
PROLYSIS LIMITED

OFFICERS AND ADMINISTRATION

DIRECTORS

Dr S Ruston
Professor J Errington
Dr H F Askew
J S Garner
L T Clay

SECRETARY

Aldwych Secretaries Limited

AUDITORS

Richardsons
Chartered Accountants
30 Upper High Street
Thame
Oxfordshire
OX9 3EZ

SOLICITORS

Manches
3 Worcester Street
Oxford
OX1 2PZ



REGISTERED OFFICE

The Oxford University Begbroke Business and Science Park
Sandy Lane
Yarnton
Oxford
OX5 1PF

COMPANY NUMBER

3548262

PROLYSIS LIMITED

DIRECTORS' REPORT

The directors present their report and accounts for the year ended 31 December 2003.

PRINCIPAL ACTIVITY

The principal activity of the company during the year continued to be that of antimicrobial research.

DIRECTORS AND THEIR INTERESTS

The directors holding office during the period and their interests in the share capital of the company were as follows:

	At 31 December 2003 0.01p Ordinary shares	At 31 December 2002 0.01p Ordinary shares
E Moses (resigned 5/6/03)	-	139,743
H F Askew	-	-
J S Garner	-	-
L T Clay	-	-
S Ruston (appointed 29/4/03)	-	-
J Errington	3,260,000	3,260,000
Share options (granted, not exercised)	650,000	-

Messrs Clay's and Garner's personal interests in the company are held through East Hill University Spinouts III LLC. Messrs Clay and Garner are members of that LLC, the managing member of which is East Hill Advisors. East Hill University Spinouts III LLC is a company focussed on investment in early stage university spinout businesses.

DIRECTORS' RESPONSIBILITIES

Company law requires the directors to prepare accounts for each financial year that give a true and fair view of the state of affairs of the company at the year end and of the profit or loss of the company for that year. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the company will continue in business.

PROLYSIS LIMITED

DIRECTORS' REPORT

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and which enable them to ensure that the accounts 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.

AUDITORS

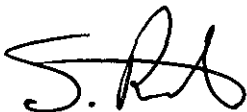
On 1 April 2003, the trade of the company's auditors, Richardsons, a partnership, was transferred to Richardsons Financial Group Limited, a limited company trading as Richardsons. The directors of Prolysis Limited agreed to transfer appointment as the company's auditors from Richardsons, the partnership, to Richardsons, the limited company, in accordance with Section 26 of the Companies Act 1989.

In accordance with Section 385 of the Companies Act 1985, a resolution proposing that Richardsons be reappointed as auditors of the company will be put to the members at the Annual General Meeting.

SMALL COMPANY EXEMPTIONS

The above report has been prepared in accordance with the special provisions of Part VII of the Companies Act 1985 relating to small companies.

Signed on behalf of the Board of Directors



DR S RUSTON
DIRECTOR

13th FEB 2004
.....Date

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF

PROLYSIS LIMITED

We have audited the financial statements of Prolysis Limited for the year ended 31 December 2003, which comprise the profit and loss account, the balance sheet and the related notes 1 to 14. These financial statements have been prepared under the accounting policies set out therein, in accordance with the Financial Reporting Standard for Smaller Entities (effective June 2002) and the historical cost convention.

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

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

As described in the Directors' Report, the company's directors are responsible for the preparation of the financial statements in accordance with applicable law and United Kingdom Accounting Standards.

Our responsibility is to audit the financial statements in accordance with relevant United Kingdom legal and regulatory requirements and Auditing Standards.

We report to you our opinion as to whether the financial statements give a true and fair view and 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.

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

BASIS OF OPINION

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. 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.

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF

PROLYSIS LIMITED

BASIS OF OPINION (CONTINUED)

FUNDAMENTAL UNCERTAINTY

In forming our opinion, we have considered the adequacy of the disclosures made in note 1 of the financial statements concerning the company's ability to continue in operational existence beyond July 2004, the point at which, forecasts indicate, the company's current financial resources will be exhausted. We have also considered the uncertainty of the outcome of the plan to raise additional capital of £8 million by that date. Details of the circumstances relating to this fundamental uncertainty are described in note 1. In view of the significance of this uncertainty we consider that it should be drawn to your attention, but our opinion is not qualified in this respect.

