

Registered No 3486675

Phoqus Pharmaceuticals (UK) Limited

Report and Financial Statements

31 December 2006

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COMPANIES HOUSE

Phoqus Pharmaceuticals (UK) Limited

Registered No 3486675

Directors

P G Johnson	(Chief Financial Officer)
D F J Leathers	(Non-Executive Director)
E Moses	(Chairman)

Secretary

S E Smith

Auditors

Ernst & Young LLP
1 More London Place
London
SE1 2AF

Bankers

HSBC Bank plc
83 Sidcup High Street
Sidcup
Kent
DA14 6DN

Solicitors

Olswang
90 High Holborn
London
WC1V 6XX

Registered office

10 Kings Hill Avenue
Kings Hill
West Malling
Kent
ME19 4PQ

Directors' report

The Directors present their report and financial statements for the year ended 31 December 2006

Results and dividends

The loss for the year amounted to £6,381,404 (2005 - £6,511,452) The Directors do not recommend the payment of a dividend

In the 12 months to 31 December 2006, the Company's turnover was £166,950 (2005 £274,137) which was derived mainly from fees arising from collaborations with pharmaceutical companies

The operating loss of £5,073,167 (2005 £5,729,998) included research and development expenses which qualify for additional tax allowances from the Inland Revenue, amounting to £1,674,074 (2005 £2,503,197) Other research and development expenditure amounted to £1,461,998 (2005 £1,923,914)

Taxation includes a Research and Development tax credit for £401,778 (2005 £600,767)

All surplus cash is kept on deposit in accordance with the Company's policy to maximise returns on low risk cash or cash-equivalent investments that safeguard the principal whilst ensuring that cash resources are available to fund the Company's operations when required

At 31 December 2006 the Company had cash and short term deposits of £4,384,328 (2005 £6,524,674)

Principal activities and review of the business

The principal activity of the Company is the development and commercialisation of the electrostatic deposition technology for the manufacture of tablets with tailored appearance and medical properties for the pharmaceutical industry These are delivered using the four drug delivery systems Qdis (fast dissolve), Qtrol (modified release), LeQtrados (active dose loading) and UniQ (unique tablet imaging)

The Company has continued to explore commercial relationship opportunities with potential customers within its services business Following the successful £3m placing the Company is also pursuing the Chronocort™ development programme

The Commercial Manufacturing Suite (CMS) is a high throughput machine capable of operation to 'Good Manufacturing Practice' for commercial manufacturing use It has been commissioned in the Cardinal Health manufacturing facility near Stuttgart in Germany and is undergoing qualification testing in readiness to meet the planned manufacturing commitments for it

Future developments and post balance sheet events

The Directors believe that there are sufficient funds raised at the AIM listing of the group together with those raised at the secondary placing, to execute the business plan presented to investors

In July 2007 the company's holding company was successful in raising a further £5m net of expenses in a further placing of shares

Research and development

The Company continues to be engaged in R&D activities as evidenced by its expanding patent portfolio All scientific and engineering staff is engaged on these activities when not servicing customer projects

Principal risks and uncertainties

The Company considers there are the following principal risks and uncertainties

- The Chronocort™ project being delayed or Phase II clinical trial results not being positive,
- Development projects with pharmaceutical companies partners not progressing to manufacturing deals,

Directors' report

- Failure of the manufacturing capability,
- Competing technologies may be developed with more attractive approaches, and
- Adequate cash resources

The Company manages the first three of these risks by careful planning of the activities, building in contingencies and mitigating actions. The progress of all the activities and how they interrelate with each other is reviewed by the management team every week. The Company also constantly reviews developments in the industry to identify potential competitive technologies to ensure firstly that there is no infringement of the Company's Intellectual Property rights and second to evaluate the relative merits of the technologies so that customers may be kept fully informed. Finally, cash resources are carefully managed, requirements forecast and actions taken to replenish as necessary.

Going concern

The Directors have prepared the financial statements on the going concern basis. Their assumptions in continuing to adopt the going concern basis are outlined in the Fundamental Accounting section of Note 1 to the financial statements.

