

3625145

SOLEXA LIMITED

Report and Financial Statements

31 December 2002

 ERNST & YOUNG



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Solexa Limited

Registered Number: 3625145

DIRECTORS

S Balasubramanian
J Berriman
M Carthy
T Daniel
S Eletr
N McCooke
T Rink
A Smith
A Williamson

SECRETARY

L Palmer

AUDITORS

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

BANKERS

Barclays Bank plc
Corporate Banking
28 Chesterton Road
Cambridge
CB4 3UT

REGISTERED OFFICE

Chesterford Research Park
Little Chesterford
Saffron Walden
Essex
CB10 1XL

Solexa Limited

DIRECTORS' REPORT

The directors present their report and financial statements of Solexa Limited (the "Company") for the year ended 31 December 2002.

RESULTS AND DIVIDENDS

The retained loss for the period amounted to £2,951,042 (2001: £1,714,351) which remains to be set against reserves.

The directors do not recommend the payment of a dividend (2001: £nil).

PRINCIPLE ACTIVITY

The Company's principle activity is the development of novel techniques for the analysis of DNA.

RESEARCH AND DEVELOPMENT

Expenditure on research and development during the period amounted to £2,864,985 (2001: £1,330,417) all of which has been written off to the profit and loss account.

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.

DIRECTORS AND THEIR INTERESTS

The directors who served during the year and their interests in the ordinary share capital of the Company at the start and end of the year were as follows:

	<i>31 December</i>	<i>31 December</i>
	<i>2002</i>	<i>2001</i>
J Berriman	30,000	30,000
S Balasubramanian	212,500	212,500
N McCooke	20,000	20,000
T Rink	40,000	40,000
A Williamson	20,000	20,000
T Daniel	—	—
M Carthy	—	—
A Smith (appointed 29 January 2002)	—	—
S Eletr (appointed 29 January 2002)	—	—

The following directors had interests in options over the ordinary share capital of the company as follows:

	<i>31 December</i>	<i>31 December</i>
	<i>2002</i>	<i>2001</i>
N McCooke	220,000	120,000
J Berriman	20,000	20,000
T Rink	50,000	40,000
A Williamson	20,000	20,000
A Smith	120,000	—
S Eletr	32,000	—

None of the directors exercised any options over the company's share capital during the year.

AUDITORS

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

By order of the board

L Palmer
Company Secretary



16 June

2003

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE
FINANCIAL STATEMENTS

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; 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 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.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SOLEXA LIMITED

We have audited the company's financial statements for the year ended 31 December 2002 which comprise the Profit and Loss Account, Balance Sheet and the related notes 1 to 13. These financial statements have been prepared on the basis of 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

As described in the Statement of Directors' Responsibilities the company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards.

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

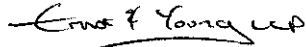
Basis of audit opinion

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.

Opinion

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



Ernst & Young LLP
Registered Auditor
Cambridge

19 June 2003

Solexa Limited

PROFIT AND LOSS ACCOUNT for the year ended 31 December 2002

		31 December	31 December
	Notes	2002	2001
		£	£
Research and development costs		(2,864,985)	(1,330,417)
Administration expenses		(650,067)	(456,421)
OPERATING LOSS	2	(3,515,052)	(1,786,838)
Interest receivable	3	369,096	153,859
Interest payable and similar charges	4	–	(81,372)
LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION		(3,145,956)	(1,714,351)
Tax on loss on ordinary activities	5	194,914	–
RETAINED LOSS FOR THE PERIOD	10	(2,951,042)	(1,714,351)

There were no recognised gains and losses other than the loss for the period attributable to shareholders of the Company of £2,951,042 (2001: £1,714,351).

The accompanying notes are an integral part of this profit and loss account.

Solexa Limited

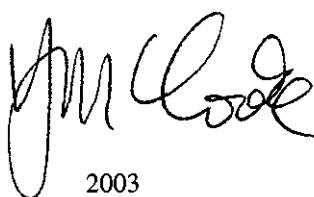
BALANCE SHEET at 31 December 2002

	Notes	2002 £	2001 £
FIXED ASSETS			
Tangible assets	6	706,961	590,865
CURRENT ASSETS			
Debtors	7	364,096	139,348
Cash at bank and in hand		8,286,525	11,610,496
		8,650,621	11,749,844
CREDITORS: amounts falling due within one year	8	(502,760)	(534,845)
NET CURRENT ASSETS		8,147,861	11,214,999
TOTAL ASSETS LESS LIABILITIES		8,854,822	11,805,864
CAPITAL AND RESERVES			
Called up share capital	9	15,845	15,845
Share premium account	10	14,307,706	14,307,706
Profit and loss account	10	(5,468,729)	(2,517,687)
Shareholders' funds:			
Equity		(3,145,178)	(194,136)
Non-equity		12,000,000	12,000,000
		8,854,822	11,805,864

N J McCooke
Director

16 June

2003



The accompanying notes are an integral part of this balance sheet.

