3625145

Solexa Limited

Report and Financial Statements

31 December 2005

Registered No: 3625145

Directors
S D Allen
S Balasubramanian
T Rink
A Smith
J West

Secretary
L Palmer

Auditors
Ernst & Young LLP
Compass House
80 Newmarket Road
Cambridge
CB5 8DZ

Bankers
Barclays Bank plc
28 Chesterton Road
Cambridge
CB4 3UT

Registered office
Chesterford Research Park
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Directors' report

The directors present their report and financial statements for the year ended 31 December 2005.

Results and dividends

The loss for the year amounted to £9,093,390 (2004: £5,473,429 – as restated). The directors do not recommend the payment of an ordinary dividend.

Principal activities and review of the business

The principal activity of the company during the year was the development of novel techniques for the analysis of DNA.

Future developments

The Company is currently investing in research and development. The directors regard investments in this area as a prerequisite for success in the medium to long-term future.

Research and development

Expenditure on research and development during the year amounted to £9,201,400 (2004: £3,966,060), all of which has been written off to the profit and loss account.

Directors and their interests

The directors at 31 December 2005 and their interests in the share capital of the company and its parent were as follows:

Solexa Ltd	*Ordinary Shares of 0.25p each*	*At 31 December 2005*	*At 1 January 2005*
S Balasubramanian		–	212,500
T Rink		–	40,000
A Smith		–	–
S D Allen		–	–
J West		–	–

Solexa Inc.	*Common Stock of $0.01 each*	*At 31 December 2005*	*At 1 January 2005*
S Balasubramanian		95,037	–
T Rink		17,889	–
A Smith		–	–
S D Allen		–	–
J West		–	–

In addition, the following who served as directors of the company resigned during the year:
M Carthy (resigned 19 April 2005)
T Daniel (resigned 19 April 2005)
H Hauser (resigned 19 April 2005)
G Lloyd-Harris (resigned 19 April 2005)

Directors' report (continued)

The following Directors had interests in options over the ordinary share capital of the company and of its parent company as follows:

Solexa Ltd		*Exercise Price*	*At 31 December 2004 No.*	*Exchanged for options over Solexa Inc. Stock No.*	*Granted During The year No.*	*At 31December 2005 No.*
T Rink	(1)	100p	50,000	50,000	–	–
A Smith	(2)	41p	20,000	20,000	–	–
	(2)	100p	100,000	100,000	–	–
	(3)	30p	80,000	80,000	–	–
			200,000	200,000	–	–
S Allen	(4)	54p	20,000	20,000	–	–
J West	(5)	30p	696,981	696,981	–	–

Solexa Inc.		*Exercise Price*	*At 31 December 2004 No.*	*Exchanged for options over Solexa Ltd Stock No.*	*Granted during the year No.*	*At 31 December 2005 No.*
T Rink	(1)	$4.27	–	22,185	–	22,185
A Smith	(2)	$1.75	–	8,863	–	8,863
	(2)	$4.27	–	44,318	–	44,318
	(3)	$1.28	–	35,466	–	35,466
	(6)	$5.97	–	–	88,000	88,000
			–	88,647	88,000	176,647
S Allen	(4)	$2.31	–	8,874	–	8,874
	(7)	$5.97	–	–	20,000	20,000
			–	8,874	20,000	28,874
J West	(5)	$1.28	–	309,353	–	309,353
	(8)	$6.39	–	–	600,000	600,000
			–	309,353	600,000	909,353
S Balasubramanian	(9)	$5.97	–	–	40,000	40,000

(1) Exercisable between 01 August 2003 and 28 November 2011.
(2) Exercisable between 28 January 2003 and 02 December 2012.
(3) Exercisable between 1 April 2005 and 10 September 2011.
(4) Exercisable between 28 January 2007 and 27 January 2014.
(5) Exercisable between 7 August 2007 and 6 August 2014.
(6) Exercisable between 6 September 2005 and 6 September 2015.
(7) Exercisable between 6 September 2005 and 6 September 2015.
(8) Exercisable between 9 May 2005 and 9 May 2015.
(9) Exercisable between 6 September 2005 and 6September 2015.

Directors' report (continued)

None of the Directors exercised any options over the company's, or the parent company's, share capital during the year.