Directors

The Directors who served the Company during the year were as follows

P G Johnson

A A Jones

(Resigned 31 January 2007)

D F J Leathers

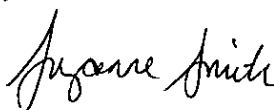
E Moses

There are no Directors' interests requiring disclosure under the Companies Act 1985. The interests of the Directors in the shares and options of the parent undertaking, Phoqus Pharmaceuticals plc are shown in the report and consolidated financial statements of that Company.

Auditors

A resolution to reappoint Ernst & Young LLP as auditors will be put to the members at the Annual General Meeting.

By order of the Board



S E Smith
Secretary

26 October 2007

Statement of Directors' responsibilities in respect of the financial statements

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom law and United Kingdom Generally Accepted Accounting Practice

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

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates that are reasonable and prudent,
- state whether applicable UK 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 which 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 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

Independent auditors' report

to the members of Phoqus Pharmaceuticals (UK) Limited

We have audited the company's financial statements for the year ended 31 December 2006 which comprise the primary financial statements such as the Profit and Loss Account, the Balance Sheet, the Statement of Total Recognised Gains and Losses and the related notes 1 to 23. These financial statements have been prepared under the accounting policies set out therein.

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

Respective responsibilities of Directors and auditors

The directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) as set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

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 other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the 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.

Independent auditors' report

to the members of Phoqus Pharmaceuticals (UK) Limited (continued)

Opinion

In our opinion

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 December 2006 and of the loss of the Company for the year then ended,
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Director's Report is consistent with the financial statements

Emphasis of matter

In forming our opinion, we have considered the adequacy of the disclosures made in note 1 of the financial statements concerning the fundamental uncertainty as to the company's (and its parent group's) short and medium – term viability with specific regard to the planned receipt in the short term of significant fees and licensing revenues from current projects, and planned revenues from the commercial application of the technology in the medium term. If the fees and licensing revenues are not forthcoming, the company and its parent group will need to raise additional funds to continue the development of its products. If the technology being developed by the company is not developed through to successful commercial launch, through lack of funding or clinical failure, the going concern basis of preparation would not be appropriate. The financial information does not include any adjustments that would result from a failure to generate significant fees and licensing revenue in the short term and failure to develop a commercial product and generate future revenues in the medium term or any other matters described in Note 1. It is not practical to quantify the adjustments that might be required, but should any adjustments be required they may be significant. In view of the significance of this uncertainty we consider that it should be drawn to your attention but our opinion is not qualified on this respect.



Ernst & Young LLP
Registered Auditor
London

26 October 2007

Profit and loss account

for the year ended 31 December 2006

	Notes	2006 £	2005 £
Turnover	2	166,950	274,137
Administrative expenses		(5,240,117)	(6,004,135)
Operating loss	3	(5,073,167)	(5,729,998)
Bank interest receivable	8	189,220	98,590
Interest payable	9	(1,899,235)	(1,480,811)
Loss on ordinary activities before taxation		(6,783,182)	(7,112,219)
Tax on loss on ordinary activities	10	401,778	600,767
Loss for the financial year	15, 16	(6,381,404)	(6,511,452)

Statement of total recognised gains and losses

There are no recognised gains or losses other than the loss of £6,381,404 attributable to the shareholders for the year ended 31 December 2006 (2005 - loss of £6,511,452)

Balance sheet

at 31 December 2006

	Notes	2006 £	2005 £
ASSETS			
Fixed assets			
Tangible assets	11	2,118,734	2,321,838
Current assets			
Debtors	12	999,626	1,301,600
Cash at bank		4,384,328	6,524,674
		<u>5,383,954</u>	<u>7,826,274</u>
		<u>7,502,688</u>	<u>10,148,112</u>
Capital and reserves			
Called up share capital	13	2,562	2,562
Share premium account	15	13,714,444	13,714,444
Capital redemption reserve	15	4,580,064	4,580,064
Capital contribution reserve	15	252,894	207,711
Profit and loss account	15	(40,964,666)	(34,583,262)
Shareholders' funds	16	(22,414,702)	(16,078,481)
Creditors			
Amounts falling due within one year	17	1,086,988	1,258,950
Amounts falling due after more than one year	18	28,830,402	24,967,643
		<u>29,917,390</u>	<u>26,226,593</u>
		<u>7,502,688</u>	<u>10,148,112</u>

