XENETIC BIOSCIENCES PLC

ANNUAL REPORT

FOR THE YEAR ENDED

31st DECEMBER 2012

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COMPANIES HOUSE

Company Registration Number 03213174

XENETIC BIOSCIENCES PLC

ANNUAL REPORT
FOR THE YEAR ENDED 31st DECEMBER 2012

CONTENTS

XENETIC BIOSCIENCES PLC

OFFICERS AND PROFESSIONAL ADVISERS

Directors	Sir Brian Richards (Non-Executive Chairman) Scott Maguire (Chief Executive Officer) Colin W Hill (Chief Financial Officer) Professor Gregory Gregoriadis (Non-Executive) Dr Dmitry D. Genkin (Non-Executive) Firdaus J. Dastoor (Non-Executive) Roman Knyazev (Non-Executive – appointed 27th January 2012) Artur Isaev (Non–Executive – appointed 27th April 2012)
Company secretary	Cargil Management Services Limited
Registered office	The London BioScience Innovation Centre 2 Royal College Street London NW1 0NH
Auditor	Ernst & Young LLP Apex Plaza Forbury Road Reading RG1 1YE
Bankers	Bank of Scotland 33 Old Broad Street London EC2N 1HW
Solicitors	Pinsent Masons LLP 30 Crown Place London EC2A 4ES

XENETIC BIOSCIENCES PLC

CHAIRMAN'S STATEMENT
FOR THE YEAR ENDED 31st DECEMBER 2012

The last 12 months have delivered important positive developments both as to clinical advancements on a number of the Group's proprietary pipeline products as well as in respect of our planned transition to the United States

Let me first address major developments in respect of some of our proprietary drug candidates.

Xenetic:	The Group will be commencing its first Western clinical trial in June/July 2013 by way of a Phase II FDA/ICH-compliant clinical trial in Australia for ErepoXen®, our PolyXen®-based biologic candidate for anaemia in pre-dialysis patients with Chronic Kidney Disease ("CKD") The trial has been contracted with and is being conducted by Novotech (Australia) Pty Limited, an Australian-based Clinical Research Organisation ("CRO"), and is expected to finally report completion of Phase II studies in H1-2015
SynBio LLC	Phase III trials for ErepoXen® commenced in Russia in May 2013 which, subject to good clinical outcomes, would lead to market approval of the drug for Russia and the Former CIS by end-2014 with the commencement of sales in 2015 This would also permit the Group to enter non-Russian/CIS markets (such as Brazil and other territories that recognise Russian approvals) and thereby expand the royalty income channels for the Group. Conducting ongoing clinical trials on our OncoHist™ candidate for both Acute Myeloid Leukaemia and for Non-Hodgkin's Lymphoma, with, to date, no Serious Adverse Events ("SAE") reported in either trial
Pharmsynthez:	Commenced clinical trials for our ImuXen®-based Multiple Sclerosis candidate, MyeloXen™ in November 2012 and has completed Phase I in healthy volunteers with no SAE. The trial has now entered the Phase II stage in patients The dose-ranging phase is expected to be completed by Q3-2013 and dose confirmation studies in patients are expected to commence before the end of 2013. Completed pre-clinical work on PulmoXen™, our PolyXen®-based biologic proprietary candidate for Cystic Fibrosis and now is expected to move the candidate into the clinic in Q3-2013
Serum Institute:	Continues to advance Indian clinical work on our ErepoXen® product candidate which has now entered Phase II(b) trials.
Dana-Farber:	Xenetic entered into a collaborative agreement with Dana-Farber Cancer Institute in Boston as announced in February 2013 This addresses important pre-clinical work in respect of our OncoHist™ therapy and is intended to conclusively establish the Mode of Action of the candidate as a back-up to the results from the ongoing Russian clinical trials mentioned above, this being a precursor to the Group filing an Investigation New Drug application with the US FDA in order to advance the therapy into the clinic in the USA in 2014 This is the second planned Western clinical trial for a pipeline candidate

XENETIC BIOSCIENCES PLC

CHAIRMAN'S STATEMENT
FOR THE YEAR ENDED 31st DECEMBER 2012

As noted in my Interim Statement, clinical advancement from the efforts of our collaborative partners (such as SynBio, Pharmsynthez and Serum Institute) is pivotal in fulfilling the de-risking development strategy that the Group is actively pursuing, this is achieved by establishing human proof of concept in local jurisdictions, thereby underpinning the likely safety, efficacy and potential of a drug candidate such that the Group can more confidently place the candidate into costly Western trials under FDA or EU regulation Western trials are essential to establish clinical data which Big Pharma and Big Bio require from smaller companies such as Xenetic as conclusive evidence of the likely long term clinical development viability of a candidate.

Corporate developments

(a) On 31st October 2012 we closed the former SymbioTec GmbH laboratory facility in Saarbrucken, Germany with all clinical data and archives transferred to London pending their ultimate move to Boston,

(b) The Group has identified, and is currently in the closing stages of negotiating the lease on new laboratories in Lexington, MA , which facility is expected to open in September 2013;

(c) The level of effort to investigate and evaluate the optimum means by which Xenetic can obtain a US public listing have increased greatly in the last 6 months; however, and as noted in the RNS issued by the Group on 18th April 2013 ". . *the Company has been considering a number of ways to efficiently achieve a listing in the US either in tandem with or in substitution for its listing on AIM, although no assurances can be given if or when such a listing will occur."*

As the Board now believes that a viable *modus operandi* will be established in the near term, arrangements are being put in place to initiate a "pre-marketing" programme by which the Xenetic story will be taken to brokers/dealers and potential institutional investors in the USA such that, when the transition is able to be executed, an appreciation of Xenetic and the potential of its technologies will already exist, and

(d) The Group's Scientific Advisory Board is now well established, and will continue to be built with a strong US bias and be charged with facilitating pipeline candidates through the clinic to commercial markets.

Key development issues

The biggest challenges facing Xenetic's executive management team remain.

(a) Ensuring the availability of capital that will permit the acceleration to and market launch of the Group's lead product candidates in the US and Europe.

(b) Recruiting executive and drug development skills to accelerate both the reduction of the Company's dependence on third parties for primary clinical development efforts concomitant with its ability to professionally and efficiently execute all things necessary to move drug candidates into Western clinical trials in the shortest practical timelines

(c) The acquisition of new product candidates with near-term commercialisation potential

XENETIC BIOSCIENCES PLC

CHAIRMAN'S STATEMENT
FOR THE YEAR ENDED 31st DECEMBER 2012

Availability of capital

As at the date of publishing this report the Group has cash reserves of £5 6m While this is adequate to meet our "baseline" working capital requirements, the fact is that the Group has moved on from being a largely research–based organisation and has taken steps to make the important (and costly) transition to the United States in tandem with the initiation of Western clinical trials on its own account Such commitments will inevitably bring fiscal pressures to bear, although they are fundamentally positive and wholly in line with the long-term strategy of the Group. This will place demands on the Group to raise new capital in order to sustain what your Board considers to be truly imperative actions for the creation of shareholder value

TECHNOLOGY PLATFORMS

Xenetic's technologies are designed to improve the efficacy, safety, stability, biological half-life and immunologic characteristics of its products using its three proprietary patented technology platforms

1 PolyXen®	For extending the efficacy and half-life of biologic drugs
2. ImuXen®	For creating new vaccines and improving existing vaccines
3 OncoHist™	For novel mode of action drugs for oncology therapies

CLINICAL PROGRAMMES

The Company has multiple drug and vaccine programmes with four products currently in human clinical development:

ErepoXen®.	A long-acting erythropoietin ("EPO") currently in Phase II(b) trials in India and Phase III trials in Russia ErepoXen® is a long-acting formulation for the treatment of anaemia in pre-dialysis patients with CKD
OncoHist™.	A recombinant human histone H1 3 molecule in Phase II clinical trials in Russia for refractory Acute Myeloid Leukaemia ("AML") and Non-Hodgkin's Lymphoma ("NHL").
SuliXen®:	A long-acting insulin with two ongoing trials in Russia being for both the treatment of diabetes and for a central nervous system ("CNS") condition
MyeloXen™:	A novel vaccine therapy for the treatment of Multiple Sclerosis ("MS").

XENETIC BIOSCIENCES PLC

CHAIRMAN'S STATEMENT
FOR THE YEAR ENDED 31st DECEMBER 2012

Baxter International Inc

The Company also has an important license agreement with Baxter International Inc ("Baxter") to develop a novel series of polysialylated blood coagulation factors, including Factor VIII. In 2010, Xenetic and Baxter announced positive results with a PSA-Factor VIII candidate in a series of pre-clinical studies and the selection of a lead candidate, providing confidence in the programme's potential to transition into clinical development.

Following a decision by Baxter to move this program into their follow-on development program this candidate is now expected to enter Western clinical trials in 2014 Baxter has affirmed that PSA-Factor VIII is an important pipeline product intended to strengthen their Haemophilia-A portfolio Accordingly, Baxter is due to pay a license extension fee of US$1m to the Group which falls due on 30th June 2013

PRODUCT DEVELOPMENT PIPELINE

Co-development Partner	Country	Product	Discovery	Lead optimisation	Pre-clinical	Phase I	Phase II	Phase III
Baxter	USA/EU	Factor VIII (Haemophilia)	→	→	→			
Pharmsynthez	Russia	PulmoXen™ (Cystic Fibrosis)	→	→	→			
SynBio	Russia	OncoHist™ (AML)	→	→	→	→	→	
Pharmsynthez	Russia	MyeloXen™ (MS)	→	→	→	→		
SynBio	Russia	OncoHist™ (Non-Hodgkin Lymphoma)	→	→	→	→	→	
SynBio	Russia	ErepoXen® (Anaemia)	→	→	→	→	→	→
SIIL	India	ErepoXen® (Anaemia)	→	→	→	→	→	
XEN	Australia/ FDA	ErepoXen® (Anaemia)	→	→	→	→	→	
SynBio	Russia	SuliXen® (Diabetes + CNS)	→	→	→	→		

XENETIC BIOSCIENCES PLC

CHAIRMAN'S STATEMENT
FOR THE YEAR ENDED 31st DECEMBER 2012

Financial Summary

The financial results for the Group in the period under review were

	2012	2011	2010
	£'000	£'000	£'000
Revenue	167	143	1,566
Total pre-tax losses for period	3,377	2,854	1,934
Non-cash component of total pre–tax loss	372	242	755
Net cash as at 31st December	6,891	11,075	851
Net asset value as at 31st December	14,568	10,976	1,987
	Pence	Pence	Pence
Loss per share – basic and fully diluted	0.91	1.44	1 13
Net asset value per share – basic	3.89	3.81	1 12
Net asset value per share – fully diluted	3.83	3.73	1 11

The following table summarises the broad application of funds in the period

	2012	2012	2011	2011
Cash settled expenses	£'000	%	£'000	%
R&D expense - cash settled	1,625	51.1	1,050	38.5
Other expenses – cash settled	1,557	48.9	1,678	61.5
Total expenses – cash settled	3,182	100.0	2,728	100.0
Non-cash items				
Equity settled share option expense	16		26	
Depreciation	66		216	
Non cash acquisition costs	290		-	
	372		242	
TOTAL ADMINISTRATIVE COSTS	3,554		2,970	

The analysis above reflects a number of important issues.