Directors' and officers' indemnity insurance

The company has taken out insurance to indemnify, against third party proceedings, the directors of the company whilst serving on the board of the company and of any subsidiary, associate or joint venture. This cover, together with that taken out by certain subsidiaries, where relevant, indemnifies all employees of the group who serve on the boards of all subsidiaries, associates and joint ventures. These indemnity policies subsisted throughout the year and remain in place at the date of this report.

Statement as to disclosure of information to auditors

The directors, who were members of the board at the time of approving this report, are listed on page 2. Having made enquiries of fellow directors and of the company's auditors, each of these directors confirms that:

- to the best of his knowledge and belief, there is no information relevant to the preparation of this report of which the company's auditors are unaware; and
- he has taken all the steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the company's auditors are aware of that information.

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

L Palmer
Secretary

21 Nov. 2006

Statement of directors' responsibilities in respect of the financial statements

The directors are responsible for preparing this report and the accounts in accordance with applicable law and 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 period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts; 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 Solexa Limited

We have audited the company's financial statements for the year ended 31 December 2005 which comprise the Profit and Loss Account, Statement of Total Recognised Gains and Losses, Balance Sheet and the related notes 1 to 21. 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 Solexa 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 2005 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP

Ernst & Young LLP
Registered Auditor
Cambridge

21 November 2006

Profit and loss account

for the year ended 31 December 2005

	Notes	2005 £	Restated* 2004 £
Turnover	2	43,420	52,175
Administrative expenses		10,291,051	5,574,763
Operating loss	3	(10,247,631)	(5,522,588)
Interest receivable and similar income	6	238,475	222,334
Interest payable and similar charges	7	(815,949)	(673,175)
		(577,474)	450,841
Loss on ordinary activities before taxation		(10,825,105)	(5,973,429)
Tax on loss on ordinary activities	8	1,731,715	500,000
Loss for the financial year		(9,093,390)	(5,473,429)

* Restated on implementation of the presentational requirements of FRS 25 "Financial Instruments: Disclosure and Presentation" (see note 20).

Statement of total recognised gains and losses

	Notes	2005 £	Restated* 2004 £
Loss for the financial year		(9,093,390)	(5,473,429)
Total recognised gains and losses relating to the year		(9,093,390)	(5,473,429)
Prior year adjustment	20	(669,705)	
Total gains and losses since last annual report		(9,763,095)	

* Restated on implementation of the presentational requirements of FRS 25 "Financial Instruments: Disclosure and Presentation" (see note 20).

Balance sheet
at 31 December 2005

	Notes	2005 £	*Restated** 2004 £
Fixed assets			
Intangible assets	9	849,388	1,008,648
Tangible assets	10	565,498	523,665
		1,414,886	1,532,313
Current assets			
Debtors	11	3,765,900	2,283,726
Cash at bank		8,873,704	5,430,672
		12,639,604	7,714,398
Creditors: amounts falling due within one year	12	13,676,822	758,112
Net current (liabilities)/assets		(1,037,218)	6,956,286
Total assets less current liabilities		377,668	8,488,599
Creditors: amounts falling due after more than one year			
Obligations under finance leases	13	25,290	2,234
Liability element of preferred shares	13	–	7,188,168
		352,378	1,298,197
Capital and reserves			
Called up share capital	18	30,224	18,512
Share premium account	19	22,329,961	14,194,102
Equity element of preferred shares	19	–	1,481,537
Profit and loss account	19	(22,007,807)	(14,395,954)
		352,378	1,298,197

* Restated on implementation of the presentational requirements of FRS 25 "Financial Instruments: Disclosure and Presentation" (see note 20).

FRS 25 requires capital instruments to be reported in accordance with the substance of the contractual arrangements entered into. Accordingly, an element in relation to the 'B' Preferred shares was reclassified within liabilities in 2004. However, legally this capital instrument gives rise to share capital and share premium and if presented as such called up share capital and share premium would have been £29,623 and £22,182,991 respectively in 2004. The 'B' preferred shares were converted to ordinary shares in 2005.

A Smith
Director

21 November 2006

Notes to the financial statements
at 31 December 2005

1. Accounting policies

Basis of preparation

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

The financial statements have been prepared on a going concern basis, which assumes that the Company will continue in operational existence for the foreseeable future. During the year the Company incurred a loss of £9,093,390 (2004: £5,473,429 – as restated), and had net assets of £352,378 (2004: net assets of £1,298,197 – as restated).