Approved by the Board on 26 October 2007



P G Johnson
Chief Financial Officer

Notes to the financial statements

at 31 December 2006

1. Accounting policies

Fundamental accounting concept

The financial statements have been prepared on a going concern basis

The Company's strategy is to commercialise the technology it has developed for the manufacture of tablets, the appearance and medical properties of which are tailored to the requirements of customers in the pharmaceutical industry. The level of retained losses as at the date of these financial statements represents the Company's costs incurred to pursue this strategy. The Company is dependent on funding from the holding company, Phoqus Pharmaceuticals plc. In order to finance the next phase of the strategy, the holding company raised £8.8m of funds (net of costs) through a Placing on the holding company's admission to AIM in November 2005 and £2.8m of funds (net of costs) through a Secondary Placing in October 2006. In addition the holding company has entered into a £2.5m loan agreement which was completed on 2 April 2007. The terms of the loan were an immediate drawdown of £1.25m, with the drawdown of the balance being subject to certain conditions. The loan is repayable over 36 monthly instalments, with an initial interest only period of 6 months, at an interest rate of 13.3%. The holding company will grant the lender a warrant to subscribe for shares equal to 6% of the drawn down loan with an exercise price equal to the average closing price per share in the 30 days preceding the closing of documentation. Furthermore in July 2007 the company's holding company was successful in raising a further £5m net of expenses in a placing of shares.

As set out in the directors' report there are risk factors inherent in the business and its potential to generate future revenues. As at the date of these financial statements, there is a fundamental uncertainty as to the viability of the Company on a medium term basis and hence the validity of the going concern basis adopted in the preparation of these financial statements.

The Directors have prepared and approved cash flow projections that indicate that the company will be able to meet its liabilities as they fall due for the foreseeable future. These projections include the planned receipt in the short term of significant fees and licensing revenues from current projects, and planned revenues from the commercial application of the technology in the medium term. If the fees and licensing revenues are not forthcoming, the holding company will need to raise additional funds to continue the development of the company's products. If the technology being developed by the company is not developed through to successful commercial launch, through lack of funding or clinical failure, the going concern basis of the preparation would not be appropriate. The financial statements do not include any adjustments that would result from a failure to develop a commercial product and generate future revenues. The Directors are of the opinion that it is not practical to quantify the adjustments that might be required, but should any adjustments be required they may be significant.

Basis of preparation

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

In preparing the financial statements for the current year, the Company has adopted FRS 20 'share based payment'. The adoption of FRS 20 has resulted in a change in accounting policy for share-based payment transactions. The FRS 20 requires the fair value of options and share awards which ultimately vest to be charged to the profit and loss account over the vesting or performance period. As the employees are employed by the Company but the options are issued by the Parent Company, the corresponding credit entry is taken to the capital contribution reserve. For equity settled transactions the fair value is determined at the date of the grant using an appropriate pricing model. If an award fails to vest as the result of certain types of performance condition not being satisfied, the charge to the income statement will be adjusted to reflect this.

There is no impact for prior years due to all options being in existence having vested prior to 1 January 2006. Under FRS 20 a charge of £45,000 was recognised in the profit and loss account in the current year. The impact in the year by applying FRS 20 as opposed to UITF 17 is to reduce the profit and loss account charge by £168,000.

Notes to the financial statements

at 31 December 2006

1. Accounting policies (continued)

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's financial statements

Cash flow statement

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 Pharmaceuticals plc which prepares consolidated financial statements that incorporate the Company's results and are publicly available

Share-based payments

Equity settled transactions

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted and is recognised as an expense over the vesting period, which ends on the date on which the relevant employees become fully entitled to the award. Fair value is determined by an external valuer using an appropriate pricing model. In valuing equity-settled transactions, no account is taken of any vesting conditions linked to the price of the shares of the group (market conditions)

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon the market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied

At each balance sheet date before vesting, the cumulative expense is calculated, representing the extent to which the vesting period has expired and management's best estimate of the achievement or otherwise of non-market conditions. Number of equity instruments that will ultimately vest or in the case of an instrument subject to a market condition, be treated as vesting as described above. The movement in cumulative expense since the previous balance sheet is recognised in the income statement, with a corresponding entry in capital contribution reserve