(a) A significant increase in the proportion of cash applied to R&D, this being largely as a result of the operating costs of SymbioTec in Germany as well as US-based costs of our developments in Massachusetts;

(b) A reduction in non-cash expenditures associated with deprecation charges, this being a consequence of the Group having now fully written off its PSA laboratory asset investment made in association with Serum Institute in 2007/8;

(c) Depreciation now includes the write off (over four years) of the leasehold improvements and office furniture and equipment assets expended in early 2012 when the corporate head office was opened in London in Q2-2012, and

(d) The £290k of non-cash acquisition costs represents the expensing in January 2012 of costs associated with the acquisition of SymbioTec, which were cash-settled in 2011

CURRENT TRADING AND CONCLUSION

I remain optimistic that the Company's very broad technology offerings will now enter a period of enhanced application and exploitation for the benefit of shareholders and, in due course, that of patients, who will benefit from the unique combination of improved therapeutics and fundamentally non-toxic therapies that our technologies confer

While there are still many operational steps to take and clinical hurdles to overcome, Xenetic is now moving decisively towards its aspired-for renaissance as a Speciality Drug Developer working closely with our key collaborative partners in Russia, India and the United States

We have made important positive steps in advancing our plans to effect a transition to the United States, and while the Group is not yet in a position to state firm dates for any complete corporate transition, the new offices and development laboratories in Lexington, MA , are expected to be available for occupation in September/October this year This will allow the drug development work of the Group to be greatly accelerated and also, upon the completion of a fundraising, the advancement of the self-determination of the Group's future growth The long term benefits of being a US-centric organisation will become apparent as a result of US markets conferring significantly greater value on enterprises such as Xenetic with its broad technology offering and vibrant proprietary drug pipeline

Once again I offer my personal thanks to our dedicated management and staff who have worked so hard to advance the Group through a number of challenging periods and circumstances, while never losing sight of the primary objective of creating long-term shareholder value, something that our US initiative is bringing that little bit closer.

I look forward to meeting as many shareholders as are able to attend the forthcoming Annual General Meeting, Notice (and related documents) of which accompany these Financial Statements.

The meeting is to be held at noon on Friday 28th June 2013 at the offices of Pinsent Masons LLP, 30 Crown Place, London, EC2A 4ES.

Bm Richard

Brian Richards
Non-Executive Chairman
London: 5th June 2013

XENETIC BIOSCIENCES PLC

REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31st DECEMBER 2012

The Directors present their report and the financial statements for the year ended 31st December 2012

PRINCIPAL ACTIVITIES

The Group's principal activity is the development of drug and vaccine delivery systems and proprietary products in the fields of protein drugs, vaccines and oncology.

The principal activity of the Company during the year was to act as a holding company.

RESEARCH AND DEVELOPMENT

Research and development is an integral part of the Group's operations and it intends to maintain this commitment in the future The Group's research and development activities are more fully described in the Chairman's statement.

REVIEW OF THE BUSINESS

A full review of the business and of future prospects is contained in the Chairman's Statement which accompanies these financial statements

The Board considers that the primary key performance indicators ("KPIs") are non-financial and relate to the progress of the scientific programs which are discussed in the Chairman's Statement The most important financial KPIs are the cash and cash equivalents position and the annual net cash spend which are also discussed in the Chairman's Statement

The Board considers that the principal risks and uncertainties facing the Group may be summarised as follows·

a) that the scientific programmes may not successfully complete clinical trials and regulatory approval processes,

b) potential loss of key scientific staff; and

c) the ability to raise finance in a timely and cost-effective manner

GOING CONCERN

As a development-stage life sciences business, the Group has incurred operating losses in the year under review, notwithstanding that substantial clinical, technical and corporate progress was also made in the continuing successful development both of its proprietary technologies and products and in its ongoing level of effort in respect of the planned transition of all drug development activities to the USA; consequently, the Group was a net consumer of cash.

In order to maintain the level of scientific effort required to develop the Group's technologies and to commercialise them to such a degree as will be necessary to become a cash-generative business, the Group will need to access new cash in addition to that available to it at the year end, such new cash will either be generated from the raising of new capital from existing and/or new shareholders, and/or internally by negotiating new feasibility or out-licensing revenues

The Directors have prepared a financial forecast for the period through to 31st December 2014

GOING CONCERN (continued)

In the next twelve months from signing the 2012 accounts, the main clinical programmes requiring significant costs to be incurred by the Group are.

a) ErepoXen®, the Group's PSA-EPO product candidate - new Western Phase II FDA/ICH-compliant trials are now starting in Australia, and

b) OncoHist™ for both Acute Myeloid Leukaemia ("AML") and Non-Hodgkin's Lymphoma – the Group will advance its collaboration with the Dana Farber Institute and build in-house clinical resources as an important step towards filing an Investigational New Drug ("IND") application, planned in early 2014 with the US FDA Filing an IND is an essential precursor event to initiating Phase I/II(a) clinical trials in the USA for OncoHist™ in the planned lead indication, the treatment of Acute Myeloid Leukaemia ("AML")

The Directors are required to raise further funds during the next nine months in order to adequately fund the Group's planned activities for at least twelve months from signing the 2012 accounts

Capital markets remain uncertain and the Company's ability to raise new capital is dependent upon market conditions that exist at the time of raising the funds and the continued validity of the Group's drug development programmes

IAS 1. "Presentation of Financial Statements" requires the Directors to disclose "material uncertainties related to events or conditions that may cast significant doubt upon the Group's ability to continue as a going concern". The Directors consider that the uncertainty regarding the Group's ability to raise further funds described above meets the definition of a "material uncertainty".

Nevertheless, the Directors have a reasonable expectation that, based on financial forecasts, continued satisfactory progress with the Group's research and development efforts, and the expected availability of future funds from financing, that this uncertainty can be managed to a successful outcome, and that the Group and the Company will have adequate resources to continue in operational existence for the foreseeable future They have therefore prepared the financial information contained herein on a going concern basis

The financial statements do not reflect any adjustments that would be required to be made, with respect to either the Company or the Group, if they were to be prepared on a basis other than the going concern basis

The Auditor's report on the financial statements for 2012 includes an emphasis of matter paragraph to draw attention to the disclosures made in Note 2 to these financial statements indicating material uncertainties about the Group's ability to continue as a going concern The Auditor's opinion is not modified in this respect. The Auditor's report for 2011 and the Auditor's conclusion on the unaudited statements for the first half of 2012 did not contain any emphasis of matter paragraph and also included unmodified audit opinions.

RESULTS AND DIVIDENDS

The trading results for the year and the Group's financial position at the end of the year are shown in the attached financial statements The Directors do not recommend a dividend

XENETIC BIOSCIENCES PLC

REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31st DECEMBER 2012

FINANCIAL INSTRUMENTS

The exposure of the Group to financial risk is discussed in Note 21 to the financial statements.

Given the nature of the Group's activities the main financial asset of the Group is cash and cash equivalents The financial risk management objectives and policies are therefore focussed around ensuring that there are adequate cash and cash equivalents available to enable the Group to continue with its research and development activities

The Group has not entered into any hedge accounting transactions

DIRECTORS AND THEIR INTERESTS

The Directors who served the Company during the year, together with the beneficial interests in the shares of the Company of those in office at the year end, were as follows

	Ordinary Shares of 0.5p		Share options	
	2012	2011	**2012**	2011
Sir Brian Richards	**2,262,606**	2,262,606	**203,486**	203,486
Scott Maguire	**1,401,361**	1,401,361	**7,747,346**	7,747,346
Colin W Hill	**1,825,420**	1,825,420	**1,547,096**	1,547,096
Professor Gregory Gregoriadis	**4,650,208**	4,650,208	**406,974**	406,974
Dr Dmitry D Genkin	-	-	-	-
Firdaus J Dastoor	**1,125,000**	1,125,000	-	-
Roman Knyazev	-	*-	-	*-
Artur Isaev	-	*-	-	*-

**at date of appointment*

<u>*Notes*</u>

1 *Roman Knyazev was appointed as a Director on 27th January 2012*
2 *Artur Isaev was appointed as a Director on 27th April 2012*
3 *Igor Nikolaev resigned as a Director on 27th April 2012*

JOINT SHARE OWNERSHIP PLAN ("JSOP") SHARES

In 2010 the Company issued 5,318,479 ordinary shares under the terms of the Company's JSOP On 2nd March 2012 a further 28,082,127 ordinary shares were issued under the terms of the JSOP at a price of 10.625 pence per share. £38,754 was subscribed in cash by the beneficiaries and £2,944,973 was advanced to the Trustees of the Plan in order that the shares were issued fully paid

The beneficiaries and their interests in the JSOP shares were as follows.

	2012	2011
	No. shares	No shares
Scott Maguire	**27,237,757**	3,857,084
Colin W Hill	**6,162,849**	1,461,395

XENETIC BIOSCIENCES PLC

REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31st DECEMBER 2012

DIRECTORS' INDEMNITIES

The Group has purchased insurance to cover its Directors and Officers against liabilities arising against them in that capacity.

