Phoqus Pharmaceuticals Limited

Directors' report and financial statements

Registered Number : 3486675

31 December 2002

Contents

Company information

Directors	FM Armstrong	Chief Executive Officer
	GJ Blaker	Chairman
	PG Johnson	VP Finance and Chief Financial Officer
	DFJ Leathers	
Secretary	PG Johnson	
Registered Office	10 Kings Hill Avenue Kings Hill West Malling Kent ME19 4PQ	
Auditors	KPMG LLP 1 Forest Gate Brighton Road Crawley RH11 9PT	
Solicitors	Jones Day Gouldens 10 Old Bailey London EC4M 7NG	
Bankers	HSBC Bank plc 83 Sidcup High Street Sidcup Kent DA14 6DN	

Directors' report

The Directors present their annual report and the audited financial statements for the year ended 31 December 2002.

Change of name

On 7 November 2002 the Company changed its name from Phoqus Limited to Phoqus Pharmaceuticals Limited.

Principal activity

The principal activity of the Company is the development and commercialisation of the electrostatic deposition technology for the development of pharmaceuticals.

Business review

The Company made significant technical progress in developing the four drug delivery systems: Qdis (fast dissolve); Qtrol (modified release); LeQtradose (active dose loading) and UniQ (unique tablet imaging) and secured three deals with major pharmaceutical companies to apply Phoqus drug delivery systems to their drugs.

A new management team was established with the appointment of Dr Frank Armstrong as Chief Executive Officer on 1 March 2002 succeeding Mr Terry Blaney, founder of Phoqus, who took on the role of Chief Operating Officer until 30 June when he stepped down. The management team consisting of Dr Frank Armstrong, Dr Peter Johnson, VP Finance and CFO, and Dr Marshall Whiteman, VP Technical Development was reinforced with the appointment of Dr Andy Jones, VP Commercial on 22 May 2002, and Mr Mike Holroyd, VP Engineering on 8 August 2002. The Board has decided to appoint Dr Andy Jones in succession to Dr Frank Armstrong, Chief Executive Officer, who has advised of his intention to resign from the Company at the end of April 2003.

The management team conducted a substantial business strategy review in the Summer and the recommendations approved by the Board in October provided the business platform for a new funding round which closed in January 2003, raising £7m in two tranches.

Substantial progress was made in establishing a manufacturing capability. Work progressed to complete the first Phoqus manufacturing machine at PA Consulting and an agreement was sought with a contract manufacturer to act as a manufacturing partner. The agreement was finalised in March 2003.

The Company invested in expanding facilities at Kings Hill to meet the needs for laboratory work, small-scale manufacture and office space for the business strategy.

Results and dividend

The results for the year are set out in the profit and loss account on page 6. The Directors do not recommend the payment of a dividend for the year. The retained loss for the financial year has been transferred to reserves.

Capital reorganisation

On 18 September 2002, each of the Company's ordinary shares and preferred ordinary shares were exchanged for 100 shares of the same class in Phoqus Group Limited, and the Company became a wholly owned subsidiary of Phoqus Group Limited.

Directors and Directors' interests

The present Directors of the Company are listed on page 1, all of whom served throughout the year except as noted below.

FM Armstrong and AA Jones were appointed Directors of the company on 1 March 2002 and 7 June 2002, respectively. The following Directors resigned during the year - JN Staniforth (7 June 2002); JR Close (15 August 2002) ; TWD Blaney, JC Benjamin, H Seager, JP Cashman and AA Jones all on 18 September 2002 in connection with the Group reorganisation.

All the Directors at 31 December 2002 were also Directors of Phoqus Group Limited and their interests in the shares of Group companies are disclosed in the Directors' report of that company.

Directors' report *(continued)*

Auditors

In accordance with Section 385 of the Companies Act 1985 a resolution for the re-appointment of KPMG LLP as auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

By order of the Board

PG Johnson
Secretary

16 April 2003

Statement of Directors' responsibilities

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; 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 proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

KPMG

1 Forest Gate
Brighton Road
Crawley
RH11 9PT

Independent auditors' report to the members of Phoqus Pharmaceuticals Limited

We have audited the financial statements on pages 6 to 19.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an 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

The Directors are responsible for the Directors' report and, as described on page 4, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and our profession's ethical guidance.