The validity of the going concern assumption depends on the continued financial support from the parent company Solexa, Inc. The company has obtained confirmation that adequate funding will be made available to enable the company to discharge its liabilities as they fall due. With this support in place, the directors believe that it is appropriate for the financial statements to be prepared on a going concern basis. In the event that continued financial support from Solexa, Inc. did not continue then the going concern basis of preparation of the financial statements would no longer be appropriate and adjustments would have to be made to reduce the balance sheet values of assets to their recoverable amounts, to provide for further liabilities that might arise and to reclassify fixed assets and long term liabilities as current assets and liabilities.

Cash flow statement

The company has taken advantage of the concession in FRS 1 "Cash Flow Statements" which exempts a company from the requirement to prepare a statement of cash flows on the grounds that the company is small as defined in companies legislation.

Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the company after deducting all of its liabilities. All charges associated with financial liabilities are classified within finance charges.

Preferred convertible redeemable shares

'B' Preferred convertible redeemable shares are regarded as compound financial instruments, consisting of a liability component and an equity component. At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for a similar instrument without a conversion feature. The difference between the proceeds of issue of the preferred convertible redeemable shares and the fair value assigned to the liability component, representing the embedded option to convert the liability into equity of the company, is included in equity. The unwinding of the value of the equity option is accreted through interest payable and similar charges to maturity such that the liability at the point of repayment equals the redemption amount.

Finance costs

Finance costs of debt are recognised in the profit and loss account over the term of such instruments at a constant rate on the carrying amount. An estimate is made by the directors of the company as to what constitutes an appropriate interest rate.

Research and development

Research and development expenditure, including patent costs, is written off in the year in which it is incurred.

Intangible assets

Intangible assets acquired separately from a business are capitalised at cost. Intangible assets acquired as part of an acquisition of a business are capitalised separately from goodwill if the fair value can be measured reliably on initial recognition, subject to the constraint that, unless the asset has a readily ascertainable market value, the fair value is limited to an amount that does not create or increase any negative goodwill arising on the acquisition. Intangible assets created within the business are not capitalised and expenditure is charged against profits in the year in which it is incurred.

Notes to the financial statements
at 31 December 2005

Intangible assets (continued)
Intangible assets are amortised on a straight line basis over their estimated useful lives up to a maximum of 20 years. The carrying value of intangible assets is reviewed for impairment at the end of the first full year following acquisition and in other periods if events or changes in circumstances indicate the carrying value may not be recoverable.

Fixed assets
All fixed assets are initially recorded at cost.
Depreciation
Depreciation is provided on all tangible fixed assets, at rates calculated to write off the cost, less estimated residual value based on prices prevailing at the date of acquisition of each asset evenly over its expected useful life, as follows:

Leasehold property	-	Over the shorter of the lease term and the estimated useful life
Laboratory equipment	-	Over 4 years
Office equipment	-	Over 4 years
Computer equipment	-	Over 3 to 4 years

The carrying values of tangible fixed assets are reviewed for impairment in periods if events or changes in circumstances indicate the carrying value may not be reasonable.

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 exceptions:

- provision is made for tax on gains arising from the revaluation (and similar fair value adjustments) of fixed assets, and gains on disposal of fixed assets that have been rolled over into replacement assets, only to the extent that, at the balance sheet date, there is a binding agreement to dispose of the assets concerned. However, no provision is made where, on the basis of all available evidence at the balance sheet date, it is more likely than not that the taxable gain will be rolled over into replacement assets and charged to tax only where the replacement assets are sold;

- 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.

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 an actuarial 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.

Pension costs
The company operates a defined contribution pension scheme. Contributions are charged in 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 2005

Adoption of Financial Reporting Standard 25

In preparing the financial statements for the current year, the company has adopted Financial Reporting Standard 25 – "Financial Instruments: Disclosure and Presentation" ("FRS 25").
Prior to 1 January 2005, preferred convertible redeemable shares were included within shareholders' funds. From 1 Janaury 2005, FRS 25 requires such compound financial instruments to be split into debt and equity components. At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for similar non-convertible debt. The difference between the proceeds of issue of the preferred convertible redeemable shares and the fair value assigned to the liability component, representing the embedded option to convert the liability into equity of the company, is included in equity. The change in accounting policy has resulted in a prior year adjustment for the company (see note 20). The impact of which has been to reduce the company's shareholders' funds at 31 December 2004 by £7,188,168.