CORPORATE GOVERNANCE

Although it is not a requirement for AIM-listed companies, the Company seeks within the practical confines of a smaller company to act in compliance with the principles of good governance and the code of best practice as set out in the UK Corporate Governance Code. The Audit Committee and the Remuneration Committee are chaired by Non-executive Directors The whole Board acts as a Nomination Committee

SUBSTANTIAL SHAREHOLDERS

The Directors are aware of the following substantial shareholdings of 3 per cent or more of the current Issued Ordinary Share Capital of 407,875,427 shares on 4 June 2013.

Ordinary Shares of 0.5p each	Number	%
SynBio LLC	**184,755,238**	45 30%
Serum Institute of India Limited and related parties	**44,316,415**	10 87%
RBC Trustees (Guernsey) Limited as Trustees of the JSOP	**33,400,606**	8 19%
Dr Volker Rusch	**16,344,599**	4 01%
Klaus Faber AG	**15,506,210**	3 80%
Securities Services Nominees Limited*	**12,230,000**	3 00%

**Excludes 1,825,420 shares held by Colin Hill, CFO*

POLICY FOR PAYMENT OF CREDITORS

It is the Company's policy to settle all agreed transactions within the terms established with suppliers Trade creditors at the year-end amounted to 17 days (2011 – 67 days) of average supplies.

XENETIC BIOSCIENCES PLC

REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31st DECEMBER 2012

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have, as required by the AIM rules of the London Stock Exchange, elected to prepare the Group and Company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union Under company law the Directors must not approve the financial statements unless they are satisfied that they present fairly the financial position and cash flows of the Group and Company and of the financial performance of the Group for that year In preparing these financial statements, the Directors are required to

- select suitable accounting policies in accordance with IAS 8: *Accounting Policies, Changes in Accounting Estimates and Errors* and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements,
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable the users to understand the impact of particular transactions, other events and conditions on the financial position and financial performance,
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and Company and enable them to ensure that the financial statements comply with the Companies Act 2006 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 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 web site and legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

XENETIC BIOSCIENCES PLC

REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31st DECEMBER 2012

DISCLOSURE OF INFORMATION TO AUDITOR

Each Director has confirmed that·

- so far as the Director is aware, there is no relevant audit information of which the Group's auditor is unaware, and
- he has taken all the steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Group's auditor is aware of that information

This confirmation is given in accordance with Section 418 of the Companies Act 2006

AUDITOR

A resolution to re-appoint Ernst & Young LLP as auditor for the ensuing year will be proposed at the Annual General Meeting

This report was approved by the Board on 5th June 2013 and signed on its behalf by

Colin Hill
~~Chief~~ Financial Officer

Company Registration Number 03213174

XENETIC BIOSCIENCES PLC

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF XENETIC BIOSCIENCES PLC

We have audited the financial statements of Xenetic Biosciences plc for the year ended 31st December 2012 which comprise the consolidated statement of comprehensive loss, the consolidated and Company balance sheets, the consolidated and Company statements of cash flows, the consolidated and Company statements of changes in equity and the related Notes 1 to 23 The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the Parent Company financial statements, as applied in accordance with the provisions of the Companies Act 2006

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

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

As explained more fully in the Directors' Responsibilities Statement set out on page 12, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of

- whether the accounting policies are appropriate to the Group's and the Parent Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the Directors, and
- the overall presentation of the financial statements.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report

XENETIC BIOSCIENCES PLC

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF XENETIC BIOSCIENCES PLC

OPINION ON FINANCIAL STATEMENTS

In our opinion·

- the financial statements give a true and fair view of the state of the Group's and the parent Company's affairs as at 31st December 2012 and of the Group's loss for the year then ended,
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union,
- the Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006, and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

EMPHASIS OF MATTER – GOING CONCERN

In forming our opinion on the financial statements, which is not modified, we have considered the adequacy of disclosures made in Note 2 to the consolidated financial statements concerning the Company's ability to continue as a going concern, which indicate the existence of a material uncertainty which may cast significant doubt over the Group's ability to continue as a going concern. The consolidated financial statements do not include the adjustments that would result if the Group was unable to continue as a going concern.

OPINION ON OTHER MATTER PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

We have nothing to report in respect of the following

Under the Companies Act 2006 we are required to report to you if, in our opinion.

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

Ernst & Young LLP

David Hales (Senior Statutory Auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
Reading
6th June 2013

XENETIC BIOSCIENCES PLC

CONSOLIDATED STATEMENT OF COMPREHENSIVE LOSS
FOR THE YEAR ENDED 31st DECEMBER 2012

	Note	2012 £	2011 £
REVENUE	3	**166,918**	142,981
Cost of goods sold		**28,291**	13,735
Research and development expenditure		**1,624,852**	1,049,550
Administrative expenses		**1,901,311**	1,906,330
Total Operating Costs		**3,554,454**	2,969,615
OPERATING LOSS	4	**(3,387,536)**	(2,826,634)
Finance income		**42,699**	12,075
Finance costs – loan interest		**(32,645)**	(39,378)
LOSS BEFORE TAXATION		**(3,377,482)**	(2,853,937)
Income tax credit	7	-	173,517
LOSS AFTER TAX AND LOSS FOR THE YEAR ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT		**(3,377,482)**	(2,680,420)
OTHER COMPREHENSIVE LOSS FOR THE YEAR AFTER TAX			
Exchange differences on translation of foreign operations		**9,467**	-
TOTAL COMPREHENSIVE LOSS FOR THE YEAR ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT		**(3,368,015)**	(2,680,420)
Loss per share (pence) – basic and fully diluted	9	**(0.91)p**	(1 44)p

The Company has elected to take the exemption under section 408 of the Companies Act 2006 to not present the Parent Company statement of comprehensive loss

XENETIC BIOSCIENCES PLC

CONSOLIDATED BALANCE SHEET
AS AT 31st DECEMBER 2012

	Note	2012 £	2012 £	2011 £
NON-CURRENT ASSETS				
Property, plant and equipment	10		75,541	48,549
Goodwill	11		2,557,423	1,061,476
Intangible assets	11		7,190,368	-
			9,823,332	1,110,025
CURRENT ASSETS				
Inventories	13	-		18,332
Trade and other receivables	14	252,516		784,105
Cash and cash equivalents	20	6,891,201		11,075,367
		7,143,717		11,877,804
CURRENT LIABILITIES				
Trade and other payables	15	(902,883)		(2,012,130)
NET CURRENT ASSETS			6,240,834	9,865,674
NON-CURRENT LIABILITIES				
Deferred tax liability	16		(1,495,947)	-
NET ASSETS			14,568,219	10,975,699
EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT				
Share capital	17		3,672,877	3,074,661
Share premium account			46,900,602	37,609,386
JSOP shares reserve			(3,350,666)	(405,694)
Reverse acquisition reserve			(8,252,127)	(8,252,127)
Currency translation reserve			9,467	-
Accumulated losses			(24,411,934)	(21,050,527)
TOTAL EQUITY			14,568,219	10,975,699

The financial statements were approved and authorised for issue by the Directors on 5th June 2013 and were signed on their behalf by:

SCOTT MAGUIRE - Director **COLIN HILL - Director**

XENETIC BIOSCIENCES PLC

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31st DECEMBER 2012

	Note	2012 £	2011 £
Cash flows from operating activities	**19**	**(3,864,166)**	(2,150,668)
Interest received		**42,699**	1,902
Taxation received		**-**	173,517
Net cash used in operating activities		**(3,821,467)**	(1,975,249)
Cash flows from investing activities			
Purchase of property, plant and equipment		**(82,077)**	(8,105)
Sale of property, plant and equipment		**23,880**	-
Loan to related party		**-**	(257,894)
Net cash used in investing activities		**(58,197)**	(265,999)
Cash flows from financing activities			
Issue of equity share capital, net of expenses		**158,210**	11,643,037
Loan (repaid to)/received from related party		**(445,581)**	822,774
Net cash (used in)/generated from financing activities		**(287,371)**	12,465,811
Effect of exchange rate changes		**(17,131)**	-
Net (decrease)/increase in cash and cash equivalents		**(4,184,166)**	10,224,563
Cash and cash equivalents at beginning of year		**11,075,367**	850,804
Cash and cash equivalents at end of year	**20**	**6,891,201**	11,075,367

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31st DECEMBER 2012

	Share capital	Share premium	JSOP shares	Reverse acquisition reserve	Currency translation reserve	Accumulated losses	Total
	£	£	£	£	£	£	£
At 1st January 2011	2,519,661	26,521,349	(405,694)	(8,252,127)	-	(18,396,374)	1,986,815
Loss and total comprehensive loss for the year	-	-	-	-	-	(2,680,420)	(2,680,420)
Shares issued for cash	555,000	11,521,180	-	-	-	-	12,076,180
Share issue expenses	-	(433,143)	-	-	-	-	(433,143)
Share-based payments	-	-	-	-	-	26,267	26,267
At 31st December 2011	3,074,661	37,609,386	(405,694)	(8,252,127)	-	(21,050,527)	10,975,699
Loss for the year	-	-	-	-	-	(3,377,482)	(3,377,482)
Other comprehensive loss	-	-	-	-	9,467	-	9,467
Total comprehensive loss for the year	-	-	-	-	9,467	(3,377,482)	(3,368,015)
Shares issued for cash	12,805	262,645	-	-	-	-	275,450
Shares issued under JSOP	140,411	2,843,315	-	-	-	-	2,983,726
Own shares held by JSOP	-	-	(2,944,972)	-	-	-	(2,944,972)
Issue of shares in relation to business combination	400,000	5,700,000	-	-	-	-	6,100,000
Shares issued for non-cash consideration	45,000	641,250	-	-	-	-	686,250
Share issue expenses	-	(155,994)	-	-	-	-	(155,994)
Share-based payments	-	-	-	-	-	16,075	16,075
At 31st December 2012	3,672,877	46,900,602	(3,350,666)	(8,252,127)	9,467	(24,411,934)	14,568,219

XENETIC BIOSCIENCES PLC

COMPANY BALANCE SHEET
AS AT 31st DECEMBER 2012

	Note	2012 £	2012 £	2011 £
NON-CURRENT ASSETS				
Property, plant and equipment	10		45,412	-
Intangible assets	11		686,250	-
Investments	12		15,145,030	9,045,030
Other receivables	14		14,352,049	9,196,771
			30,228,741	18,241,801
CURRENT ASSETS				
Trade and other receivables	14	1,087,935		692,438
Cash and cash equivalents	20	6,863,403		11,041,792
		7,951,338		11,734,230
CURRENT LIABILITIES				
Trade and other payables	15	(766,769)		(1,427,498)
NET CURRENT ASSETS			7,184,569	10,306,732
NET ASSETS			37,413,310	28,548,533
EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY				
Share capital	17		3,672,877	3,074,661
Share premium account			46,900,602	37,609,386
Retained earnings			(13,160,169)	(12,135,514)
TOTAL EQUITY			37,413,310	28,548,533

The financial statements were approved and authorised for issue by the Directors on 5th June 2013 and were signed on their behalf by.