Where the terms of an equity-settled award are modified or a new award is designated as replacing a cancelled or settled award, the cost based on the original award terms continues to be recognised over the original vesting period. In addition, an expense is recognised over the remainder of the new vesting period for the incremental fair value of any modification, based on the difference between the fair value of the original award and the fair value of the modified award, both as measured on the date of the modification. No reduction is recognised if this difference is a negative

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any cost not yet recognised in the income statement for the award is expensed immediately. Any compensation paid up to the fair value of the award at the cancellation or settlement date is deducted from equity, with any excess over fair value being treated as an expense in the income statement

The Company has taken advantage of the transitional provisions of FRS 20 in respect of equity-settled awards so as to apply FRS 20 only to those equity-settled awards granted after 7 November 2002 that had not vested before 1 January 2006

For awards granted before 7 November 2002, the Company recognises only the intrinsic value or cost of these potential awards as an expense. This is accrued over the performance period of each plan based on the intrinsic value of the equity settled awards

Related parties transactions

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 Pharmaceuticals plc group

Research and development

Research and development expenditure is written off in the year in which it is incurred

Notes to the financial statements

at 31 December 2006

1. Accounting policies (continued)

Tangible fixed assets

Tangible 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	- 2-15 years
Office furniture and fittings	- 2-10 years

Assets in the course of construction are not depreciated until they are brought into use

The carrying values of tangible fixed assets are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable

Deferred taxation

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or a right to pay less or to receive more, tax, with the following exception. Deferred tax assets are recognised only to the extent that the Directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted

Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date

Foreign currencies

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction

Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date

All differences are taken to the profit and loss account

Finance lease agreements

Where the Company enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a finance lease. The asset is recorded in the balance sheet as a tangible fixed asset and is depreciated in accordance with the above depreciation policies. Future instalments under such leases, net of finance charges, are included with creditors. Rentals payable are apportioned between the finance element, which is charged to the profit and loss account on a straight line basis, and the capital element which reduces the outstanding obligation for future instalments

Operating lease agreements

Rentals payable under operating leases are charged in the profit and loss account on a straight line basis over the lease term. Lease incentives are recognised over the shorter of the lease term and the date of the next rent review

Pension costs

The Company is a member of a group personal pension scheme. Employees contribute at various rates, which are partially matched by the Company and charged to the profit and loss account as they become payable in accordance with the rules of the scheme.

Notes to the financial statements

at 31 December 2006

1. Accounting policies (continued)

Finance and warrants

Finance secured with the issue of warrants is accounted for in accordance with FRS 25. The finance proceeds are allotted 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.

Employee Benefit Trust

Contribution 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 deducted from the contributions by the Trustees are also charged to the profit and loss account as incurred. Funds unappointed at the balance sheet date are included in the financial statements, although the Company's access to these funds is subject to the agreement of the Trustees of the Trust.

2. Turnover

Turnover arises from the provision of services to client companies in respect of the application of the Company's technology to the client's active materials, and comprises the value of invoiced sales, less value added tax. All turnover arises from continuing activities.

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.

An analysis of turnover by geographical market is given below:

	2006 £	2005 £
United Kingdom	72,000	91,060
USA	76,199	166,200
Europe	18,751	16,877
	<u>166,950</u>	<u>274,137</u>

3. Operating loss

This is stated after charging:

	2006 £	2005 £
Auditors' remuneration - audit services – parent	28,750	17,500
- audit services – subsidiary	25,000	25,000
- taxation services	31,750	–
Research and development - qualify for additional tax allowances	1,674,074	2,500,580
- not qualifying for additional tax allowances	1,461,998	1,900,000
Depreciation of owned fixed assets	69,751	191,597
Depreciation of assets held under finance leases	285,653	175,395
Loss on disposal of fixed assets	98,330	33,539
Operating lease rentals - land and buildings	189,837	401,800
Net loss on foreign currency translation	423	4,534

Notes to the financial statements

at 31 December 2006

4. Staff costs

	2006 £	2005 £
Wages and salaries	1,699,606	1,440,460
Social security costs	190,665	168,843
Other pension costs	87,048	75,254
	<u>1,977,319</u>	<u>1,684,557</u>