OPINION

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 2003 and of its results for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Richardsons

RICHARDSONS
Chartered Accountants
Registered Auditors

30 Upper High Street
Thame
Oxfordshire
OX9 3EZ

13 February 2004

PROLYSIS LIMITED**PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2003**

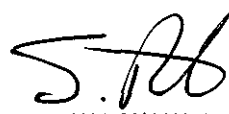
NOTES	<u>2003</u>	<u>2002</u>
2(a) TURNOVER	-	-
Cost of sales	<u>-</u>	<u>-</u>
GROSS PROFIT	-	-
Administrative expenses	(2,215,864)	(1,838,470)
Other operating income	<u>93,618</u>	<u>2,787</u>
3 OPERATING LOSS	(2,122,246)	(1,835,683)
Interest receivable	63,173	11,854
Interest payable	<u>-</u>	<u>(25,123)</u>
LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION	(2,059,073)	(1,848,952)
4 Taxation	<u>204,454</u>	<u>312,020</u>
LOSS ON ORDINARY ACTIVITIES AFTER TAXATION	(1,854,619)	(1,536,932)
Retained loss brought forward	<u>(3,649,525)</u>	<u>(2,112,593)</u>
RETAINED LOSS CARRIED FORWARD	<u>£ (5,504,144)</u>	<u>£ (3,649,525)</u>

The attached notes form part of, and are to be read in conjunction with, these accounts.

PROLYSIS LIMITED**BALANCE SHEET AS AT 31 DECEMBER 2003**

NOTES		<u>2003</u>	<u>2002</u>
FIXED ASSETS			
5	Intangible assets	104,167	187,500
6	Tangible assets	<u>182,885</u>	<u>143,628</u>
		287,052	331,128
CURRENT ASSETS			
7	Debtors	378,109	505,927
	Cash at bank and in hand	<u>1,498,813</u>	<u>2,686,285</u>
		1,876,922	3,192,212
8	CREDITORS: amounts falling due within one year	<u>(421,334)</u>	<u>(477,464)</u>
	NET CURRENT ASSETS	1,455,588	2,714,748
	TOTAL ASSETS LESS CURRENT LIABILITIES	<u>1,742,640</u>	<u>3,045,876</u>
9	CREDITORS: amounts falling due after more than one year	<u>(1,383)</u>	<u>-</u>
	NET ASSETS	<u>£1,741,257</u>	<u>£3,045,876</u>
CAPITAL AND RESERVES			
10	Called up share capital	3,909	3,601
11	Share premium account	6,241,331	5,691,639
11	Capital redemption reserve	1,000,161	1,000,161
11	Profit and loss account	<u>(5,504,144)</u>	<u>(3,649,525)</u>
	SHAREHOLDERS' FUNDS	<u>£1,741,257</u>	<u>£3,045,876</u>

The accounts have been prepared in accordance with the special provisions relating to small companies within Part VII of the Companies Act 1985 and the Financial Reporting Standard for Smaller Entities (effective June 2002).



.....Dr S Ruston - Director 13 FEBRUARY 2004 Date

The attached notes form part of, and are to be read in conjunction with, these accounts.

PROLYSIS LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2003

1. **GOING CONCERN**

Cash flow forecasts for Prolysis Limited, in respect of the year ending 31 December 2004, show that the company's current financial resources are sufficient for the period to the end of July 2004. In order to continue in operational existence past this date, further funds will need to be raised by the company. The directors plan to raise approximately £8 million from a share issue by the end of July 2004.

The financial statements have been prepared on the going concern basis which assumes that the company will continue in operational existence for the foreseeable future. The validity of this assumption depends upon the success of the proposed share issue. The financial statements do not include any adjustments that would result if insufficient funds were available.

Despite the inherent uncertainty as to the outcome of the matter mentioned above, the directors are confident of a successful conclusion, and therefore believe that it is appropriate for the financial statements to be prepared on the going concern basis.

2. **ACCOUNTING POLICIES**

Accounting convention

The accounts are prepared under the historical cost convention, and in accordance with the Financial Reporting Standard for Smaller Entities (effective June 2002) and the accounting policies adopted below.

(a) Turnover

Turnover represents amounts invoiced to third parties, net of VAT and trade discounts.

(b) Intangible fixed assets

Amortisation is provided, on a straight-line basis, at rates calculated to write off the cost, over the expected useful life of each asset as follows:

Concessions

Contractual agreement for discounted FTE rates	3 years
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PROLYSIS LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2003

2. ACCOUNTING POLICIES (CONTINUED)

Accounting convention

(c) Tangible fixed assets and depreciation

Fixed assets are recorded at cost, less depreciation.