SCOTT MAGUIRE - Director

COLIN HILL – Director

XENETIC BIOSCIENCES PLC

COMPANY STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31st DECEMBER 2012

	Note	2012 £	2011 £
Cash flows from operating activities	**19**	**(1,642,635)**	(791,156)
Interest received		**43,195**	1,902
Net cash outflow from operating activities		**(1,599,440)**	(789,254)
Cash flows from investing activities			
Purchase of property, plant and equipment		**(60,549)**	-
Loan to subsidiaries		**(2,210,306)**	(1,221,810)
Loan to JSOP Trustees		**(2,944,972)**	-
Loan to related party		**-**	(257,894)
Net cash used in investing activities		**(5,215,827)**	(1,479,704)
Cash flows from financing activities			
Issue of equity share capital		**3,103,182**	11,643,037
Loan (repaid to)/received from related party		**(445,581)**	822,774
Net cash generated from financing activities		**2,657,601**	12,465,811
Effect of exchange rate changes		**(20,723)**	-
Net (decrease)/increase in cash and cash equivalents		**(4,178,389)**	10,196,853
Cash and cash equivalents at beginning of year		**11,041,792**	844,939
Cash and cash equivalents at end of year	**20**	**6,863,403**	11,041,792

XENETIC BIOSCIENCES PLC

COMPANY STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31st DECEMBER 2012

	Share capital £	Share premium £	Retained earnings £	Total £
At 1st January 2011	2,519,661	26,521,349	(11,273,064)	17,767,946
Loss and total comprehensive income for year	-	-	(862,450)	(862,450)
Shares issued for cash	555,000	11,521,180	-	12,076,180
Share issue expenses	-	(433,143)	-	(433,143)
At 31st December 2011	3,074,661	37,609,386	(12,135,514)	28,548,533
Loss and total comprehensive income for year	-	-	(1,024,655)	(1,024,655)
Shares issued for cash	12,805	262,645	-	275,450
Shares issued under JSOP	140,411	2,843,315	-	2,983,726
Issue of shares in relation to business combination	400,000	5,700,000	-	6,100,000
Shares issued for non-cash consideration	45,000	641,250	-	686,250
Share issue expenses	-	(155,994)	-	(155,994)
At 31st December 2012	3,672,877	46,900,602	(13,160,169)	37,413,310

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31st DECEMBER 2012

1. AUTHORISATION OF FINANCIAL STATEMENTS AND STATEMENT OF COMPLIANCE WITH IFRSs

The Group financial statements for the year ended 31st December 2012 were authorised for issue by the board of directors on 5th June 2013 and the balance sheet was signed on the board's behalf by Scott Maguire and Colin Hill. Xenetic Biosciences plc is a public limited company incorporated and domiciled in England and Wales The Company's ordinary shares are traded on the AIM

The Group's principal activity is the development of drug and vaccine delivery systems and proprietary products in the fields of protein drugs, vaccines and oncology

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS and in accordance with the AIM Rules of the London Stock Exchange

2. ACCOUNTING POLICIES

Basis of consolidation

The Group financial statements incorporate the financial statements of the Parent Company and all of its subsidiary undertakings The results of subsidiary undertakings acquired or disposed of during the year are included in the Group financial statements from, or up to, the date of acquisition or disposal

The accounts of all Group entities are prepared on a basis consistent with the reporting obligations of the Parent Company

Acquisitions completed after 30th November 2009

IFRS 3 (Revised 2009) sets out the accounting for business combinations completed by the Group after 30th November 2009

Business combinations are accounted for using the acquisition method The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree For each business combination, the acquirer measures the non-controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets Acquisition costs incurred are expensed and included in administrative expenses.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree

2. ACCOUNTING POLICIES (continued)

Acquisitions completed after 30th November 2009 (continued)

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date through profit or loss Any contingent consideration to be transferred by the acquirer will be recognised at fair value at the acquisition date Subsequent changes to the fair value of the contingent consideration which is deemed to be an asset or liability will be recognised in accordance with IAS 39 either in profit or loss or as a change to other comprehensive income If the contingent consideration is classified as equity, it should not be remeasured until it is finally settled within equity

Goodwill, as maybe acquired, is initially measured at cost being the excess of the aggregate of the consideration transferred and the amount recognised for non-controlling interest over the net identifiable assets acquired and liabilities assumed If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognised immediately in profit or loss

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained

Fair values on acquisition

When acquiring a business, the Directors have to make judgements and best estimates about the fair value of the assets, liabilities and contingent liabilities acquired. These are estimated regardless of whether or not they were recognised in the financial statements of the subsidiary prior to acquisition. The valuation of externally acquired in-process research and development requires judgements regarding the estimated future cash outflows required to complete development and the cash inflows expected to arise from a marketed product, discounted at a suitable rate reflecting the time value of money and the risks inherent in drug development

Intangible Assets

Intellectual property comprises in-process research and development which has been either purchased or acquired as a result of a business combination

Purchased intellectual property

Purchased intellectual property has been recognised at cost

2. ACCOUNTING POLICIES (continued)

Acquired as a result of a business combination intellectual property

Intangible assets acquired as a result of a business combination are recorded at their fair value at the acquisition date Amounts are recorded at their fair value at the acquisition date and will be amortised on a straight-line basis over their estimated useful economic lives from the time they are available for use which, is typically from product launch

Going Concern

As a development-stage life sciences business, the Group has incurred operating losses in the year under review, notwithstanding that substantial clinical, technical and corporate progress was also made in the continuing successful development both of its proprietary technologies and products and in its ongoing level of effort in respect of the planned transition of all drug development activities to the USA; consequently, the Group was a net consumer of cash

In order to maintain the level of scientific effort required to develop the Group's technologies and to commercialise them to such a degree as will be necessary to become a cash-generative business, the Group will need to access new cash in addition to that available to it at the year end, such new cash will either be generated from the raising of new capital from existing and/or new shareholders, and/or internally by negotiating new feasibility or out-licensing revenues.

The Directors have prepared a financial forecast for the period through to 31st December 2014

In the next twelve months from signing the 2012 accounts, the main clinical programmes requiring significant costs to be incurred by the Group are

a) ErepoXen®, the Group's PSA-EPO product candidate - new Western Phase II FDA/ICH-compliant trials are now starting in Australia, and

b) OncoHist™ for both Acute Myeloid Leukaemia ("AML") and Non-Hodgkin's Lymphoma – the Group will advance its collaboration with the Dana Farber Institute and build in-house clinical resources as an important step towards filing an Investigational New Drug ("IND") application, planned in early 2014 with the US FDA. Filing an IND is an essential precursor event to initiating Phase I/II(a) clinical trials in the USA for OncoHist™ in the planned lead indication, the treatment of Acute Myeloid Leukaemia ("AML")

The Directors are required to raise further funds during the next nine months in order to adequately fund the Group's planned activities for at least twelve months from signing the 2012 accounts

Capital markets remain uncertain and the Company's ability to raise new capital is dependent upon market conditions that exist at the time of raising the funds and the continued validity of the Group's drug development programmes

2. ACCOUNTING POLICIES (continued)

Going Concern (continued)

IAS 1: "Presentation of Financial Statements" requires the Directors to disclose "material uncertainties related to events or conditions that may cast significant doubt upon the Group's ability to continue as a going concern" The Directors consider that the uncertainty regarding the Group's ability to raise further funds described above meets the definition of a "material uncertainty"

Nevertheless, the Directors have a reasonable expectation that, based on financial forecasts, continued satisfactory progress with the Group's research and development efforts, and the expected availability of future funds from financing, that this uncertainty can be managed to a successful outcome, and that the Group and the Company will have adequate resources to continue in operational existence for the foreseeable future. They have therefore prepared the financial information contained herein on a going concern basis

The financial statements do not reflect any adjustments that would be required to be made, with respect to either the Company or the Group, if they were to be prepared on a basis other than the going concern basis

Goodwill

Goodwill is initially measured at cost being the excess of the aggregate of the acquisition-date fair value of the consideration transferred over the net identifiable amounts of the assets acquired and the liabilities assumed in exchange for the business combination Goodwill is recognised as an asset and is reviewed for impairment at least annually Any impairment is recognised immediately through the statement of comprehensive loss and is not reversed.