2. Turnover

Turnover, which is stated net of value added tax, represents amounts invoiced to third parties. Turnover is attributable to one continuing activity, the use of the NMR machine.

An analysis of turnover by geographical market is given below:

	2005	*2004*
	£	*£*
United Kingdom	43,420	52,175

3. Operating loss

This is stated after charging/(crediting):

		2005	*2004*
		£	*£*
Auditors' remuneration	- audit services	78,250	7,750
	- non-audit services	21,815	7,825
Research and development expenditure written off		9,201,400	3,966,060
Depreciation of owned fixed assets		423,455	331,810
Depreciation of assets held under finance leases		27,076	11,166
Amortisation of intangible fixed assets		159,260	106,173
Operating lease rentals	- land and buildings	176,356	159,774
	- plant and machinery	2,013	1,996

Notes to the financial statements
at 31 December 2005

4. Staff costs

	2005	*2004*
	£	*£*
Wages and salaries	2,562,296	2,151,274
Social security costs	278,017	231,760
Other pension costs (note 15)	229,540	192,176
	3,069,853	2,575,210

The monthly average number of employees during the year was as follows:

	2005	*2004*
	No.	*No.*
Administrative staff	6	6
Research and development	55	46
	61	52

5. Directors' emoluments

	2005	*2004*
	£	*£*
Emoluments	312,499	461,178
Value of company pension contributions to money purchase schemes	14,000	21,525

	2005	*2004*
	No.	*No.*
Members of money purchase pension schemes	1	2

The amounts in respect of the highest paid director are as follows:

	2005	*2004*
	£	*£*
Emoluments	140,000	142,660
Value of company pension contributions to money purchase schemes	14,000	12,766

6. Interest receivable

	2005	*2004*
	£	*£*
Interest received on treasury deposits	110,266	222,334
Interest from group undertakings	128,209	–
	238,475	222,334

Notes to the financial statements
at 31 December 2005

7. Interest payable and similar charges

	2005 £	Restated 2004 £
Finance charges payable under finance leases	4,117	3,470
Accretion of equity option on 'B' Preferred shares	811,832	669,705
	815,949	673,175

8. Taxation on ordinary activities
(a) Tax on loss on ordinary activities

The tax credit is made up as follows:

	2005 £	2004 £
Current tax:		
Research and development tax credit	(1,731,715)	(500,000)
Total current tax (note 8(b))	(1,731,715)	(500,000)

(b) Factors affecting current tax credit

The differences are reconciled below:

	2005 £	Restated 2004 £
Loss on ordinary activities before tax	(10,825,105)	(5,973,429)
Loss on ordinary activities multiplied by the standard rate of tax of 30%	(3,247,531)	(1,792,029)
Effect of:		
Expenses not deductible for tax purposes	266,188	213,789
Losses arising in the year not relievable against current tax	1,881,764	1,839,587
Capital allowances in (arrears)/advance of depreciation	(4,849)	(261,347)
Adjustments in respect of prior periods	(691,821)	–
Research and development tax credit – current year	(1,039,894)	(500,000)
Other timing differences	(4,609)	–
Enhanced R&D deduction	(839,201)	–
Losses surrendered for R&D Tax Credit	1,948,238	–
Total current tax (note 8(a))	(1,731,715)	(500,000)

Notes to the financial statements
at 31 December 2005

8. Taxation on ordinary activities (continued)

(c) Factors that may affect future tax charges

The company has tax losses arising in the UK of £13,943,633 (2004: £11,300,418) that are available indefinitely for offset against future taxable profits. Deferred tax assets have not been recognised in respect of these losses on the basis that the company is still investing heavily in research and development and, as a result, the company is uncertain as to when these losses will be used. The company has surrendered an element of their losses relating to research and development in exchange for the payment of a tax credit. The company anticipates that similar surrenders will be made in the future.