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

Basis of audit opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company as at 31 December 2002 and of the loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG LLP

KPMG LLP
Chartered Accountants
Registered Auditor

16 April 2003

Profit and loss account
for the year ended 31 December 2002

	Note	2002 £	2001 £
Turnover	*1*	**57,570**	5,000
Administrative expenses		**(5,765,750)**	(4,903,288)
Operating loss		**(5,708,180)**	(4,898,288)
Interest receivable	*5*	**148,466**	110,451
Interest payable and similar charges	*6*	**(217,600)**	(355,217)
Loss on ordinary activities before taxation	*7*	**(5,777,314)**	(5,143,054)
Tax on loss on ordinary activities	*8*	**1,271,664**	-
Loss on ordinary activities after taxation		**(4,505,650)**	(5,143,054)
Finance costs accrued on non-equity shares	*9*	-	(245,976)
Retained loss for the financial year		**(4,505,650)**	(5,389,030)

The results stated in the profit and loss account above all relate to continuing operations. The Company has no recognised gains or losses other than those included in the profit and loss account above.

Balance sheet
At 31 December 2002

	Note	2002		2001	
ASSETS		£	£	£	£
Fixed assets					
Tangible assets	10		2,698,084		1,748,575
Current assets					
Debtors	11	1,343,434		203,900	
Cash at bank and in hand		639,218		7,220,064	
			1,982,652		7,423,964
			4,680,736		9,172,539
LIABILITIES					
Capital and reserves					
Called up share capital	12		2,562		4,582,622
Share premium account	13		13,714,444		13,714,444
Capital redemption reserve	14		4,580,064		-
Capital contribution reserve	14		132,711		-
Other reserve - warrants	14		-		148,420
Profit and loss account	14		(16,052,549)		(11,546,899)
Shareholders' funds	15		2,377,232		6,898,587
Equity			2,377,232		6,897,035
Non-equity			-		1,552
			2,377,232		6,898,587
Creditors					
Amounts falling due within one year	16	1,957,547		1,457,636	
Amounts falling due after more than one year	17	345,957		816,316	
			2,303,504		2,273,952
			4,680,736		9,172,539

These financial statements were approved by the Board of Directors on 16 April 2003 and were signed on its behalf by:

FM Armstrong
Chief Executive Officer

PG Johnson
VP Finance & Chief Financial Officer

Notes

(forming part of the financial statements)

1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's financial statements. The Company has adopted Financial Reporting Standard No.18 "Accounting policies" and Financial Reporting Standard No.19 "Deferred tax" in these financial statements. There has been no need to restate comparative figures on implementation of these standards.

Basis of preparation

The financial statements have been prepared under the historical cost convention and in accordance with applicable accounting standards.

The Company has taken advantage of the exemption from the requirement to prepare a cash flow statement as provided for in Financial Reporting Standard No 1 (Revised 1996) on the grounds that it is 100% owned by Phoqus Group Limited which prepares consolidated financial statements that incorporate the Company's results and are publicly available.

The Company has also taken advantage of the exemption in Financial Reporting Standard No.8 "Related party transactions" from disclosing transactions with other companies within the Phoqus Group Limited group.

Turnover

Turnover arises from the provision of services to client pharmaceutical companies in respect of the application of the Company's technology to the client's drugs, and comprises the value of invoiced sales, less value added tax.

Revenue is recognised by reference to the terms and conditions of the contract. Revenue related to the achievement of objectives is recognised when those objectives are met, whilst revenue related to time is recognised over the period of the contract.

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange ruling at the balance sheet date and the gains or losses on translation are included in the profit and loss account.

Fixed assets

Fixed assets are recorded at cost less depreciation. Depreciation is calculated so as to write off the cost of such assets, less their estimated residual values, on a straight line basis over their expected useful economic lives as follows:

Leasehold improvements	Over the period of the lease
Plant and machinery	2-10 years
Office furniture and fittings	5-10 years

Deferred taxation

The charge for taxation is based on the result for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. Full provision is made for deferred tax except as otherwise provided for in Financial Reporting Standard No.19 - Deferred Tax.

Leases

Assets acquired under finance leases are capitalised and the outstanding future lease obligations are shown in creditors. Operating lease rentals are charged to the profit and loss account on a straight line basis over the period of the lease.

Finance and warrants

Finance secured with the issue of warrants is accounted for in accordance with Financial Reporting Standard No.4 - Capital Instruments. The finance proceeds are allocated between debt and warrants; the value of warrants is accounted for in reserves and the discount on issue of the debt is treated as a finance cost and apportioned to accounting periods so that the total finance cost on the debt will have a constant relationship to the outstanding obligation.