Revenue

Revenue is stated net of sales taxes, rebates and discounts and after eliminating sales within the Group. Revenue is recognised as follows:

<u>Licence signing and milestone fees</u>
Licence signing and milestone fees represent amounts earned from licensing agreements, including up-front payments, milestone payments and technology access fees. Revenues are recognised where they are non-refundable, where the Group's obligations related to the revenues have been discharged and their collection is reasonably assured Refundable contract revenue is treated as deferred until such time that it is no longer refundable. In general, up-front payments are deferred and recognised on a systematic basis over the period of development to regulatory filing

Milestone payments related to scientific or technical achievements are recognised as income when the milestone is accomplished

2. ACCOUNTING POLICIES (continued)

Revenue (continued)

Contract research and development revenue

Contract research and development revenue represents amounts earned for services rendered under development contracts Revenues are recognised in the period in which they are earned

Interest income

Interest income is accounted for on a cash received basis and not on an accrual basis

Impairment

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation or depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable An impairment loss is recognised for the amount by which the asset's carrying value exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. The expected cash flows generated by the assets are discounted using asset specific discount rates which reflect the risks associated with the groups of assets These risks vary with the nature and the location of the cash generating units

Any impairment loss is charged to the statement of comprehensive income in the year concerned For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows (cash-generating units)

Property, plant and equipment

All property, plant and equipment assets are stated at cost less accumulated depreciation

Depreciation is provided to write off the cost less the estimated residual value of property, plant and equipment on a straight line basis over their estimated useful economic lives as follows:

Leasehold improvements	-	4 years
Laboratory equipment	-	4 years
Computer equipment	-	4 years
Plant	-	5 years

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in-first-out method The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and an appropriate proportion of related production overheads.

Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses

Provision is made for obsolete, slow-moving or defective items where appropriate

2. ACCOUNTING POLICIES (continued)

Financial instruments

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group becomes a contractual party to the instrument

Financial assets other than hedging instruments can be divided into the following categories. loans and receivables, financial assets at fair value through profit or loss, available-for-sale financial assets and held-to-maturity investments Financial assets are assigned to the different categories by management on initial recognition, depending on the purpose for which the investments were acquired

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date which are classified as non-current assets. The Group's loans and receivables comprise 'trade debtors and other receivables' and 'cash and cash equivalents' in the balance sheet. The Group has no other financial assets

Financial liabilities and equity instruments issued by the Group are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. Equity instruments issued by the Group, other than equity-settled share-based payments which are described below, are recorded at the proceeds received net of direct issue costs

Trade receivables

Trade receivables are measured at initial recognition at fair value and are subsequently measured at amortised cost less impairment losses Appropriate amounts for estimated irrecoverable amounts are recognised in the statement of comprehensive income when there is objective evidence that the asset is impaired.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, bank balances and deposits repayable on demand

Trade payables

Trade and other payables are measured at initial recognition at fair value and are subsequently measured at amortised cost.

Operating lease agreements

Operating lease rentals are charged in the statement of comprehensive income on a straight line basis over the lease term

2. ACCOUNTING POLICIES (continued)

Research and development costs

Research and development costs are written off to the statement of comprehensive income as incurred, except that development expenditure incurred on an individual project is carried forward when its future recoverability can be reasonably regarded as assured. Any expenditure carried forward is amortised in line with the expected future sales from the related project.

Foreign currencies

Items included in the accounts of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated accounts are presented in pounds sterling, which is the Company's functional and Group's presentation currency In preparing the individual accounts of the Group companies, transactions in currencies other than the entity's functional currency are translated into the functional currency at the exchange rate prevailing at the date of the transaction The assets and liabilities of foreign operations are translated into sterling at the rate of exchange ruling at the balance sheet date Income and expenses are translated at weighted average exchange rates for the year The resulting exchange differences are recognised in other comprehensive income. Foreign exchange gains and losses resulting from the settlement of such transactions are recognised in the income statement

Monetary assets and liabilities in foreign currencies are translated into sterling at the rate ruling at the balance sheet date

Pension costs

Company contributions to money purchase pension schemes are written off to the statement of comprehensive income as incurred

Share based payments

In accordance with IFRS 2 "Share-based Payments", the Group measures the fair value of equity settled transactions with employees at the grant date of the equity instruments. The fair value is calculated using an appropriate valuation model and requires assumptions regarding dividend yields, risk-free interest rates, share price volatility and expected life of an employee share option, plus the likelihood of meeting other performance-related vesting objectives where applicable. further details can be found in Note 18 The arising expense is charged to the consolidated statement of comprehensive income on a straight-line basis over the expected vesting period.

Share options granted to employees are valued at the date of grant using the Black-Scholes option pricing model and are charged to the statement of comprehensive income over the vesting period of the option. A corresponding credit is recognised in the retained earnings reserve.

2. ACCOUNTING POLICIES (continued)

Share based payments (continued)

Shares issued under the Joint Share Ownership Plan ("JSOP") which vest immediately are valued at the date of grant using the Black-Scholes option pricing model. JSOP shares issued with share price targets are valued at the date of grant using a Monte Carlo simulation approach as this allows the fair value to reflect the interaction of the Black-Scholes formula and the performance targets These amounts are charged to the statement of comprehensive income over the expected period to vesting of the shares

A corresponding credit is recognised in the retained earnings reserve

For equity-settled share-based payments in relation to acquisitions, the entity shall measure the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted

Warrants to subscribe for new equity in the Company are valued at the date of grant using the Black-Scholes option pricing model. The excess of this amount over the consideration received for the grant is charged to the statement of comprehensive income A corresponding credit is recognised in retained earnings

Equity

Share capital is determined using the nominal value of shares that have been issued.

The share premium account includes any premiums received on the initial issuing of the share capital. Any transaction costs associated with the issue of shares are deducted from the share premium account, net of any related income tax benefits

The JSOP shares reserve arises when the Company issues equity share capital under its Joint Share Ownership Plan, which is held in trust by the Group's Guernsey Special Purpose Trust The interests of the Trust are consolidated into the Group's financial statements and the relevant amount treated as a reduction in equity.

The reverse acquisition reserve arises on the restatement of the equity structure shown in the consolidated financial statements from that of Lipoxen Technologies Limited immediately after the deemed acquisition of Xenetic Biosciences plc to reflect the equity structure of the legal Parent Company

The currency translation reserve arises on the retranslation of the net assets of overseas operations into pounds sterling

Taxation

The tax expense recognised in the statement of comprehensive income represents the sum of the current and deferred tax

2. ACCOUNTING POLICIES (continued)

Taxation (continued)

The tax expense is based on the taxable profit for the year Taxable profit differs from the profit as reported in the statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date

Tax income arises from the UK legislation regarding the treatment of certain qualifying research and development costs, allowing for the surrender of tax losses attributable to such costs in return for a tax rebate

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realised.

New and amended standards

The following Standards and Interpretations to existing standards have been published and are mandatory for the Group's accounting periods beginning on or after 1st January 2012 The Group intends to adopt these standards when they become effective

- IAS 1 – Presentation of Items of Other Comprehensive Income – Amendments to IAS 1 (effective 1st July 2012)
- IFRS 9 – Financial Instruments Classification and Measurement (effective 1st January 2015)
- IFRS 10 – Consolidated Financial Statements (effective 1st January 2013, EU adoption effective 1st January 2014)
- IFRS 12 – Disclosure of Involvement with Other Entities (effective 1st January 2013, EU adoption effective 1st January 2014)
- IFRS 13 – Fair Value Measurement (effective 1st January 2013)
- IAS 19 – Employee Benefits (Amendment) (effective 1st January 2013)
- IAS 27 – Separate Financial Statements (as revised in 2011) (effective 1st January 2013, EU adoption effective 1st January 2014)

The Directors do not expect that adoption of the other standards listed above will have a material impact on the financial statements of the Group in future periods

2. ACCOUNTING POLICIES (continued)

Critical accounting judgements and key sources of estimation uncertainty

In the process of applying the Group's accounting policies, management makes estimates and assumptions that have an effect on the amounts recognised in the financial statements Although these estimates are based on management's best knowledge of current events and actions, actual results may ultimately differ from those estimates

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are those relating to.

(a) the future recoverability of goodwill, and the corresponding review of goodwill for impairment (see Note 11);

(b) the expense recognised in the comprehensive income statement in respect of share options and JSOP shares granted to employees (see Notes 17 and 18), and

(c) the fair values recognised for the intangible assets and goodwill acquired as a result of the business combination during the year (see Notes 11 and 12).

3. SEGMENTAL ANALYSIS

The revenue and loss before tax are attributable to the one principal activity of the Group The Group's principal activity is the development of drug and vaccine delivery systems and proprietary products in the fields of protein drugs, vaccines and oncology

The net assets of the Group at 31st December 2012 and 31st December 2011 are wholly attributable to the principal activity. The Group comprises one operating segment for reporting purposes Management measures performance and allocates resources based on the results of this one segment only.

An analysis of turnover (by location of customer) is given below.

	2012	2011
	£	£
United States	**77,587**	117,420
Europe	**27,514**	8,230
Rest of the World	**61,817**	17,331
	166,918	142,981

3. SEGMENTAL ANALYSIS (continued)

An analysis of the Group's total net assets by location is given below

	2012	2011
	£	£
United Kingdom	**14,580,839**	10,975,699
Europe	**(17,287)**	-
United States	**4,667**	-
	14,568,219	10,975,699

The following customers accounted for greater than 10% of the Group's revenues

	2012	2011
	£	£
Customer 1	**65,422**	79,768
Customer 2	**61,817**	-
Customer 3	-	41,316
Customer 4	**27,514**	-
Customer 5	-	17,331

4. OPERATING LOSS

Operating loss is stated after charging/(crediting)·

	2012	2011
	£	£
Depreciation of owned property, plant and equipment	**66,010**	215,764
Cost of inventories recognised as an expense (included in cost of goods sold)	**28,291**	13,735
Operating lease payments.		
- land and buildings	**35,394**	48,000
Net (gain)/loss on foreign currency translation	**(7,953)**	77,837
Research and development costs - cash settled	**1,624,852**	1,049,550
Share option and JSOP expense - equity settled	**16,075**	26,267

The operating lease payments relate to office accommodation used by the Company until April 2012 when the arrangements were terminated by mutual agreement at no cost to the Company. The Company then entered into a formal lease arrangement with The Crown Estates for the lease of corporate offices in London The lease is for a period of 5 years with a break clause (exercisable at the sole discretion of the Company) after 3 years

5. AUDITOR'S REMUNERATION

Services provided by the Company's auditor

	2012	2011
	£	£
Fees payable to the Company's auditor for the audit of the Parent Company and consolidated financial statements	**5,000**	5,000
Fees payable to the Company's auditor and its associates for other services·		
- audit of the Company's subsidiaries pursuant to legislation	**48,600**	32,500
- taxation compliance services	**11,250**	5,000
- taxation advisory services	**24,000**	-

6. PARTICULARS OF EMPLOYEES

The average number of staff employed by the Group during the financial year was

	2012	2011
	No	No
Office and management	**4**	4
Research	**13**	11
	17	15

The aggregate payroll costs of the above (excluding the share option expense) were

Group:	2012	2011
	£	£
Wages and salaries	**1,157,519**	1,170,670
Social security costs	**146,966**	144,029
Other pension costs	**85,528**	129,518
	1,390,013	1,444,217

Company:	2012	2011
	£	£
Wages, salaries and short term employment benefits	**153,600**	221,200
Other pension costs	**18,432**	50,000
	172,032	271,200

6. PARTICULARS OF EMPLOYEES (continued)

Key management personnel received compensation as follows

Group:	2012	2011
	£	£
Salaries and short-term employment benefits	**794,144**	956,020
Post-employment benefits	**71,172**	120,220
Share-based payments	**16,075**	8,787
	881,391	1,085,027

Company:	2012	2011
	£	£
Salaries and short-term employment benefits	**153,600**	221,200
Post-employment benefits	**18,432**	50,000
	172,032	271,200

Key management comprises the Directors of the Company, those Directors of the subsidiary who are not also Directors of the Parent Company, together with the Company's senior scientific staff.