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

	2006	2005
Pharmaceutical and technical	27	21
Business development and administration	9	8
	<u>36</u>	<u>29</u>

5. Directors' emoluments

	2006 £	2005 £
Emoluments	<u>321,764</u>	<u>291,750</u>

The amounts in respect of the highest paid Director are as follows

	2006 £	2005 £
Emoluments	<u>162,675</u>	<u>148,572</u>

No pension contributions are made in respect of Directors

6. Employee Benefit Trust

In addition to the Directors' emoluments set out above, £127,500 (2005 - £177,880) 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 £67,400 (2005 - £90,330). The amounts will be chargeable to taxation at the time of distribution.

7. Pensions

The Company contributes to a group personal pension scheme operated by Scottish Widows. The employees contribute at various rates which are partially matched by the Company. The cost to the Company for the year was £87,048 (2005 - £75,254) and has been charged to the profit and loss account. Included in accruals and deferred income is £nil (2005 - £nil) relating to pension contributions unpaid at the balance sheet date.

8. Interest receivable

	2006 £	2005 £
Bank interest receivable	<u>189,220</u>	<u>98,590</u>

Notes to the financial statements

at 31 December 2006

9. Interest payable

	2006 £	2005 £
On bank loans and overdrafts	227	165
Finance charges payable under finance leases	173,164	163,962
Interest on loans from Group undertakings	1,689,890	1,294,049
On other loans	35,954	22,635
	<u>1,899,235</u>	<u>1,480,811</u>

10. Tax**(a) Tax on loss on ordinary activities**

The R&D tax credit is made up as follows

	2006 £	2005 £
<i>Current tax</i>		
UK corporation tax	(401,778)	(600,767)
Total current tax (note 10(b))	<u>(401,778)</u>	<u>(600,767)</u>

(b) Factors affecting current tax credit

The tax assessed on the loss on ordinary activities for the year differs from than the standard rate of corporation tax in the UK of 30% (2005 - 30%) The differences are reconciled below

	2006 £	2005 £
Loss on ordinary activities before taxation	<u>(6,783,182)</u>	<u>(7,112,219)</u>
Loss on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (2005 - 30%)	(2,034,955)	(2,133,666)
Expenditure qualifying for enhanced R&D relief		
Expenses not deductible for tax purposes	300	(2,412)
Group relief surrendered	476,622	331,486
Depreciation in excess of capital allowances	(25,120)	414,857
Losses surrendered to research and development tax credit	502,222	749,781
R&D tax credit claim	(401,778)	(600,767)
Other timing differences	13,555	—
Losses arising in the year not relievable against current tax	1,067,376	639,954
Total current tax (note 10(a))	<u>(401,778)</u>	<u>(600,767)</u>

Notes to the financial statements

at 31 December 2006

10. Tax (continued)

(c) Deferred tax

The deferred taxation asset/(liability) recognised in the financial statements is as follows

	2006 £	2005 £
Accelerated capital allowances	142,976	143,403
Other timing differences	(83,197)	(69,642)
Tax Losses	(59,779)	(73,761)
	<u> </u>	<u> </u>
	-	-

The Company has further tax trading losses of approximately £26m (2005 - £23m) for which no deferred tax is being recognised in the accounts. The deferred tax asset will be realised when the Company has future taxable profits. The asset has not been recognised due to the uncertainties over the timing and nature of such profits.

(d) Factors that may affect future tax charges

The tax losses are available for carry forward and offset against future trading profits for an indefinite period, subject to the agreement of the Inland Revenue and any changes in government tax legislation.