Notes *(continued)*

1 Accounting policies *(continued)*

Research and development

Research and development expenditure is charged to the profit and loss account as incurred.

Employee Benefit Trust

Payments made to the Trust are charged to the profit and loss account when they are appointed to or for the benefit of specific individuals. Administration expenses are also charged to the profit and loss account as incurred. Funds unappointed at the year end are included in the accounts.

Pensions

The Company operates a defined contribution pension scheme. Contributions payable for the year are charged to the profit and loss account.

2 Remuneration of Directors and employees

	2002	2001
	£	£
The remuneration paid to the Directors was:		
Directors' fees	**44,270**	56,839
Emoluments (excluding pension contributions)	**357,842**	262,508
Pension contributions	**18,359**	33,600
	420,471	352,947

The Directors have chosen not to participate in the Company's defined contribution pension scheme. There were two Directors participating in 2001.

The emoluments attributable to the highest paid Director were £134,261 *(2001: £157,781)* – see also note 3. Pension contributions attributable to the highest paid Director were £nil *(2001: £21,000)*.

	2002	2001
	£	£
Staff numbers and costs		
Wages and salaries	**1,430,413**	891,021
Social security costs	**155,570**	90,425
Pension costs	**83,155**	80,179
	1,669,138	1,061,625

The average number of staff employed by the Company during the year (including executive Directors) was 35 *(2001: 25)*.

Notes *(continued)*

3 Employee Benefit Trust

In addition to the Directors' emoluments set out above, £158,700 of the amount paid by the Company into the Employee Benefit Trust during the year has been allocated by the Trustees indirectly for the benefit of the Directors. The amount in respect of the highest paid Director during the year was £55,300. The amounts will be chargeable to taxation at the time of distribution.

4 Pensions

The Company contributes to a grouped personal pension scheme operated by HSBC. The employees contribute at various rates which are partially matched by the Company. The cost to the Company for 2002 was £83,026 *(2001: £80,179)* and has been charged to the profit and loss account.

5 Interest receivable

	2002	2001
	£	£
Interest on bank deposits	**148,466**	110,451

6 Interest payable and similar charges

	2002	2001
	£	£
On bank loans and overdrafts	**70**	1,530
On other loans	**103,050**	248,012
On finance leases	**114,480**	105,675
	217,600	355,217

7 Loss on ordinary activities before taxation

	2002	2001
	£	£
The loss on ordinary activities before taxation is stated after charging:		
Auditors' remuneration		
- Audit	**14,944**	12,000
- Other services	**130,019**	16,200
Depreciation of tangible fixed assets	**296,922**	190,224
Operating leases - Hire of plant and vehicles	**-**	28,116
- Other assets	**139,719**	73,881
Exchange losses on foreign currency transactions	**2,004**	83,524

Other services provided by the Auditors included tax compliance and advisory, the establishment of the Enterprise Management Incentive Scheme, the share scheme for non-executive Directors, the Employee Share Ownership Trust, the Group reorganisation and other sundry matters. The majority of these services are of an exceptional nature and will not be required in future years.

Notes *(continued)*

8 Tax on loss on ordinary activities

The credit for taxation comprises:

	2002	2001
	£	£
UK corporation tax		
Current tax on income for the period	**-**	-
Research and development tax credit		
- current year	**589,404**	-
- in respect of prior years	**682,260**	-
Total current tax credit	**1,271,664**	-

The current tax charge for the period is lower *(2001: lower)* than the standard rate of corporation tax in the UK (30%, *2001:30%*). The differences are explained below.

	2002	2001
	£	£
Current tax reconciliation		
Loss on ordinary activities before tax	**5,777,314**	5,389,030
Current tax at 30% *(2001 : 30%)*	**1,733,194**	1,077,806
Effects of:		
Unrelieved tax losses carried forward	**(461,530)**	(1,077,806)
Total current tax credit (see above)	**1,271,664**	-

Subject to agreement with the Inland Revenue, tax losses of approximately £11m *(2001: £9.4m)* are available for carry forward and offset against future trading profits. No deferred tax asset has been recognised in respect of these losses, in accordance with Financial Reporting Standard No.19.