The remuneration of the Directors was as follows.

	Salaries and short-term benefits	Share-based payments	Pension contributions	Total 2012	Total 2011
	£	£	£	£	£
Sir Brian Richards	-	-	-	-	-
Scott Maguire	**334,885**	**6,057**	**39,600**	**380,542**	513,912
Colin W Hill	**158,400**	**2,730**	**18,432**	**179,562**	273,930
Professor Gregory Gregoriadis	**102,254**	-	-	**102,254**	95,133
Dr Dmitry D Genkin	-	-	-	-	-
Firdaus J Dastoor	-	-	-	-	-
Igor Nikolaev	-	-	-	-	-
Roman Knyazev	-	-	-	-	-
Artur Isaev	-	-	-	-	-
Total	**595,539**	**8,787**	**58,032**	**662,358**	882,975

The charge in 2011 comprised salaries and short-term benefits of £769,088, share-based payments of £8,787 and pension contributions of £105,100

6. PARTICULARS OF EMPLOYEES (continued)

The number of Directors who accrued benefits under Company pension schemes was as follows·

	2012	2011
	No	No
Money purchase schemes	1	1

In addition to the above, the Group was charged the following amounts by Directors or by companies controlled by Directors for the provision of consultancy services

	2012	2011
	£	£
Sir Brian Richards	75,000	75,000
Dr Dmitry Genkin	51,000	51,000
Firdaus Dastoor	3,000	-
Igor Nikolaev	1,500	3,000
Roman Knyazev	2,750	-
Artur Isaev	2,000	-

7. INCOME TAX CREDIT

(a) Analysis of credit in the period

	2012	2011
	£	£
Current tax·		
UK corporation tax based on the results for the year at 24.5% (2011 – 26.5%)	-	-
Research and Development tax credit in relation to previous years	-	(173,517)
Current tax for the period	-	(173,517)

7. INCOME TAX CREDIT (continued)

(b) Factors affecting the tax credit for the year

The tax credit for the year differs from the standard rate of 24.5% (2011 – 26 5%) as follows·

	2012 £	2011 £
Loss on ordinary activities before tax	**(3,377,482)**	(2,853,937)
Loss on ordinary activities multiplied by the standard rate of corporation tax	**(827,483)**	(756,293)
Effects of:		
Tax effect of non deductible items	-	49,000
Prior year losses utilised in year	**(6,689)**	-
Unrelieved tax losses arising in the year	**831,431**	703,293
Research and Development tax credit	-	(173,517)
Temporary differences on which deferred tax not recognised	**2,741**	4,000
Current tax for the period	-	(173,517)

The Group has corporation tax losses available for offset against future profits of the same trade of approximately £22,150,000 (2011 - £19,850,000) The deferred taxation asset not provided for in the accounts due to the uncertainty that future taxable profits will be available to allow recovery of the asset is approximately £5,100,000 (2011 - £5,400,000)

(c) Factors that may affect future tax charges

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the asset is realised or the liability settled, based on tax rates that have been enacted or substantively enacted at the statement of financial position date.

The Finance Act 2012, which includes a reduction in the UK corporate tax rate to 24% from April 2012 and 23% from April 2013 has now been enacted and so UK deferred tax assets and liabilities have been calculated accordingly at 23%

The UK government intends to reduce the UK corporate income tax rate further, to 21% by 1 April 2014 and 20% by 1 April 2015, which will be enacted in subsequent Finance Bills

Consequently, the Company will only recognise the impact of the rate change which is substantively enacted at that time in its financial statements. The further reduction in tax rate will affect both the future current and deferred tax charge of the Company

8. LOSS ATTRIBUTABLE TO MEMBERS OF THE PARENT COMPANY

The loss dealt with in the accounts of the Parent Company was £1,024,655 (2011 – £862,450)

9. LOSS PER SHARE

The calculation of loss per share is based on the loss of £3,377,482 (2011 - £2,680,420) and on the number of shares in issue, being the weighted average number of shares in issue during the period of 370,463,646 ordinary 0 5p shares (2011 – 186,134,173 ordinary 0.5p shares). There is no dilutive effect of share options and warrants outstanding on the basic loss per share

10. PROPERTY, PLANT AND EQUIPMENT

Group	Leasehold improvements	Plant	Laboratory equipment	Computer equipment	Total
	£	£	£	£	£
COST					
At 1st January 2011	-	800,000	601,436	81,993	1,483,429
Additions	-	-	7,230	875	8,105
At 31st December 2011	-	800,000	608,666	82,868	1,491,534
Additions	42,023	-	24,961	15,093	82,077
Acquired with subsidiary	-	-	32,456	2,349	34,805
Disposals	-	-	(29,726)	-	(29,726)
At 31st December 2012	42,023	800,000	636,357	100,310	1,578,690
DEPRECIATION					
At 1st January 2011	-	640,000	525,585	61,636	1,227,221
Charge for the year	-	160,000	46,128	9,636	215,764
At 31st December 2011	-	800,000	571,713	71,272	1,442,985
Charge for the year	10,506	-	42,681	12,823	66,010
Disposals	-	-	(5,846)	-	(5,846)
At 31st December 2012	10,506	800,000	608,548	84,095	1,503,149
NET BOOK VALUE					
At 31st December 2012	31,517	-	27,809	16,215	75,541
At 31st December 2011	-	-	36,953	11,596	48,549

10. PROPERTY, PLANT AND EQUIPMENT (continued)

Company	Leasehold improvements	Plant	Furniture and equipment	Total
	£	£	£	£
COST				
At 1st January 2011	-	800,000	-	800,000
Additions	-	-	-	-
At 31st December 2011	-	800,000	-	800,000
Additions	42,023	-	18,526	60,549
At 31st December 2012	42,023	800,000	18,526	860,549
DEPRECIATION				
At 1st January 2011	-	640,000	-	640,000
Charge for the year	-	160,000	-	160,000
At 31st December 2011	-	800,000	-	800,000
Charge for the year	10,506	-	4,631	15,137
At 31st December 2012	10,506	800,000	4,631	815,137
NET BOOK VALUE				
At 31st December 2012	31,517	-	13,895	45,412
At 31st December 2011	-	-	-	-

11. GOODWILL AND INTANGIBLE ASSETS

There are no intangible assets with an indefinite useful life

Goodwill

Group

	£
COST	
At 1st January 2011 and 31st December 2011	1,061,476
Arising on acquisition	1,495,947
At 31st December 2012	2,557,423

Goodwill of £1,495,947 arose on the excess of the cost over the net assets of the business combination of SymbioTec GmbH during the year and is due to deferred tax on the fair value of in-process research and development acquired

11. GOODWILL AND INTANGIBLE ASSETS (continued)

In the prior period goodwill of £1,061,476 arising on consolidation represents the excess of the cost of the reverse acquisition over the net assets of Xenetic Biosciences plc

The reverse acquisition of Xenetic Biosciences plc provided Lipoxen Technologies Limited with access to the AIM market to enable it to raise funds to finance the ongoing development of its technology This access to capital markets does not satisfy the criteria for separate recognition as an intangible asset as set out in IAS 38. Intangible assets, and is therefore treated as goodwill in these financial statements

The Group tests annually for impairment or more frequently if there are indications that goodwill might be impaired The impairment review has been carried out on the Group as a whole

As primarily a research and development Group, the use of discounted cash flow or similar tools is not appropriate given the inherent risks and uncertainties in the sector and the long timespans involved. Instead the Board look at longer term indicators of impairment

Since the date of the previous impairment review the Group has made further technical progress in the development of its PSA biopolymer and nanoparticle technologies in both pre-clinical and clinical trials The revenue generating capacity of the Group has been enhanced through this progress.

In assessing the impairment, the recoverable amount has been determined as the fair value less cost to sell by reference to the Group's market capitalisation on AIM

Consequently, it is the view of the Board that no impairment of the carrying value of the Group's goodwill or other assets has occurred during the year

Intangible assets

	Group £	Company £
COST		
At 1st January 2011 and 31st December 2011	-	-
Arising on acquisition	6,504,118	-
Additions	686,250	686,250
At 31st December 2012	7,190,368	686,250

The fair value of the additions to the intangible assets has been determined by taking the fair value of equity instruments issued and the fair value of equity instruments issued has been determined using the quoted share price on AIM which was 7 625p The consideration for the intangible asset arising on acquisition was the issue to the vendors of 80,000,000 ordinary shares in the Company. The consideration for the additions to intangible assets was 9,000,000 fully paid new ordinary shares of the Company.