11. Tangible fixed assets

	<i>Leasehold improvements</i> £	<i>Assets in the Course of Construction</i> £	<i>Plant and machinery</i> £	<i>Office furniture and fittings</i> £	<i>Total</i> £
Cost					
At 1 January 2006	902,266	22,120	2,560,017	494,973	3,979,376
Additions	23,495	-	215,830	11,305	250,630
Transfers	-	(22,120)	22,120	-	-
Disposals	-	-	(163,884)	-	(163,884)
At 31 December 2006	<u>925,761</u>	<u>-</u>	<u>2,634,083</u>	<u>506,278</u>	<u>4,066,122</u>
Depreciation					
At 1 January 2006	216,823	-	1,062,027	378,688	1,657,538
Provided during the year	63,887	-	257,735	33,782	355,404
Disposals	-	-	(65,554)	-	(65,554)
At 31 December 2006	<u>280,710</u>	<u>-</u>	<u>1,254,208</u>	<u>412,470</u>	<u>1,947,388</u>
Net book value					
At 31 December 2006	<u>645,051</u>	<u>-</u>	<u>1,379,875</u>	<u>93,808</u>	<u>2,118,734</u>
At 31 December 2005	<u>685,443</u>	<u>22,120</u>	<u>1,497,990</u>	<u>116,285</u>	<u>2,321,838</u>

The net book value of assets above includes an amount of £1,642,148 (2005 - £1,843,829) in respect of assets held under finance leases.

Notes to the financial statements

at 31 December 2006

12. Debtors

	2006 £	2005 £
Trade debtors	107,012	156,762
Other debtors and deposits	306,567	338,708
Prepayments and accrued income	184,269	205,363
Research and development tax credit receivable	401,778	600,767
	<u>999,626</u>	<u>1,301,600</u>

Included within other debtors and deposits is £129,660 (2005 - £173,961) relating to deposits that are repayable in more than one year

13. Share capital

	No	2006 £	No	Authorised 2005 £
Ordinary shares of £0.01 each	458,705,000	<u>4,587,050</u>	458,705,000	<u>4,587,050</u>

	No	2006 £	No	Allotted, called up and fully paid 2005 £
Ordinary shares of £0.01 each	256,188	<u>2,562</u>	256,188	<u>2,562</u>

14. Share Based Payments

The employees of the Company are entitled to options in the Parent Company. In connection with the Initial Public Offering in November 2005, certain options over series D and F ordinary shares in Phoqus Group Limited were surrendered and replaced by options over ordinary shares in Phoqus Group plc under the terms of the share conversion agreement approved by the shareholders. In place of the surrendered options a total of 2,641 new options were granted over the new shares. Under the terms of an agreement in place when the original series F share options were granted, a grant of 1,141,046 options over shares held by the investors was made with an exercise price of 0.01p and vested immediately. In addition a grant of 488,299 options over shares held by the investors was made. All the options were granted with an exercise price of 0.01p and vested immediately. Finally, a grant of 178,570 options was made at an exercise price of 10p and vested immediately. A charge of £232,141 to profit and loss was made to reflect the grant of these options at less than fair value, during the year ended 31 December 2005.

On 10 May 2006, the group granted a total of 668,880 ordinary share options under a Long Term Incentive Plan (LTIP) using New EMI Scheme and the Non-EMI Scheme. These were granted at an exercise price of 10p per share and may be exercised at any point from the date of release at the end of the three year holding period until the tenth anniversary of the date of grant.

Exercisable in ten year period commencing	Class	At 1 January 2006	Granted	Exercised	Surrendered/ Lapsed	At 31 December 2006
November 2005	Ordinary	1,810,556	–	(882,320)	–	928,236
May 2006	Ordinary	–	668,880	–	(106,690)	562,190
		<u>1,810,556</u>	<u>668,880</u>	<u>(882,320)</u>	<u>(106,690)</u>	<u>1,490,426</u>

Notes to the financial statements

at 31 December 2006

14. Share Based Payments (continued)

The following table illustrates the number and weighted average exercise prices (WAEP) of, and movements in, share options during the year

	2006 No	2006 WAEP pence	2005 No	2005 WAEP pence
Outstanding as at 1 January	1,810,556	1 0	—	—
Granted during the year	668,880	10 0	1,810,556	1 0
Forfeited during the year	(106,690)	10 0	—	—
Exercised	(882,320)	1 0 ¹	—	—
Outstanding at 31 December	1,490,426	5 0	1,810,556	1 0

¹The weighted average share price at the date of exercise was £1 40

The weighted average remaining life of all options outstanding at the end of the year was 4 years (2005 2 years). The range of exercise prices is 0 01 pence to 10 pence. The weighted average fair value of the options granted in May 2006 under the group's LTIP scheme was determined using a Monte Carlo model to be 70p. The share-based compensation charge for the year ended 31 December 2006 is £45,000 (2005 £232,000).