9 Finance costs of non-equity shares

	2002	2001
	£	£
Amount in respect of the year	**-**	245,976

The 8% cumulative redeemable preference shares were exchanged for deferred ordinary shares as a condition of the second round of financing on 22 August 2001.

Notes *(continued)*

10 Fixed assets

	Short leasehold property	Assets in the course of construction	Plant and machinery	Office furniture and fittings	Total
	£	£	£	£	£
Cost					
At 1 January 2002	198,900	-	1,628,000	274,313	2,101,213
Additions	118,545	496,375	520,959	110,552	1,246,431
At 31 December 2002	317,445	496,375	2,148,959	384,865	3,347,644
Depreciation					
At 1 January 2002	35,360	-	228,163	89,115	352,638
Charge for the year	19,463	-	208,002	69,457	296,922
At 31 December 2002	54,823	-	436,165	158,572	649,560
Net book value					
At 31 December 2002	**262,622**	**496,375**	**1,712,794**	**226,293**	**2,698,084**
At 31 December 2001	163,540	-	1,399,837	185,198	1,748,575

Included in the net book value for short leasehold property and plant and machinery is £890,495 relating to assets held under finance leases *(2001: £1,043,898)*. The depreciation charge on those assets for the year was £153,402 *(2001: £125,210)*.

11 Debtors

	2002	2001
	£	£
Trade debtors	**61,550**	-
Amount due from Group undertakings	**251,210**	-
Other debtors and deposits	**352,681**	170,604
Prepayments and accrued income	**88,589**	33,296
Research and development tax credit receivable	**589,404**	-
	1,343,434	203,900

Notes *(continued)*

12 Called up share capital

	2002		2001	
	No.	**£**	No.	£
Authorised				
Ordinary shares of 1p each	**458,705,000**	**4,587,050**	-	-
'A' Ordinary shares of 1p each	-	-	407,500	4,075
'B' Ordinary shares of 1p each	-	-	71,000	710
'C' Ordinary shares of 1p each	-	-	15,000	150
'D' Ordinary shares of 1p each	-	-	20,000	200
'E' Ordinary shares of 1p each	-	-	10,000	100
Deferred shares of £1 each	-	-	4,580,065	4,580,065
Preferred Ordinary shares of 1p each	-	-	175,000	1,750
		4,587,050		4,587,050
Allotted, called up and fully paid				
Ordinary shares of 1p each	**256,188**	**2,562**	-	-
'A' Ordinary shares of 1p each	-	-	62,500	625
'B' Ordinary shares of 1p each	-	-	16,000	160
'C' Ordinary shares of 1p each	-	-	15,000	150
'D' Ordinary shares of 1p each	-	-	7,000	70
'E' Ordinary shares of 1p each	-	-	-	-
Deferred shares of £1 each	-	-	4,580,065	4,580,065
Preferred Ordinary shares of 1p each	-	-	155,188	1,552
		2,562		4,582,622

Ordinary shares

On 7 November 2002 the Company passed a special resolution to redesignate all of the classes of ordinary share, including the preferred ordinary shares to a single class of ordinary share with a nominal value of 1p.

Deferred shares

On 13 September 2002, an agreement was entered into whereby the Company redeemed all of the £1 deferred shares in issue for a total payment of £1. This payment was made out of the proceeds of the issue of 500 D ordinary shares to a Director. A capital redemption reserve of £4,580,064 was created upon this transaction.

On 7 November 2002, the Company passed a special resolution to convert each authorised £1 deferred share into 100 ordinary shares of 1p each.

Notes *(continued)*

12 Called up share capital *(continued)*

Contingent rights to the allotment of shares

Warrants to subscribe shares

In September and November 2000, the Company negotiated two finance facilities totalling £2.75m with two finance providers of which £2.0m in aggregate had been drawn down by 31 December 2001 (see note 17). The finance facilities each included the issue to the provider of warrants to subscribe in total for up to 7,421 new 'A' ordinary shares of £1 each in the Company at a price of £80 per share. In accordance with FRS 4 the Directors valued the warrants in isolation at that time and determined the value at the equivalent of £20 per ordinary share. Accordingly a warrant reserve for £148,420 was established on issue of the warrants. During 2002 the Company was advised that the undrawn facility for £0.75m had expired, notwithstanding earlier informal discussions with the finance provider regarding the extension of the facility. Accordingly, the warrants attached to the undrawn facility are no longer exercisable. A corresponding adjustment of £42,180 has been made to the value of the warrant reserve and the loan.