11. GOODWILL AND INTANGIBLE ASSETS (continued)

The in-process research and development assets acquired are assets which are not used in launched products These assets have not yet begun to be amortised but have been tested for impairment by assessing their value-in-use Value-in-use calculations for each drug programme are utilised to calculate the recoverable amount. Key assumptions for the value-in-use calculations are as follows

- Launch dates of products employing these technologies – launch dates reflect management's most recent information on the expected date of launching products,
- Development costs to obtain regulatory approval – costs are estimated net of any contributions expected from collaborative arrangements with existing or future partners;
- Sales projections – these are based on management's projections using external market data,
- Discount rates – the discount rate is estimated on a pre-tax basis reflecting the risk associated with the assets, giving a rate of 12 per cent,
- Cash flow projections – cash flow projections are made usually to the expiry of the patent which confers certain protection against generic competition, this is greater than five years,
- Probability of successful development – management estimates probabilities of success for each phase of development based on industry averages and knowledge of specific programmes

In-process research and development assets were tested for impairment at 31st December 2012. At this stage of development, the key sensitivity is the successful completion of clinical trials and, therefore, full impairment is expected should such trials be unsuccessful

12. INVESTMENTS

Company	Group companies £
COST	
At 1st January 2011 and 31st December 2011	9,045,030
Additions	6,100,000
At 31st December 2012	15,145,030

The Company owns the whole of the issued share capital of Lipoxen Technologies Limited, a company incorporated in England and Wales engaged in research into drug delivery systems.

12. INVESTMENTS (continued)

On 17th January 2012 the Company completed the acquisition of the entire issued share capital of SymbioTec GmbH, a company registered in Germany which is principally involved with early stage clinical trials for its patent-protected drug candidate, OncoHist™. This acquisition is core to the Company's product development strategy The fair value determination of the assets and liabilities acquired is set out in the table below.

	Book values at acquisition	Fair value adjustments	Fair value
	£	£	£
Intangible asset	-	6,504,118	6,504,118
Property, plant and equipment	34,805	-	34,805
Trade and other receivables	33,721	-	33,721
Cash and cash equivalents	(228)	-	(228)
Trade and other payables	(203,985)	-	(203,985)
Amount owed to seller	(268,431)	-	(268,431)
Deferred tax liability	-	(1,495,947)	(1,495,947)
Net assets/(liabilities) acquired	(404,118)	5,008,171	4,604,053
Goodwill			1,495,947
Consideration satisfied by:			
Issue of shares in Xenetic Biosciences plc			6,100,000

Deferred tax has been provided on temporary differences arising on the intangible asset. Goodwill of £1,495,947 is due to deferred tax on the fair value of the intangible assets

The consideration for the acquisition was the issue to the vendors of 80,000,000 ordinary shares in the Company at a share price of 7 625p None of the goodwill is expected to be deductible for income tax purposes.

The fair value and gross amount of the trade receivables amounts to £33,721. None of the trade receivables have been impaired and it is expected that the full contractual amount can be collected

The amounts owed to the seller are non-interest bearing as at 31st December 2012

There has been no revenue and profit or loss generated since the acquisition

The Company has also formed a new wholly-owned subsidiary, Xenetic USA Inc , a company registered in the United States of America

It is the view of the Board that no impairment of the carrying value of the Company's investment has occurred during the year

13. INVENTORY

	Group		Company	
	2012	2011	**2012**	2011
	£	£	**£**	£
Laboratory consumables	-	18,332	-	-

14. TRADE AND OTHER RECEIVABLES

	Group		Company	
	2012	2011	**2012**	2011
	£	£	**£**	£
Due in more than one year:				
Receivables from subsidiaries	-	-	**11,001,383**	8,791,077
Provision for impairment	-	-	-	-
Loan to JSOP Trustees	-	-	**3,350,666**	405,694
	-	-	**14,352,049**	9,196,771
Due within one year:				
Trade receivables	**83,000**	10,702	-	-
Provision for impairment	-	-	-	-
	83,000	10,702	-	-
Receivables from subsidiaries	-	-	**1,050,167**	-
Loan to related party	-	268,067	-	268,067
Other receivables	**48,294**	83,193	**18,781**	52,464
Prepayments and accrued income	**121,222**	422,143	**18,987**	371,907
	252,516	784,105	**1,087,935**	692,438

The carrying amount of the trade receivables is denominated in currencies as follows

	2012	2011
	£	£
Pounds sterling	**83,000**	10,702
US dollars	-	-
Euros	-	-
	83,000	10,702

14. TRADE AND OTHER RECEIVABLES (continued)

Trade receivables are considered to be impaired if they are more than three months overdue at the date of approval of the financial statements. At 31st December 2012 trade receivables of £Nil (2011 - £Nil) were impaired and provided against

The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivable mentioned above. Neither the Group nor the Company holds any collateral as security

The Company's receivables from its subsidiaries are payable on demand. It is the view of the Board that no impairment of the carrying value of the Company's trade and other receivables has occurred during the year.

15. TRADE AND OTHER PAYABLES

	Group		Company	
	2012	2011	**2012**	2011
	£	£	**£**	£
Trade payables	**108,079**	218,957	**89,700**	146,958
Loan payable to related party	**422,618**	862,152	**422,618**	862,152
Social security and other taxes	**53,586**	35,485	-	-
Other payables	**33,201**	31,467	-	-
Accrued expenses	**285,399**	859,879	**254,451**	418,388
Deferred income	-	4,190	-	-
	902,883	2,012,130	**766,769**	1,427,498

16. DEFERRED TAX LIABILITY

Group

	£
COST	
At 1st January 2011 and 31st December 2011	-
Arising on acquisition	**1,495,947**
At 31st December 2012	**1,495,947**

17. SHARE CAPITAL

	2012 No	2012 £	2011 No	2011 £
Authorised share capital				
Ordinary shares of 0.5p each	**673,300,000**	**3,366,500**	673,300,000	3,366,500
Deferred shares of 0 01p each	**16,335,000,000**	**1,633,500**	16,335,000,000	1,633,500
		5,000,000		5,000,000
Allotted, called up and fully paid				
Ordinary shares of 0 5p each	**407,875,427**	**2,039,377**	288,232,254	1,441,161
Deferred shares of 0.01p each	**16,335,000,000**	**1,633,500**	16,335,000,000	1,633,500
		3,672,877		3,074,661

On 17th January 2012 the Company completed the acquisition of the entire issued share capital of SymbioTec GmbH, a company registered in Germany which is principally involved with early stage clinical trials for its patent-protected drug candidate, OncoHist™ The consideration for the acquisition was the issue to the vendors of 80,000,000 ordinary shares in the Company at a share price of 7 625p

On 16th January 2012 the Company concluded the proposed Master Agreement with Serum Institute of India Limited ("Serum") in order to consolidate and refine the Group's commercial arrangements with Serum. Under the terms of the Agreement, Serum surrendered back to the Company the development rights to up to fourteen drug candidates and uplifted the Company's economic interests in ErepoXen® In consideration for this, the Company has allotted 9,000,000 new ordinary shares as fully paid Serum has also subscribed for 2,500,000 new ordinary shares at a price of 11 pence each, raising £275,000 in cash Serum was also granted warrants rights to subscribe for ordinary shares as set out below.

On 2nd March 2012 a further 28,082,127 ordinary shares were issued under the terms of the JSOP at a price of 10.625 pence per share £38,754 was subscribed in cash by the beneficiaries and £2,944,973 was advanced to the Trustees of the Plan in order that the shares were issued fully paid.

Following the exercise of share options, 61,046 ordinary shares were issued on 8th March 2012 for cash of £450

17. SHARE CAPITAL (continued)

Share warrants

In January 2012, the Company granted Serum warrant rights to subscribe for 7,500,000 ordinary shares, exercisable over a period of two years in three equal tranches of 2,500,000 shares at prices of 15 pence, 20 pence and 25 pence per share

During 2011, the Company granted Synbio LLC warrant rights to subscribe for 11,080,000 ordinary shares at a price of 33 0 pence per share These rights are exercisable for a period of three years from 2nd December 2011

During 2010 the Company granted Baxter International Inc ("Baxter") warrant rights entitling Baxter to subscribe for up to 14,338,430 ordinary shares until 30th June 2015 at an exercise price of 9 02 pence per share

Shares issued under the Joint Share Ownership Plan (JSOP)

The estimated fair values of the JSOP shares granted in March 2012, and the vesting conditions applying to the grants, are as follows

Vesting conditions	Number of shares	Fair value per share
Vest when share price exceeds 15p	**11,232,852**	**2.407p**
Vest when share price exceeds 25p	**7,020,532**	**1.128p**
Vest when share price exceeds 35p	**7,020,532**	**0.474p**
Vest when share price exceeds 50p	**2,808,211**	**0.137p**

In 2010 the Company issued 5,318,479 ordinary shares under the terms of the Company's JSOP. The estimated fair values of the JSOP shares granted, and the vesting conditions applying to the grants, are as follows

Vesting conditions	Number of shares	Fair value per share
Vested immediately	**614,575**	**3.1543p**
Vest when share price exceeds 20p	**1,567,967**	**2.8290p**
Vest when share price exceeds 40p	**1,567,967**	**1.9480p**
Vest when share price exceeds 100p	**1,567,970**	**0.8270p**

Disclosure of the valuation assumptions for the Monte-Carlo model used to value the JSOP shares issued with share price targets, has not been made on the basis that the related IFRS 2 charge is immaterial

17. SHARE CAPITAL (continued)

Deferred shares

The rights attached to the deferred shares are as follows·

(a) no entitlement to any dividend,

(b) on a winding-up, an entitlement to receive an amount equal to the nominal value of each share, but only after an amount of £50,000,000 per share has been paid to the holders of the issued and fully paid ordinary 0 5 pence shares,

(c) no right to attend or vote at a general meeting; and

(d) an obligation to permit the Company to transfer the shares to such person as the Company may determine, without receiving any payment

18. SHARE OPTIONS

The Company utilises two forms of share option plan, being.

1 the Lipoxen plc Unapproved Share Option Plan (the "Unapproved Plan"), and

2. the Lipoxen plc 2007 Share Option Scheme incorporating Enterprise Management Incentives ("EMI") provisions ("the EMI Plan")

Share options are held by option holders in either the Unapproved Plan or the EMI plan All options in both plans are settled in equity when the options are exercised Since the formal adoption of the 2007 Scheme at the Company's AGM held in July 2009 employee awards have been made only under the more recent plan by virtue of the favourable tax treatment that this plan can confer on both the Company and awardees

Options under both plans vest based on one or more of time employed at Xenetic, individual performance, and market performance The maximum term of options is 10 years The IFRS 2 share option charge for the year was £16,075 (2011: £26,267).