(d) Deferred tax

The elements of deferred taxation, which result in a nil balance at the end of the year, together with details of other amounts not provided for, are as follows:

		2005		*2004*
	Provided	*Not provided*	*Provided*	*Not provided*
	£	*£*	*£*	*£*
Depreciation in advance of capital allowances	161,852	–	459,597	–
Tax losses available	(152,252)	(4,030,838)	(450,189)	(2,939,937)
Short term timing differences	(9,600)	–	(9,408)	–
Provision for deferred taxation	–	(4,030,838)	–	(2,939,937)

9. Intangible fixed assets

	Intellectual property
	£
Cost:	
At 1 January 2005 and 31 December 2005	1,114,821
Amortisation:	
At 1 January 2005	106,173
Provided during the year	159,260
At 31 December 2005	265,433
Net book value:	
At 31 December 2005	849,388
At 1 January 2005	1,008,648

Notes to the financial statements
at 31 December 2005

10. Tangible fixed assets

	Land and buildings Leasehold Property £	Assets under construction £	Laboratory Equipment £	Office Equipment £	Computer Equipment £	Total £
Cost:						
At 1 January 2005	165,089	–	1,134,208	63,237	266,917	1,629,451
Additions	57,831	25,000	327,315	15,914	66,304	492,364
At 31 December 2005	222,920	25,000	1,461,523	79,151	333,221	2,121,815
Depreciation:						
At 1 January 2005	144,763	–	729,096	45,973	185,954	1,105,786
Provided during the year	77,491	–	290,510	16,639	65,891	450,531
At 31 December 2005	222,254	–	1,019,606	62,612	251,845	1,556,317
Net book value:						
At 31 December 2005	666	25,000	441,917	16,539	81,376	565,498
At 1 January 2005	20,326	–	405,112	17,264	80,963	523,665

The net book value of assets above includes an amount of £75,006 (2004: £16,750) in respect of assets held under finance leases.

11. Debtors

	2005 £	*2004* £
Trade debtors	3,525	12,810
Amounts owed by group undertakings	2,611,854	–
Loan to Lynx Therapeutics Inc.*	–	1,297,623
Other debtors	1,118,241	647,761
Prepayments and accrued income	32,280	325,532
	3,765,900	2,283,726

* On 8 March 2005, a merger agreement was completed between the company and Lynx Therapeutics Inc.

Notes to the financial statements
at 31 December 2005

12. Creditors: amounts falling due within one year

	2005	*2004*
	£	*£*
Obligations under finance leases (note 14)	18,107	12,138
Trade creditors	281,560	424,109
Amounts owed to group undertakings	12,681,709	–
Other taxation and social security	74,683	69,936
Pension creditor	–	21,718
Accruals and deferred income	620,763	230,211
	13,676,822	758,112

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

		*Restated**
	2005	*2004*
	£	*£*
Obligations under finance leases (note 14)	25,290	2,234
Liability component of 'B' Preferred shares	–	7,188,168
	25,290	7,190,402

* Restated on implementation of the presentational requirements of FRS 25 "Financial Instruments: Disclosure and Presentation" (see note 20).

14. Obligations under finance leases
The maturity of these amounts is as follows:

	2005	*2004*
	£	*£*
Amounts payable:		
Within one year	21,397	13,692
In two to five years	27,139	2,282
	48,536	15,974
Less: finance charges allocated to future periods	(5,139)	(1,602)
	43,397	14,372
Finance leases are analysed as follows:		
Current obligations (note 12)	18,107	12,138
Non-current obligations (note 13)	25,290	2,234
	43,397	14,372

15. *Pensions*
The company operates a Group Personal Pension Plan with defined contributions, managed by The Prudential, for all its directors and employees. The assets of the scheme are held separately from those of the Company in an independently administered fund. There are no contributions outstanding at the year-end (2004: £21,718).

Notes to the financial statements
at 31 December 2005

16. Commitments under operating leases

At 31 December 2005 the company had annual commitments under non-cancellable operating leases as set out below:

	Land and buildings	
	2005	*2004*
	£	*£*
Operating leases which expire:		
Within one year	–	96,146

17. Capital Commitments

At 31 December 2005 the company had capital commitments of £nil (2004: £172,616).