NOTES TO THE FINANCIAL STATEMENTS
at 31 December 2002

1. ACCOUNTING POLICIES

Accounting convention

The accounts 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 19 'Deferred Taxation'. Adoption of this standard has not required any revisions to the financial statements in either the current or prior periods.

Basis of preparing the financial statements - going concern

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 £2,951,042 (2001: £1,714,351).

The Company is involved in research and development activities and until it is able to convert this activity into a significant profitable revenue stream it will continue to rely for financial support on funding from investors. If such finance were not available it might not be appropriate to continue recording the assets and liabilities of the Company at the values set out in the balance sheet and, accordingly, adjustments might be required to write down the value of assets and recognise contingent and other liabilities.

The directors believe that financial support to carry out the Company's activities will continue to be made available. They have therefore prepared these accounts on a going concern basis whilst recognising that the Company will require further funding to complete the development of its technology before it is able to generate profits. The terms on which such funding may be available, if at all, will be dependent upon the results of ongoing research and development activities.

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 or valuation, less estimated residual value based on prices prevailing at the date of acquisition or revaluation, of each asset on a straight-line basis over its expected useful life, as follows:

Computer equipment	-	over 4 years
Laboratory equipment	-	over 4 years
Office equipment	-	over 4 years
Leasehold improvements	-	over the shorter of the lease term and estimated useful life

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 recoverable.

Research and development

Research and development expenditure, including patent costs and the cost of purchased intellectual property rights, is written off to the profit and loss account as incurred.

NOTES TO THE FINANCIAL STATEMENTS

at 31 December 2002

1. ACCOUNTING POLICIES (continued)

Deferred taxation

In the current year the company has implemented Financial Reporting Standard ("FRS") 19 'Deferred Tax'. 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 that result in an obligation to pay more, or a right to pay less, tax in the future have occurred at the balance sheet date. 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 a non-discounted basis at the tax rates that are expected to apply in the period in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date. There is no prior year effect of implementing FRS 19 nor any effect on the current year tax charge.

Leasing commitments

Rentals payable under operating leases are charged in the profit and loss account on a straight line basis over the lease term.

Pensions

The Company operates a defined contribution pension scheme. Contributions are charged to the profit and loss account as they become payable in accordance with the rules of the scheme.

Cash flow statement

The Company has taken advantage of the exemption in Financial Reporting Standard No 1 (Revised) not to present a cash flow statement as it qualifies as a small company.

Employee share options

The Company may, from time to time, grant share options to employees. In accordance with Urgent Issues Task Force pronouncement number 17 ("UITF17"), the Company records a non-cash charge to the profit and loss account for the difference between the exercise price of the option and fair value of the underlying shares on the date of grant. The profit and loss charge is recognised over the period during which the incentive benefits of the option relate. No charges have been recorded in the year to 31 December 2002 (2001: nil).

2. OPERATING LOSS

(a) This is stated after charging:

	2002	2001
	£	£
Auditors' remuneration:		
- audit services	7,500	5,000
- non-audit services	22,200	3,520
Depreciation of tangible fixed assets	263,597	126,409
Operating lease rentals:		
- land and buildings	102,089	90,000
	<u> </u>	<u> </u>

NOTES TO THE FINANCIAL STATEMENTS
at 31 December 2002

2. OPERATING LOSS (continued)

(b) Directors' remuneration:

	2002 £	2001 £
Emoluments	336,568	161,073
Company contributions paid to money purchase pension schemes	25,000	12,166
	No.	No.
Members of money purchase pension schemes	2	1

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

	2002 £	2001 £
Emoluments	146,000	131,073
Company contributions paid to money purchase pension schemes	14,000	12,166

Emoluments includes an amount of £nil (2001: £7,000) payable to a third party in order to secure the services of J Berriman.