The key inputs of the Monte Carlo model are as follows

Life of Option	10 years
Expected volatility	36%
Expected dividends	nil
Risk free interest rate	4 69%
Weighted average share price at grant	£1 59

Given the lack of share price trading the expected volatility was determined by benchmarking against peer companies based on the advice of independent advisors. The expected life of the options is 3 years. The options granted under the group's LTIP scheme in May 2006 have a minimum vesting period of 3 years. It is assumed that once the performance conditions have been met after the initial 3 years, they will be exercised.

15. Reserves

	Share premium account £	Capital redemption reserve £	Capital contribution reserve £	Profit and loss account £
At 1 January 2006	13,714,444	4,580,064	207,711	(34,583,262)
Share-based payment	—	—	45,183	—
Loss for the year	—	—	—	(6,381,404)
At 31 December 2006	13,714,444	4,580,064	252,894	(40,964,666)

Notes to the financial statements

at 31 December 2006

16. Reconciliation of movements in shareholders' funds

	2006 £	2005 £
Loss for the financial year	(6,381,404)	(6,511,452)
Loan Warrants	–	75,000
Share-based payment capital contribution	45,183	–
Opening shareholders' deficit	(16,078,481)	(9,642,029)
Closing shareholders' deficit	<u>(22,414,702)</u>	<u>(16,078,481)</u>

17. Creditors: amounts falling due within one year

	2006 £	2005 £
Other loans	41	41
Obligations under finance leases (note 19)	565,128	473,030
Trade creditors	242,233	455,636
Amounts owed to Group undertakings	16,638	41,982
Other taxation and social security	59,681	52,983
Accruals and deferred income	203,267	235,278
	<u>1,086,988</u>	<u>1,258,950</u>

18. Creditors: amounts falling due after more than one year

	2006 £	2005 £
Obligations under finance leases (note 19)	344,413	845,263
Amounts owed to Group undertakings	28,485,989	24,122,380
	<u>28,830,402</u>	<u>24,967,643</u>

The other loans are secured by a floating charge over the Company's assets and the finance lease over specific assets (note 11)

19. Obligations under finance leases

The maturity of these amounts is as follows

	2006 £	2005 £
Amounts payable		
Within one year	565,128	473,030
In two to five years	344,413	845,263
	<u>909,541</u>	<u>1,318,293</u>

Notes to the financial statements

at 31 December 2006

20. Commitments under operating leases

At 31 December 2006 the Company had annual commitments under non-cancellable operating leases as set out below

	<i>Land and buildings</i>	
	<i>2006</i>	<i>2005</i>
	<i>£</i>	<i>£</i>
Operating leases which expire		
In two to five years	71,970	107,225
In over five years	85,077	82,617
	<u>157,047</u>	<u>189,842</u>

21. Capital commitments

Amounts contracted for but not provided in the financial statements amounted to £5,000 (2005 - £88,480)

22. Related party transactions

During the year the following directors of the parent company were paid by the Company for consultancy services and/or other expenses to the Company over and above their duties as directors

	<i>2006</i>	<i>2005</i>
	<i>£000</i>	<i>£000</i>
ML Bakalı	60	—
J Benjamin	20	—

J Benjamin's fees are paid to Advent Venture Partners

At the end of the year there was a loan to ML Bakalı of £17,000 (2005 - £nil) representing a payment in advance of January fees. There was no outstanding amount at the end of January 2007.

E Moses, a Director of the Company, is also a director of Biofusion plc, a company that has a substantial interest in a joint development agreement with the Company. In the future there may be royalty payments due to the Company but to date no transactions have occurred and there are £nil balances between the two companies (2005 - £nil).

23. Ultimate parent company

The Company's immediate and ultimate parent undertaking is Phoqus Pharmaceuticals plc. Phoqus Pharmaceuticals plc is the smallest and the largest group preparing consolidated financial statements that include the Company. Copies of the consolidated financial statements in which the results of the Company have been included can be obtained from 10 Kings Hill Avenue, Kings Hill, West Malling, Kent, ME19 4PQ.