	05/05/2004	See note (a) below	0%	62 6%	5 5%	4
2003 Share option plan	03/12/2004	See note (a) below	0%	69 1%	5 4%	4
2003 Share option plan	11/05/2005	3 years	0%	67 8%	5 4%	4
2003 Share option plan	03/11/2005	3 years	0%	67 7%	5 4%	4
2003 Share option plan	14/12/2005	3 years	0%	52 7%	5 6%	4
2003 Share option plan	08/05/2006	3 years	0%	69 1%	5 4%	4
2003 Share option plan	08/11/2006	3 years	0%	67 8%	5 4%	4
2003 Share performance plan	03/12/2004	3 years	0%	43 7%	5 6%	5
2003 Share performance plan	11/05/2005	3 years	0%	43 7%	5 6%	5
2003 Share performance plan	03/11/2005	3 years	0%	47 6%	5 6%	5

22. Options over shares of Phytopharm plc continued

Notes to assumptions:

(a) i) 40% of participants exercise after 3 years if a gain of 40% is available If this gain is not available, these individuals hold on to their shares until such a gain can be made The performance test must be satisfied If the test has not been satisfied at the date of leaving, the awards lapse
ii) 25% of the remainder exercise from the 3rd anniversary onwards using a reducing balance methodology, providing that a gain of 20% is available If this gain is not available, these individuals refrain from exercising until such a gain can be made
iii) 15% of the total participants are "good leavers (where the employee may have up to twelve months to exercise options)
iv) 5% of the participants exercise per annum in years 4 onwards on a reducing balance methodology, providing that the options are in the money (irrespective of the level of gain) to allow for leavers in these periods. This is reduced to 7 years for the 7 year options granted under the ESOS
v) any remaining options are exercised at maturity providing that they are in the money" Any awards that are "underwater therefore lapse at maturity This exercise strategy is subject to the passing of the performance conditions described above

(b) The dividend yield of 0% reflects the absence of a history of paying dividends and a clear dividend policy statement at the relevant grant dates.

(c) Expected volatility is the measurement of the amount by which a share price is expected to fluctuate during a period The expected volatility has been calculated using the standard approach of calculating the standard deviation of the natural logarithm of historical share price movements.

(d) UK Gilt rates prevalent on the date of grant with a period commensurate with the term of the award

A reconciliation of share option scheme movements for the periods ended 31 August 2006 and 30 September 2007 is set out below

	2007		2006	
	Number	**Weighted average exercise price £**	Number	Weighted average exercise price £
At 1 September	**3,132,918**	**1.67**	3,417,276	1 87
Surrendered	**(2,546,620)**	**1.39**	–	–
Granted	**3,960,436**	**0.42**	1,048,792	0 48
Exercised	**–**	**–**	–	–
Lapsed	**(921,375)**	**1.97**	(1,333,150)	2 14
At 30 September (31 August)	**3,625,359**	**0.42**	3,132,918	1 29

The following tables summarise the information about the range of exercise prices for share options outstanding at 31 August 2006 and 30 September 2007

	30 September 2007			31 August 2006		
Range of exercise prices	**Weighted average exercise price £**	**Number of shares**	**Weighted average remaining life contractual years**	Weighted average exercise price £	Number of shares	Weighted average remaining life contractual years
£0 01	**0.01**	**306,136**	**10.00**	0 01	262,955	8 46
£0 48–£0 56	**0.45**	**3,291,170**	**9.76**	0 53	937,109	9 22
£1 165–£1 85	**1.57**	**26,253**	**6 52**	1 40	1,090,711	6 46
£2 125–£2 915	**–**	**–**	**–**	2 20	341,484	6 32
£3 89	**–**	**–**	**–**	3 89	124,808	0 42
£4 20–4 95	**4.50**	**1,800**	**3.50**	4 65	249,072	2 55
£5 42–£5 62	**–**	**–**	**–**	5 53	10,573	4 09
£6 00–£6 89	**–**	**–**	**–**	6 59	116,206	1 35

The total charge for the period relating to employee share-based payment plans was £563,202 (2006 £302,492) all of which related to the above equity based transactions.

Notes to the financial statements continued

23. Post balance sheet events

There are no balance sheet events of significance

24. Capital commitments

Neither the Group nor the Company had capital commitments contracted but not provided for at 30 September 2007 (2006 £nil)

25. Contingent liabilities

There were no contingent liabilities in the Group or Company at 30 September 2007 (2006 £nil)

26. Financial commitments

At 30 September 2007 there were the following commitments under non-cancellable operating leases

Group

	30 September 2007		31 August 2006	
	Land and buildings £	**Other £**	Land and buildings £	Other £
Within one year	**25,900**	**–**	25,900	1,263
Between two and five years inclusive	**6,474**	**–**	34,528	22,267
	32,374	**–**	60,428	23,530

Company

The Company has no annual commitments under non-cancellable operating leases.

The Group has purchase obligations of £488,180 in respect of its sub-contracted research and development activities as at 30 September 2007 (2006 £1,590,186) The Company had no such commitments

27. Related party transactions

Group

Under IAS 24 Related Party Disclosures the Group is not required to disclose inter-group transactions which are eliminated on consolidation

The Directors regard Phytopharm plc as the ultimate controlling party of the Group

Company

The inter-company balances outstanding at 30 September 2007 and 31 August 2006 are shown on the Company balance sheet

The Company has been charged £674,615 (2006 £633,619) for corporate services provided by subsidiary undertakings.

The remuneration received by key management personnel, including the Directors, is disclosed in note 5

Shareholder information

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Phytopharm plc is a company registered in England & Wales, which is listed on the London Stock Exchange (symbol PYM)

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3131723

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