18. Share capital

		Authorised
	2005	*2004*
	£	*£*
Ordinary shares of £0.0025 each	34,849	11,071
'A' Ordinary shares of £0.0025 each	–	12,667
'B' Preferred shares of £0.25p each	–	11,111
	34,849	34,849
FRS 25 Reclassification (see note 1)		
Liability element of 'B' Preferred shares	–	(11,111)
	34,849	23,738

			Allotted and called up	
		2005		*2004*
	No.	*£*	*No.*	*£*
Ordinary shares of £0.0025 each	12,089,515	30,224	2,338,138	5,845
'A' Ordinary shares of £0.0025 each	–	–	5,066,669	12,667
'B' Preferred shares of £0.25p each	–	–	4,444,444	11,111
		30,224		29,623
FRS 25 Reclassification (see note 1)				
Liability element of 'B' Preferred shares		–		(11,111)
		30,224		18,512

During the year the company issued 240,264 ordinary shares with an aggregate nominal value of £601 for cash of £135,091, on the exercise of share options.

On 30 June 2005 the A ordinary shares and B preferred shares were converted to ordinary shares at a ratio of 1:1.

During the year, following the merger with Lynx Therapeutics Inc. (Solexa Inc.), the share options over Solexa Ltd ordinary shares were exchanged for options over Solexa Inc. common stock.

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at 31 December 2005

18. Share capital (continued)

As at 31 December 2005, all share capital is in the form of ordinary shares. The rights of the ordinary shares, and of the A ordinary and B preferred shares that were in existence during the year, are set out below:

Ordinary shares, 'A' ordinary shares and 'B' preferred shares

Each Ordinary and 'A' ordinary share entitles the holder to one vote on all matters submitted to a vote of the Company's shareholders. Each 'B' preferred share entitles the holder to one vote for every ordinary share into which the 'B' preferred shares are convertible. When a dividend is declared by the Board, all 'A' ordinary and 'B' preferred shareholders are entitled to receive a fixed dividend accruing at a rate of 8% per annum (accruing on a daily basis and calculated on a simple and not compounded basis). The dividend payable to holders of the 'B' preferred shares is in priority to the dividend payable to the holders of the 'A' ordinary shares, which in turn is in priority to any dividend which the Board may declare as payable to the holders of all Ordinary shares. To date, no dividends have been declared.

In the event of liquidation of the Company, the return of assets to Ordinary shareholders shall be applied in the following order of priority:

1. First in paying to the holders of the 'B' preferred shares the greater of a) 1.5 times the subscription price paid by them per share together with an amount equal to any arrears or accruals of dividends on the 'B' preferred shares and b) an amount equal to any arrears or accruals of dividends on the 'B' preferred shares together with the amount which the holders would receive if their 'B' preferred shares had been converted into Ordinary shares immediately prior to such liquidation.

2. Second in paying to the holders of the 'A' ordinary shares the greater of a) the subscription price paid by them per share (£3) together with an amount equal to any arrears or accruals of dividends on the 'A' ordinary shares and b) an amount equal to any arrears or accruals of dividends on the 'A' ordinary shares, the amount which the holders would receive if their 'A' ordinary shares had been converted into Ordinary shares immediately prior to such liquidation on a one to one basis.

3. Third in paying to the holders of the Ordinary shares any remaining capital after payment of all outstanding liabilities.

Any holder of 'A' ordinary shares may require the Company to convert their 'A' ordinary shares into Ordinary shares on a one to one basis. Any holder of 'B' preferred shares may require the Company to convert their 'B' preferred shares into Ordinary shares at a ratio of one Ordinary share for each 'B' preferred share. This ratio may be adjusted if additional shares are issued by the Company in accordance with anti-dilution provisions.

In the event of a merger and/or consolidation of the Company or an acquisition of or by the Company, which results in the shareholders receiving at least 40% of the nominal share capital and at least 40% of the voting control in the surviving or succeeding entity the shareholders shall be entitled, immediately prior to or upon the completion of such event, to the following:

a) In the case of the 'B' preferred Shareholders, at the election of the 'B' Majority and in priority to all other Shareholders, either:
    i. to receive, pro rata, the number of equity securities of the surviving entity determined by multiplying the sum of the subscription price paid for the 'B' preferred shares plus the per share arrears accrued on or after January 1, 2005 by the number of outstanding 'B' preferred shares and by 1.25 and dividing the result by the per share price of the equity securities issued in the merger provided, that the maximum number of equity securities issuable shall not exceed the aggregate number of equity securities issued to all other shareholders calculated on a fully-diluted basis, as if all 'A' ordinary shares, all 'B' preferred shares and all convertible securities had been fully converted into ordinary shares and any outstanding options had been fully exercised; or