(c) Staff costs

	2002 £	2001 £
Wages and salaries	1,433,253	685,770
Social security costs	148,017	71,888
Other pension costs	131,262	60,208
	1,712,532	817,866

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

	2002 No.	2001 No.
Administration	5	3
Research and development	32	13
	37	16

Solexa Limited

NOTES TO THE FINANCIAL STATEMENTS at 31 December 2002

3. INTEREST RECEIVABLE

	2002	2001
	£	£
Interest received on treasury deposits	369,096	153,859

4. INTEREST PAYABLE AND SIMILAR CHARGES

	2002	2001
	£	£
Interest payable on convertible loan	—	81,276
Bank charges and interest	—	96
	—	81,372

5. TAX

(a) Tax credit

	2002	2001
	£	£
Current tax:		
UK corporation tax: Research and Development Tax Credit	(194,914)	—

(b) Factors affecting current tax charge

The differences are reconciled below:

The tax assessed on the profit on ordinary activities for the year is higher than the standard rate of corporation tax in the UK of 30% (2001 – 30%). The differences are reconciled below:

	2002	2001
	£	£
Loss on ordinary activities before taxation	(3,145,956)	(1,714,351)
Loss on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (2001: 30%)	(943,787)	(507,573)
Expenses not deductible for tax purposes	3,930	7,859
Losses arising in the year not relieviable against current tax	973,703	560,507
Capital allowances in excess of depreciation	(34,801)	(64,173)
Research and development tax credit received	(194,914)	—
Other timing differences	955	3,380
Total current tax	(194,914)	—

NOTES TO THE FINANCIAL STATEMENTS
at 31 December 2002

5. TAX (continued)

(c) Deferred tax

Under FRS 19 full provision has been made for deferred tax liabilities although these have been offset by some of the losses and differences being carried forward.

The amounts provided and unprovided at the end of the year are as follows:

	2002	2002	2001	2001
		Not		Not
	Provided	Provided	Provided	Provided
	£	£	£	£
Accelerated capital allowances	212,088	–	156,260	–
Short term timing differences	(1,389)	–	(3,380)	–
Tax losses	(210,699)	(1,441,649)	(152,880)	(735,802)
	–	(1,441,649)	–	(735,802)

(d) Factors that may affect future tax charges

The Company has tax losses arising in the UK of £5,507,828 (2001 – £2,262,152) 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 the 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.

6. TANGIBLE FIXED ASSETS

	Laboratory equipment £	Office equipment £	Computer equipment £	Leasehold improve- ments £	Total £
Cost:					
At 1 January 2002	526,414	39,574	130,531	65,441	761,960
Additions	261,672	12,866	42,906	62,249	379,693
At 31 December 2002	788,086	52,440	173,437	127,690	1,141,653
Depreciation:					
At 1 January 2002	73,575	8,337	68,628	20,555	171,095
Provided during the period	166,048	11,579	40,264	45,706	263,597
At 31 December 2002	239,623	19,916	108,892	66,261	434,692
Net book value:					
At 31 December 2002	548,463	32,524	64,545	61,429	706,961
At 1 January 2002	452,839	31,237	61,903	44,886	590,865

Solexa Limited

NOTES TO THE FINANCIAL STATEMENTS at 31 December 2002

7. DEBTORS

	2002 £	2001 £
VAT receivable	44,544	69,250
Other debtors and prepayments	319,552	70,098
	<u>364,096</u>	<u>139,348</u>

8. CREDITORS: amounts falling due within one year

	2002 £	2001 £
Trade creditors	195,933	314,288
Other taxes and social security	49,170	40,564
Accruals and deferred income	240,160	168,726
Pension creditor	17,497	11,267
	<u>502,760</u>	<u>534,845</u>

9. SHARE CAPITAL

Authorised

	No.	2002 £	No.	2001 £
Ordinary shares of 0.25p each	3,648,513	9,121	3,346,000	8,365
'A' Ordinary shares of 0.25p each	4,000,000	10,000	4,000,000	10,000
	<u>7,648,513</u>	<u>19,121</u>	<u>7,346,000</u>	<u>18,365</u>

During the year the shareholders passed an Ordinary Resolution increasing the Company's authorised share capital as above.

Ordinary and 'A' Ordinary 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. When a dividend is declared by the Board, all 'A' Ordinary shareholders are entitled to receive a fixed non-cumulative participating dividend at 8% per annum of the subscription price of the shares. This is in priority to any dividend, which the Board may declare as payable to the holders of all Ordinary shares.

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 'A' Ordinary shares the subscription price paid by them respectively per share together with an amount equal to any arrears or accruals of dividends on the 'A' Ordinary shares, or, if greater, the amount which the holders would receive if their 'A' Ordinary shares had been converted into Ordinary shares immediately prior to such liquidation.
2. Second in paying to the holders of the Ordinary shares any remaining capital after payment of all outstanding liabilities.

NOTES TO THE FINANCIAL STATEMENTS
at 31 December 2002

9. **SHARE CAPITAL** (continued)

Holders of at least 67% of the 'A' Ordinary shares may at any time prior to a sale or listing require the Company to convert all of the 'A' Ordinary shares into a like number of Ordinary shares. Conversion shall be effective by written notice given by the holder to the Company.

The 'A' Ordinary shares shall automatically be converted into Ordinary shares immediately prior to a listing if, following conversion, the Ordinary shares would have an aggregate value of no less than £10 each.