On 16 July 2002 and 12 August 2002, each finance provider consented to the cancellation of the original warrants and their rights under them in consideration of the issue of new warrants in Phoqus Group Limited. Deeds of warrants in this company were issued on 18 September 2002. These warrants are therefore attached to the debt facilities held by Phoqus Pharmaceuticals Limited (see note 17). These transactions have been accounted for as a capital contribution from Phoqus Group Limited to the Company and the amount of the warrant reserve at the date of contribution was transferred to a capital reserve (see note 14).

13 Share premium

	2002	2001
	£	£
At 1 January 2002	**13,714,444**	527,281
Premium paid on issue of shares	-	13,187,163
At 31 December 2002	**13,714,444**	13,714,444

14 Reserves

	Other reserve - warrants	**Capital contribution reserve**	**Capital redemption reserve**	**Profit and loss account**	**Total**
	£	£	£	£	£
At 1 January 2002	148,420	-	-	(11,546,899)	(11,398,479)
Loss for the year	-	-	-	(4,505,650)	(4,505,650)
Adjustment to warrants (see note 12)	(42,180)	-	-		(42,180)
Redemption of deferred shares	-	-	4,580,064	-	4,580,064
Transfer to capital contribution reserve	(106,240)	106,240	-	-	-
Issue of warrants by parent undertaking	-	26,471	-	-	26,471
At 31 December 2002	-	**132,711**	**4,580,064**	**(16,052,549)**	**(11,339,774)**

Notes *(continued)*

15 Reconciliation of movement in shareholders' funds

	2002 £	2001 £
At 1 January 2002	**6,898,587**	(1,147,144)
Issue of preferred ordinary shares	**-**	13,188,715
Issue of D ordinary shares	**5**	70
Redemption of deferred ordinary shares	**(4,580,065)**	-
Creation of capital redemption reserve	**4,580,064**	-
Issue of deferred ordinary shares	**-**	4,580,065
Deferral of preference shares	**-**	(4,580,000)
Deferral of B ordinary shares	**-**	(65)
Cancellation of warrants	**(148,420)**	-
Transfer to capital contribution reserve	**132,711**	-
Loss for the year	**(4,505,650)**	(5,389,030)
Finance costs of non-equity shares	**-**	245,976
At 31 December 2002	**2,377,232**	6,898,587

16 Creditors: amounts falling due within one year

	2002 £	2001 £
Other loans	**531,336**	324,968
Amounts payable under finance leases	**345,363**	260,230
Trade creditors	**746,998**	658,705
Amounts payable to Group undertakings	**155,300**	-
Director's loan account	**-**	3,535
Other taxation and social security	**50,478**	45,343
Accruals and deferred income	**128,072**	164,855
	1,957,547	1,457,636

Notes *(continued)*

17 Creditors: amounts falling due after more than one year

	2002	2001
	£	£
Other loans	**201,384**	300,381
Amounts payable under finance leases	**144,573**	515,935
	345,957	816,316

The maturity of debt is as follows:

	2002	2001
	£	£
Amounts falling due in less than one year	**531,336**	324,968
1-2 years	**201,384**	299,381
2-5 years	-	1,000
	732,720	625,349

Obligations under finance leases

These are analysed as follows:

	2002	2001
	£	£
Amounts payable within one year	**345,363**	260,230
Amounts payable within 2 - 5 years	**144,573**	515,935
	489,936	776,165

The other loans are secured by a floating charge over the Company's assets and the finance lease over specific assets.

Loan disclosures

GATX

A £1.75m venture loan facility was established on 21 September 2000 with GATX European Technology Ventures. Of this, £1m was drawn down. The loan facility had warrants attached to subscribe for up to 4,921 new 'A' ordinary shares at £80 per share exercisable up to 10 years from the commencement of the facility, on which the Directors have placed a valuation of £98,420.

The loan therefore had an effective interest rate of 23.6% (nominal rate 16%) per annum and is repayable by 36 monthly instalments of £35,161.97 from October 2000.

On 19 September 2002, GATX Venture Finance Partners Partnership provided a further loan of £500,000 to the Company, secured by a debenture. This facility included warrants to subscribe for 132,353 preferred ordinary shares of 0.01p each in Phoqus Group Limited at 85p per share. The warrants are exercisable independently of the finance facility over the period that is the last to occur of either 19 September 2012 or 5 years from the date of an initial public offering. The Directors have placed a valuation on these warrants of 20p each and a warrant reserve for £26,471 has been set up in Phoqus Group Limited. The loan therefore has an effective interest rate of 19.4% (nominal rate 13.8 %) and is repayable by 24 monthly instalments of £23,954.51.