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18. Share capital (continued)

ii. to have each 'B' preferred share held converted into 1.25 ordinary shares; then

b) In the case of the 'A' ordinary shareholders, at the election of 51% of the 'A' ordinary shareholders, either:

i. to receive, pro rata, the number of equity securities of the surviving entity determined by multiplying the sum of the 'A' ordinary subscription price for each such share plus the per share arrears accrued on or after January 1, 2005 by the number of outstanding 'A' ordinary shares, and by dividing the result by the per share price of the equity securities issued in the merger provided, however, that the maximum number of equity securities issuable shall not exceed four times the aggregate number of the equity securities issued in such a merger to the holders or ordinary shares calculated on a fully-diluted basis, as if all 'A' ordinary shares, all 'B' preferred shares and all convertible securities had been fully converted into ordinary shares any outstanding options had been fully exercised; or

ii. to have converted into, and re-designated as, ordinary shares at a rate of one ordinary share per each 'A' ordinary share held; then

c) In the case of the ordinary shareholders, the remaining equity securities of the surviving entity that are distributable to the shareholders of the Company.

As regards redemption any 'B' preferred shareholder subject to approval by the Investor Majority may request in writing that the Company redeem on or after July 31, 2010 all of their 'B' preferred shares as a cash amount equivalent to the greater of either (i) the subscription price paid by that shareholder plus the arrears, or (ii) the fair value of the 'B' preferred shares being redeemed.

19. Reconciliation of shareholders' funds and movement on reserves

	Share capital	*Share premium account*	*Equity element of preferred shares*	*Profit and loss account*	*Total share-holders' funds*
	£	*£*		*£*	*£*
At 1 January 2004	15,845	14,307,706	–	(8,922,525)	5,401,026
Loss for the year – restated*	–	–	–	(5,473,429)	(5,473,429)
Equity element of issued B preferred shares – restated*	–	–	1,481,537	–	1,481,537
Bonus issue	2,667	(2,667)	–	–	–
Fundraising expenses	–	(110,937)	–	–	(110,937)
At 31 December 2004 – restated*	18,512	14,194,102	1,481,537	(14,395,954)	1,298,197
Loss for the year	–	–	–	(9,093,390)	(9,093,390)
Conversion of B preferred shares	11,111	7,988,889	–	–	8,000,000
Reserve reclassification	–	–	(1,481,537)	1,481,537	–
Share Options	601	146,970	–	–	147,571
At 31 December 2005	30,224	22,329,961	–	(22,007,807)	352,378

* Restated on implementation of the presentational requirements of FRS 25 "Financial Instruments: Disclosure and Presentation" (see note 20).

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20. Prior year adjustment

With effect from 1 May 2005, the company adopted the presentational requirements of FRS 25 "Financial Instruments: Disclosure and Presentation" which requires that financial liabilities and equity instruments are classified according to the contractual arrangement entered into.

'B' Preferred ordinary shares

'B' Preferred convertible redeemable shares are regarded as compound financial instruments, consisting of a liability component and an equity component. At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for a similar instrument without a conversion feature. The difference between the proceeds of issue of the preferred convertible redeemable shares and the fair value assigned to the liability component, representing the embedded option to convert the liability into equity of the company, is included in equity. The unwinding of the value of the equity option is accreted through interest payable and similar charges to maturity such that the liability at the point of repayment equals the redemption amount.

The effect of the change in policy is as follows:

	2004
	£
Balance sheet	
Creditors: amounts falling due after more than one year	
As previously stated	758,112
Restatement of 'B' Preferred convertible redeemable shares	7,188,168
As restated	7,946,280

	2004
	£
Decrease in net assets	(7,188,168)
Represented by:	
Decrease in share capital	(11,111)
Decrease in share premium	(7,988,889)
Creation of equity element of preferred convertible redeemable shares	1,481,537
Decrease in profit and loss account	(669,705)
	(7,188,168)
Profit and loss account	
Interest payable and similar shares	
As previously stated	3,470
Accretion of equity option on Preferred convertible redeemable shares	669,705
As restated	673,175

21. Ultimate Parent Undertaking and Related Party Transactions

The company's parent undertaking and controlling party is Solexa Inc., a company registered in the USA. Copies of its group accounts, which include the company, are available from 25861 Industrial Blvd , Hayward, California 94545, USA.

No transactions with related parties were undertaken such as are required to be disclosed under Financial Reporting Standard 8.