Depreciation is provided, on a straight-line basis, at rates calculated to write off the cost, less estimated residual value, over the expected useful life of each asset as follows:

Robot	5 years
Bioinformatics system	3 years
Administration equipment and computers	2 years
Laboratory equipment	5 years
Leasehold Improvements	5 years
Furniture	4 years

(d) Research and development

Expenditure on research and development is written off in the year in which it is incurred.

(e) Leasing and hire purchase commitments

Assets held under finance leases and hire purchase contracts, which are those where substantially all the risks and rewards of ownership of the asset have passed to the company, are capitalised in the balance sheet and are depreciated over their useful lives. The corresponding lease or hire purchase obligation is treated in the balance sheet as a liability.

The interest element of the rental obligations is charged to the profit and loss account over the period of the lease and represents a constant proportion of the balance of capital repayments outstanding.

Rentals paid under operating leases are charged to income on a straight line basis over the lease term.

(f) Pensions

The company operates a defined contribution pension scheme covering certain employees. Contributions are charged to the profit and loss account as they become payable in accordance with the rules of the scheme. The assets of the scheme are held separately from those of the company in an independently administered fund.

(g) Government grants

Government grants of a revenue nature are related to research in applied genomics. They are credited to laboratory operating costs in the profit and loss account in the period in which they are incurred and discharged.

These notes form part of, and are to be read in conjunction with, the attached accounts.

PROLYSIS LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2003

2. ACCOUNTING POLICIES (CONTINUED)

Accounting convention

(h) Deferred taxation

Deferred tax arises as a result of including items of income and expenditure in taxation computations in periods different from those in which they are included in the company's accounts. Deferred tax is provided in full on timing differences which result in an obligation to pay more (or less) tax at a future date, at the average tax rates that are expected to apply when the timing differences reverse, based on current tax rates and laws. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

3. OPERATING LOSS

2003

2002

This is stated after charging/(crediting):

Auditors' remuneration	5,100	4,950
Directors' emoluments	166,176	84,824
Pension costs	32,218	23,602
Operating lease rentals – land and buildings	62,412	58,354
Rent received	-	(2,787)
Government grants received	(192,470)	(27,704)
Other grants received	(93,618)	-
Amortisation	83,333	62,500
Depreciation (owned assets)	90,649	91,257
Depreciation (leased assets)	<u>207</u>	<u>-</u>

4. TAXATION

Taxation for the year ended 31 December 2003 is (£204,454) (2002: (£312,020)) comprising a Research & Development tax credit in respect of the accounting period ended 31 December 2003 for (£204,072) and an under accrual of the Research & Development tax credit in respect of the accounting period ended 31 December 2002 for (£382).

PROLYSIS LIMITED**NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2003**

5. INTANGIBLE FIXED ASSETS

	<u>Concessions</u>
COST:	
At 1 January 2003	250,000
Acquired during the year	-
At 31 December 2003	<u>£ 250,000</u>
AMORTISATION:	
At 1 January 2003	62,500
Provided during the year	<u>83,333</u>
At 31 December 2003	<u>£ 145,833</u>
NET BOOK VALUE:	
At 31 December 2003	<u>£ 104,167</u>
At 31 December 2002	<u>£ 187,500</u>

"Concessions" relates to discounted FTE rates received by the company in a three-year contractual relationship with EVOTEC OAI Limited that started in April 2002.

6. TANGIBLE FIXED ASSETS

	<u>Plant and Machinery</u>	<u>Leasehold Improvements</u>	<u>Furniture</u>	<u>Total</u>
COST:				
At 1 January 2003	1,067,005	204,444	5,857	1,277,306
Additions	<u>116,914</u>	<u>8,318</u>	<u>4,881</u>	<u>130,113</u>
At 31 December 2003	<u>£1,183,919</u>	<u>£ 212,762</u>	<u>£ 10,738</u>	<u>£1,407,419</u>
DEPRECIATION:				
At 1 January 2003	987,119	141,969	4,590	1,133,678
Provided during the year	<u>47,747</u>	<u>41,276</u>	<u>1,833</u>	<u>90,856</u>
At 31 December 2003	<u>£1,034,866</u>	<u>£ 183,245</u>	<u>£ 6,423</u>	<u>£1,224,534</u>
NET BOOK VALUE:				
At 31 December 2003	<u>£ 149,053</u>	<u>£ 29,517</u>	<u>£ 4,315</u>	<u>£ 182,885</u>
At 31 December 2002	<u>£ 79,886</u>	<u>£ 62,475</u>	<u>£ 1,267</u>	<u>£ 143,628</u>

The net book value of fixed assets above includes an amount of £2,559 (2002: £nil) in respect of assets held under hire purchase contracts.