Movements in the aggregate number of share options, and their weighted average exercise prices, in issue during the year were as follows·

	Number 2012	**Weighted avg exercise price 2012**	Number 2011	Weighted avg exercise price 2011
At 1st January	**12,712,574**	**6.0882p**	12,371,411	5.9729p
Granted	**3,000,000**	**18.0000p**	840,000	9 0000p
Exercised	**(61,046)**	**0.7371p**	(200,000)	0 7371p
Expired	**(71,904)**	**41.7200p**	(298,837)	13 0666p
At 31st December	**15,579,624**	**8.2384p**	12,712,574	6 0882p
Exercisable at 31st December	**11,725,924**		11,648,874	

18. SHARE OPTIONS (continued)

At 31st December 2012, the weighted average remaining contractual life of options exercisable was 5 49 years (2011 – 5 54 years) The weighted average fair value of options granted, estimated using the Black-Scholes option-pricing model, was 0 4297 pence (2011 – 2.0808 pence) The estimated fair values are based on the following weighted average assumptions·

	2012	2011
Share price	**7.2500p**	8.1300p
Exercise price	**18.0000p**	9.0000p
Expected volatility	**35.00%**	35.00%
Expected life	**3.25 years**	3 years
Expected dividend yield	**Nil**	Nil
Risk free interest rate	**1.5%**	2.00%

The expected volatility is determined by using as a base the share price movements recorded since the share placing on AIM on 16th January 2006

Options outstanding at 31st December 2012 were exercisable as follows·

Range of exercise prices	Number 2012	Weighted avg exercise price 2012	Number 2011	Weighted avg exercise price 2011
£0 - £0 01	**7,655,432**	**£0.0096**	7,716,478	£0 0096
£0 0101 - £0.10	**1,140,000**	**£0.0841**	1,140,000	£0 0841
£0 1001 - £0.30	**6,444,192**	**£0.1526**	3,444,192	£0 1288
£0.3001 - £0 50	**340,000**	**£0.3847**	411,904	£0 3904
Total	**15,579,624**	**£0.0824**	12,712,574	£0 0609

19. RECONCILIATION OF LOSS BEFORE TAXATION TO NET CASH OUTFLOW FROM OPERATING ACTIVITIES

Group	2012	2011
	£	£
Loss before taxation	**(3,377,482)**	(2,853,937)
Adjustments for:		
Equity-settled share options	**16,075**	26,267
Depreciation	**66,010**	215,764
Interest income	**(42,699)**	(12,075)
Finance costs	**32,645**	39,378
	(3,305,451)	(2,584,603)
Decrease/(increase) in inventories	**18,332**	(18,332)
Decrease/(increase) in receivables	**297,015**	(172,011)
(Decrease)/increase in payables	**(874,062)**	624,278
Net cash outflow from operating activities	**(3,864,166)**	(2,150,668)

Company	2012	2011
	£	£
Loss before taxation	**(1,024,655)**	(862,450)
Adjustments for:		
Depreciation	**15,137**	160,000
Investment income	**(69,504)**	(12,075)
Finance costs	**32,645**	39,378
	(1,046,377)	(675,147)
Increase in receivables	**(375,063)**	(411,515)
(Decrease)/increase in payables	**(221,195)**	295,506
Net cash outflow from operating activities	**(1,642,635)**	(791,156)

20. CASH AND CASH EQUIVALENTS

	2012	2011
	£	£
Group		
Cash and cash equivalents at beginning of year	**11,075,367**	850,804
Net movement in cash and cash equivalents in the year	**(4,184,166)**	10,224,563
Cash and cash equivalents at end of year (see Note 21)	**6,891,201**	11,075,367
Company		
Cash and cash equivalents at beginning of year	**11,041,792**	844,939
Net movement in cash and cash equivalents in the year	**(4,178,389)**	10,196,853
Cash and cash equivalents at end of year (see Note 21)	**6,863,403**	11,041,792

21. FINANCIAL INSTRUMENTS

Financial assets and liabilities were held as follows.

	Group		Company	
	2012	2011	2012	2011
Assets	£	£	£	£
Loans and receivables:				
Receivables from subsidiaries	-	-	**12,051,550**	8,791,077
Loan to JSOP Trustees	-	-	**3,350,666**	405,694
Trade receivables	**83,000**	10,702	-	-
Loan to related party	-	268,067	-	268,067
Cash and cash equivalents	**6,891,201**	11,075,367	**6,863,403**	11,041,792
Total financial assets	**6,974,201**	11,354,136	**22,265,619**	20,506,630
Liabilities				
Financial liabilities measured at amortised cost:				
Trade payables	**108,079**	218,957	**89,700**	146,958
Loan from related party	**422,618**	862,152	**422,618**	862,152
Accrued expenses	**285,399**	859,879	**254,451**	418,388
Deferred income	-	4,190	-	-
Total financial liabilities	**816,096**	1,945,178	**766,769**	1,427,498

21. FINANCIAL INSTRUMENTS (continued)

The Group is engaged in the development of drug delivery systems and proprietary products in the fields of protein drugs, vaccines and oncology Whilst it is therefore exposed to some financial risk this is significantly less than a trading company which has significant receivables, payables and inventories

The Directors consider that the carrying value of the financial assets and financial liabilities approximates their fair value.

The loans to and from related parties are denominated in US dollars.

The credit risk and foreign currency risk of trade receivables are considered in Note 14

All financial liabilities are payable within 12 months

Cash and cash equivalents comprise cash on hand of £1,010 and balances at bank of £6,890,191, of which £1,201,534 is held in a US dollar denominated account and £7,434 is held in a euro-denominated account Whilst the bank balances are held with a reputable financial institution, the maximum exposure to credit risk is the carrying value of the balances as disclosed above

A 5% increase or decrease in the US dollar/sterling exchange rate would have increased or decreased the reported sterling carrying amount of the US dollar denominated financial assets by approximately £57,000 and the US dollar financial liabilities by approximately £23,000 A 5% increase or decrease in the euro/sterling exchange rate would have had an immaterial impact on the carrying amounts of the euro-denominated financial assets and liabilities.

The trade payables are considered to have a maturity date of 3 months or less

Foreign currency risk

Foreign currency risk refers to the risk that the value of a financial commitment or recognised asset or liability will fluctuate due to changes in foreign currency exchange rates. The Group monitors its foreign currency risk through cash flow forecasting and currency is held in foreign currency bank accounts only to the extent that it is required for clinical development purposes

Interest rate risk

Interest rate risk is the risk that the value of a financial instrument or cash flows associated with it will fluctuate due to changes in market interest rates

The Group has financial assets in the form of trade receivables and cash and cash equivalents These are considered to be short term liquid assets and as a result the exposure to interest rate risk is not considered to be significant

On this basis no sensitivity analysis has been prepared on the grounds that there would not be a material impact on either the carrying values of the respective assets, the net loss for the year or the equity at the end of the period

21. FINANCIAL INSTRUMENTS (continued)

Liquidity risk

The Group maintains sufficient cash and cash equivalents Management reviews cashflow forecasts to determine whether the Group has sufficient cash reserves to continue with its research and development activities. The Group has no significant financial liabilities and no borrowings.

Capital management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern and to provide a means of attracting investors. The Group has no debt and does not therefore have a strategy in terms of maintaining a certain debt to equity ratio Rather capital is managed with a view to generating further cash and cash equivalents which can be used in the furtherance of the Group's aims and objectives.

22. RELATED PARTY TRANSACTIONS

The Group and Company was charged the following amounts by Directors or by companies controlled by Directors for the provision of consultancy services

	2012	2011
	£	£
Sir Brian Richards	**75,000**	75,000
Dr Dmitry Genkin	**51,000**	51,000
Firdaus Dastoor	**3,000**	-
Igor Nikolaev	**1,500**	3,000
Roman Knyazev	**2,750**	-
Artur Isaev	**2,000**	-

At 31st December 2012, the balance owed to Dr Genkin by the Company and the Group was £Nil (2011 - £37,619)

During 2011 the Company negotiated a short term unsecured loan facility of up to $1 70 million from Synbio LLC, a company which is now a substantial shareholder in the Company This loan bears interest (rolled up) at 0 67% per month and is repayable by agreement between the parties. The balance owed to Synbio LLC at 31st December 2012 was £422,618 (2011 - £862,152)

The Company charged a management charge of £120,000 (2011 - £120,000) to its subsidiary, Lipoxen Technologies Limited, during the year The Company continued to advance monies to the subsidiary during the year to fund the ongoing development of the Group's technology. The balance receivable from the subsidiary at 31st December 2012 was £11,001,383 (2011 - £8,791,077)

22. RELATED PARTY TRANSACTIONS (continued)

During 2011 the Company has advanced monies on loan on behalf of Synbio LLC to SymbioTec GmbH, a related party because one of its shareholders was a company controlled by Dr Dmitry Genkin. The whole of the issued share capital of SymbioTec was acquired by the Company on 17th January 2012 This loan bears interest (rolled up) at 0 85% per month and is repayable upon demand at any time after completion of the acquisition. The balance owed by SymbioTec GmbH at 31st December 2012 was £288,501 (2011 - £268,067) The Company charged a management charge of £178,402 to SymbioTec during the year and advanced monies to fund the ongoing development of SymbioTec's technology The balance owed by SymbioTec to the Company at 31st December 2012, excluding the loan referred to above, was £652,797 (2011 – £Nil).

The company advanced monies to its subsidiary, Xenetic USA Inc , to fund its operations The balance owed at the 31st December 2012 was £108,869 (2011 – £Nil).

23. GENERAL INFORMATION

Xenetic Biosciences plc and its subsidiaries are principally engaged in the development of drug delivery systems and proprietary products in the fields of protein drugs, vaccines and oncology

Xenetic Biosciences plc, a public limited company incorporated and domiciled in England and Wales, has its registered office and the principal place of business at The London BioScience Innovation Centre, 2 Royal College Street, London NW1 0NH