Allotted, called up and fully paid

	No.	2002 £	No.	2001 £
Ordinary shares of 0.25p each	2,338,138	5,845	2,338,138	5,845
'A' Ordinary shares of 0.25p each	4,000,000	10,000	4,000,000	10,000
	<u>6,338,138</u>	<u>15,845</u>	<u>6,338,138</u>	<u>15,845</u>

At 31 December 2002 options were outstanding over (a) 72,625 Ordinary shares at £0.725 each, exercisable between 15 September 1999 and 15 September 2008 (2001: 72,625 options), and (b) 788,417 Ordinary shares at £1 each, exercisable between 24 May 2001 and 24 May 2010 (2001: 448,250 options). At 31 December 2002, 302,430 options had vested (2001: 137,982), but none had been exercised (2001: nil). In addition the Company had commitments at 31 December 2002 to grant a further 34,000 (2001: 146,000) options to purchase Ordinary Shares.

10. **RECONCILIATION OF MOVEMENTS ON RESERVES AND SHAREHOLDERS' (DEFICIT)/ FUNDS**

	Share capital £	Share premium account £	Profit & loss account £	Total £
At 1 January 2001	3,650	657,537	(803,336)	(142,149)
Issue of ordinary share capital	12,195	13,650,169	—	13,662,364
Loss for the year	—	—	(1,714,351)	(1,714,351)
At 1 January 2002	<u>15,845</u>	<u>14,307,706</u>	<u>(2,517,687)</u>	<u>11,805,864</u>
Loss for the year	—	—	(2,951,042)	(2,951,042)
At 31 December 2002	<u>15,845</u>	<u>14,307,706</u>	<u>(5,468,729)</u>	<u>8,854,822</u>

11. **CAPITAL COMMITMENTS**

Amounts contracted for but not provided in the accounts amount to £nil (2001: £85,254).

NOTES TO THE FINANCIAL STATEMENTS
at 31 December 2002

12. OPERATING LEASE COMMITMENTS

At 31 December 2002 the Company had annual commitments under non-cancellable operating leases as set out below:

	<i>Land and Buildings</i>	
	<i>2002</i>	<i>2001</i>
	<i>£</i>	<i>£</i>
Operating leases which expire:		
- within one year	95,000	—
- in two to five years	—	96,575
	<u>95,000</u>	<u>96,575</u>

13. RELATED PARTIES

Dr Balasubramanian is an employee of the University of Cambridge a shareholder of the Company. He received £20,000 (2001: £26,386) for consultancy services provided to the Company.

£13,250 (2001: £10,000) was paid to Dr Rink in respect of consultancy services provided.

Mr Carthy is a General Partner of OBP Management IV L.P., which serves as general partner of Oxford Bioscience Partners IV L.P., and mRNA Fund II L.P., which own 990,066 and 9,934 'A' Ordinary shares in the Company, respectively. Mr Daniel is a General Partner at Schroder Ventures Life Sciences, which advised International Life Sciences Fund II, which owns 1,333,333 'A' Ordinary shares in the Company. John Berriman is a Director of Abingworth Management Limited. Abingworth Management Limited acts as manager and advisor respectively to the limited partnerships constituting the Abingworth Bioventures III Fund and to Abingworth Bioventures II SICAV. Abingworth Bioventures III and Abingworth Bioventures II hold a total of 1,656,096 Ordinary shares and 1,333,337 'A' Ordinary shares in the Company.

Solexa Limited

PRO FORMA US GAAP BALANCE SHEET AT 31 DECEMBER 2002 (UNAUDITED)

	2002 £	2001 £
Assets		
Current assets:		
Cash and cash equivalents	8,286,525	11,610,496
Prepaid expenses and other current assets	364,096	139,348
Total current assets	8,650,621	11,749,844
Property and equipment, net	706,961	590,865
Total assets	9,357,582	12,340,709
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	262,600	366,119
Accrued liabilities	240,160	168,726
Total current liabilities	502,760	534,845
Shareholders' equity:		
Common shares:		
Convertible 'A' ordinary shares, £0.0025 par value; 0 shares authorised in 2002; 4,000,000 shares authorised in 2001; 0 shares issued in 2002; 4,000,000 shares issued and outstanding in 2001	10,000	10,000
Ordinary shares, £0.0025 par value; 3,648,513 shares authorised in 2002; 3,346,000 shares authorised in 2001; 2,338,138 shares issued and outstanding in 2001	5,845	5,845
Additional paid-in capital	14,307,706	14,307,706
Deferred stock compensation	-	-
Accumulated deficit	(5,468,729)	(2,517,687)
Total shareholders' equity	8,854,822	11,805,864
	9,357,582	12,340,709