These notes form part of, and are to be read in conjunction with, the attached accounts.

PROLYSIS LIMITED**NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2003**

7. DEBTORS	<u>2003</u>	<u>2002</u>
Other debtors	350,223	479,543
Prepayments and accrued income	<u>27,886</u>	<u>26,384</u>
	<u>£ 378,109</u>	<u>£ 505,927</u>

The aggregate amount of debtors due after more than one year is £31,206 (2002: £31,206).

8. **CREDITORS:** amounts falling due within one year

Obligations under finance leases and hire purchase contracts	922	-
Trade creditors	377,231	413,470
Other taxes and social security costs	16,787	12,404
Other creditors	3,210	436
Accruals	<u>23,184</u>	<u>51,154</u>
	<u>£ 421,334</u>	<u>£ 477,464</u>

Included in "Other creditors" is £3,210 (2002: £436), relating to amounts due to the defined contribution pension scheme.

9. **CREDITORS:** amounts falling due after one year

Obligations under finance leases and hire purchase contracts	<u>£ 1,383</u>	<u>£ -</u>
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PROLYSIS LIMITED**NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2003**

10. SHARE CAPITAL20032002Authorised

50,770,000 ordinary shares of 0.01p each £ 5,077 £ 5,077

Issued

	<u>Number</u>		<u>Number</u>
Ordinary shares of 0.01p each	<u>39,088,509</u>	£ <u>3,909</u>	<u>36,014,170</u> £ <u>3,601</u>

Issued and fully paid

	<u>Number</u>		<u>Number</u>
Ordinary shares of 0.01p each	<u>39,088,509</u>	£ <u>3,909</u>	<u>34,150,341</u> £ <u>3,415</u>

During the year, 3,074,339 ordinary shares of 0.01p each with an aggregate nominal value of £307.43 were issued and fully paid up for cash of £550,000.

During the year, 6,390,235 warrants to subscribe for up to 25,560,940 ordinary shares were issued and 6,174,913 warrants were cancelled. The conditions of the warrant allow for up to 4 shares to be subscribed at a price of £0.1789 per 0.01p ordinary share at any time up to 8 November 2007. The rights of the shares will rank pari passu with existing shares in issue.

The company has granted the following options under its Employee Share Option Scheme:

Year of Grant	No. of 0.01p shares granted	Exercise price
2003	1,551,400	7p
2001	337,200	0.01p

The options are exercisable between April 2003 and December 2013. No share options have been exercised to date.

These notes form part of, and are to be read in conjunction with, the attached accounts.

PROLYSIS LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2003

11. MOVEMENTS IN RESERVES

	Share Capital	Share Premium	Capital Redemption	Profit and Loss
At 1 January 2003	3,601	5,691,639	1,000,161	(3,649,525)
Loss for the financial period	-	-	-	(1,854,619)
Issue of shares	308	-	-	-
Premium on issue of shares	-	549,692	-	-
At 31 December 2003	<u>£ 3,909</u>	<u>£6,241,331</u>	<u>£1,000,161</u>	<u>£(5,504,144)</u>

12. OTHER FINANCIAL COMMITMENTS

At 31 December 2003, the company had annual commitments under non-cancellable operating leases as set out below:

	<u>2003</u>	<u>2002</u>
Operating leases, which expire: within two to five years	<u>£ 62,412</u>	<u>£ 58,314</u>

13. CONTROL AND RELATED PARTY TRANSACTIONS

The company is not under the control of any individual or company.

14. DEFERRED TAXATION

At 31 December 2003 the company had a net unprovided deferred tax asset of £760,410 (2002: £531,288). The net deferred tax asset at 31 December 2003 is composed of a deferred tax asset of £757,214 arising from trading losses carried forward and a deferred tax asset of £3,196 in respect of accelerated depreciation.

No provision for the net deferred tax asset has been made at 31 December 2003 on the grounds of uncertainty over its recoverability in light of the nascent revenue streams and commitment to continued investment in research and development.