Notes *(continued)*

Loan disclosures *(continued)*

GATX *(continued)*

In conjunction with the loan facility granted on 19 September 2002, GATX was granted an irrevocable option to participate in the next equity funding round in whichever Group company this takes place up to a maximum subscription amount of £500,000. The consideration paid for this option was £1.

EVP

A £1m asset leasing facility was established on 8 November 2000 with European Venture Partners which was fully drawn down during 2001. Each tranche of the facility is repayable over 36 months and the current aggregate monthly repayment is £33,231. The facility included warrants to subscribe for 2,500 new 'A' ordinary shares at £80 per share exercisable up to 10 years from the commencement of the facility, on which the Directors placed a valuation of £50,000. The finance lease therefore has an effective interest rate of 15.6% (implied nominal interest rate of approximately 14% per annum).

On 16 July 2002 and 12 August 2002, GATX and EVP, respectively consented to cancellation of the original warrants and their rights under them in consideration for the issue of new warrants in Phoqus Group Limited. Deeds of warrants in this new parent company were issued on 18 September 2002. These new warrants are therefore attached to the debt facilities held by Phoqus Pharmaceuticals Limited. These transactions have been accounted for as a capital contribution from Phoqus Group Limited to the Company and the amount of the warrant reserve at the date of contribution was transferred to a capital contribution reserve (see note 14).

GATX Venture Finance Partners Partnership was issued with warrants over the number of A ordinary shares in Phoqus Group Limited that would equal £225,000 at the first tranche subscription price of 82.5p per share and £168,750 at the second tranche subscription price of 82.5p per share. The warrants are exercisable during the period ending on the last to occur of 29 September 2010 and five years from the date of an Initial Public Offering.

European Venture Partners (Holdings) Limited was issued with warrants over 250,000 A ordinary shares at a subscription price of 80p per share for a consideration of £1. The warrants are exercisable during the period commencing 18 September 2002 and expiring on the earlier of 7 November 2009 and the fourth anniversary of an Initial Public Offering.

The warrants over the shares of Phoqus Group Limited are exercisable independently of the finance facilities.

Rouse Kent

In May 1999, the landlord provided a £60,000 loan to the Company to partially finance fit-out costs for the building. The loan is repayable over 5 years with an interest rate of 10% per annum and quarterly payments commencing on 6 July 1999 of £3,868.90, the final payment being due on 24 March 2004.

Notes *(continued)*

18 Commitments

Capital commitments

	2002 £	2001 £
Contracted but not provided for in the financial statements	**181,340**	166,822

Operating leases

The Company has annual financial commitments under non-cancellable operating leases as follows:

Company	**2002**		2001	
	Land and buildings	**Other**	Land and buildings	Other
Leases expiring:	**£**	**£**	£	£
Within one year	**-**	**-**	-	-
Within two to five years	**145,164**	**-**	-	28,116
After five years	**73,785**	**-**	73,881	-
	218,949	**-**	73,881	28,116

Notes *(continued)*

20 Related party transactions

Mr TWD Blaney had made a loan of £98,319 to the Company as at 31 December 2000. Upon completion of the second round of financing, this was partially repaid, with the balance of £3,535 repaid in 2002.

Three Directors also provided consultancy services to the Company during the year of £28,895 *(2001: £95,058).*

21 Ultimate parent undertaking

On 22 March 2002, a new parent company, Phoqus Group Limited was incorporated. On 18 September 2002, Phoqus Group Limited purchased the entire issued share capital of Phoqus Pharmaceuticals Limited by way of a share exchange agreement in conjunction with the existing shareholders of the Company. Phoqus Group Limited is therefore the ultimate parent undertaking. The results of the Company have been included within the consolidated financial statements of Phoqus Group Limited, copies of which can be obtained from the registered office address given in the Company information section of these financial statements.

22 Post balance sheet event

In January 2003 the Company closed a third funding round raising £7m in two tranches: the first £3.9m paid immediately and the balance to be paid in July 2003 subject to certain milestones being achieved.

The Board has decided to appoint Dr Andy Jones in succession to Dr Frank Armstrong, Chief Executive Officer, who has advised of his intention to resign from the Company at the end of April 2003.