Ionix Pharmaceuticals Limited

Annual report

for the year ended 31 December 2004

Registered Number 04217756

Ionix Pharmaceuticals Limited

Annual report
for the year ended 31 December 2004

Contents

Ionix Pharmaceuticals Limited

Directors and advisers

Directors
Dr L Bruce
Dr P Fellner
Dr A Hayes
Dr E Moses
Ms C Petty
Mr A Sandham

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Eversecretary Limited
10 Wellington Street
Cambridge
CB1 1HW

Auditors
PricewaterhouseCoopers LLP
Abacus House
Castle Park
Cambridge
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Solicitors
Eversheds
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CB1 2JY

Bankers
Barclays Bank plc
28 Chesterton Road
Cambridge
CB4 3UT

Ionix Pharmaceuticals Limited

Directors' report for the year ended 31 December 2004

The directors present their report and the audited financial statements of the company for the year ended 31 December 2004.

Principal activities
The company's activities focus on the discovery and development of new medicines for the treatment of pain, urological disorders and other diseases mediated by the nervous system. Using novel drug delivery technologies, drug targets and state of the art biology and chemistry techniques, the company is developing proprietary drugs that are designed to alleviate pain associated with surgery, trauma, cancer, arthritis, diabetes, neuralgia and to treat urological disorders including urinary incontinence and irritable bowel syndrome. The company is investing in the development of its product candidates to proof-of-concept stage, involving the preparation of preclinical or clinical data packages. The company intends to form strategic alliances with development and commercialisation partners to bring its medicines to the global market place.

Review of business and future developments
The profit and loss account for the year is set out on page 9.

The company's business is to discover and develop proprietary drugs for the treatment of pain, urological disorders and other diseases mediated by the nervous system. The company's scientists have considerable experience in the development of pharmaceuticals and have established the resources and networks to evaluate the preliminary safety and efficacy of its drug candidates in preclinical and clinical studies to appropriate regulatory standards in Europe and the United States. The company plans to commercialise its drug candidates through the formation of strategic alliances with pharmaceutical companies, in return for development fees, milestone payments and royalties on downstream product sales. Where appropriate, the company intends to retain certain marketing rights to its products within these strategic alliances, as a platform to building a franchise in the commercialisation of specialty pharmaceuticals in selected disease areas and countries. During 2004, the company completed planning and commenced activities to conduct a phase II clinical trial on its most advanced drug candidate, IX-1003 for the treatment of acute post-operative pain, in the United States. Partnering plans for IX-1003 were also progressed during the year, with the result that a strategic alliance is likely to be completed during 2005 to enable further clinical and commercial development of the drug candidate. The company's product pipeline is designed to address chronic pain and urological conditions, based on discovery of novel compounds that address multi-mediator mechanisms, particularly through drug targets in the peripheral nervous system. The company has specialist expertise and intellectual property in ion channel drug targets, assay technologies, mechanistic analysis and medicinal chemistry providing it with significant competitive advantage in the discovery of proprietary compounds with selective mechanism of action. The company believes that this will lead to drug candidates with enhanced efficacy and superior tolerability to current medications. During 2004, the company made good progress in demonstrating preliminary efficacy and tolerability of its lead candidate ion channel modulators in disease model systems. The company has an experienced management team who are supported by internationally recognised Science and Clinical Advisory Board members. In addition to its internal research and development resources, the company has formed alliances with a series of corporate partners that provide preclinical and clinical development services and product manufacturing capability.

At the end of 2004, the company employed fifty-two research scientists and business professionals. These resources were supplemented by contracts with a number of academic and corporate collaborators. The company occupies state-of-the-art research laboratories on the Cambridge Science Park, within its headquarters facility that provides sufficient expansion space for the company to progress its business over the next few years.

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Research and development

During 2004, the company made substantial progress on its principal product development programmes. The most advanced programmes, summarised in Table 1, derive from inventions made and developed by the company. The company has access to new inventions in drug targets in the nervous system through its strong relationships with European centres of excellence in sensory neuronal research. Product development milestones achieved during 2004 were as follows:

- Completion of planning and initiation of activities for a Phase II trial of IX-1003, intranasal buprenorphine for the treatment of acute post-operative pain.
- Progression of lead series of compounds in programme IX-2000 (selective calcium channel blockers) showing preclinical efficacy and tolerability in urinary incontinence and pain models.
- Selection of lead series of compounds in programme IX-3000 (selective sodium channel blockers) based on target selectivity profiles and preclinical efficacy in pain models.
- Characterisation of hit compounds in programme IX-4000, selective regulators of sodium channel function designed to address pain and other disorders.
- Investment in proprietary ion channel screening and chemistry technologies.

Based on marketing activities and negotiations conducted during 2004, the company intends to conclude a strategic alliance with a commercialisation partner for IX-1003 during the year ahead. The alliance will likely involve collaboration of product manufacture, clinical development and marketing on a global basis. Development of the ion channel blocker programmes for pain and urology will focus on selection of development candidate drugs for preclinical development. The company believes that it has sufficient expertise and human resources to progress these drug candidates during 2005, and consequently significant expansion in employees is not anticipated. Further utilisation of corporate relationships to support preclinical and clinical development is planned.

Table 1: Product Development Programmes

Programme	Lead Indication	Description	2004 Status
IX-1003	Post-operative and other acute pain	Intranasal buprenorphine for the treatment of patient-controlled post-operative pain in hospital and home settings	Phase II activities commenced
IX-2000	Pain and Urinary Incontinence	Orally administered selective calcium channel blocker for urological disorders and chronic pain	Lead Series
IX-3000	Pain, Urinary Incontinence and IBS	Orally administered selective sodium channel blocker for chronic pain and other indications	Lead Series
IX-4000	Pain	Orally administered selective regulator of sodium channel function for chronic pain and other indications	Lead Discovery
Pipeline	Pain	Modulators of new drug targets, validated to be involved in pain pathways	Research

Total research and development expenditure during the year was £6,886,930 (2003: £5,484,701).

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Post balance sheet events
On 22 February 2005, the company signed an agreement with Reckitt Benckiser Healthcare relating to a multi-product strategic alliance. The alliance involves collaboration on the development and commercialisation of IX-1003, intranasal buprenorphine for acute pain and expands the company's intranasal opioid development portfolio through the addition of IX-1004 for chronic pain and IX-1005 for opiate addiction. Under the agreement, the company and Reckitt Benckiser Healthcare will jointly develop all three products and Reckitt Benckiser Healthcare will be responsible for worldwide manufacture and marketing. The company has retained an option to co-promote IX-1003 in the United States and will receive a stream of revenues, including substantial milestone and royalty payments through the development and commercialisation of all three products. To support this strategic alliance, on 22 February 2005 the company expanded its agreements with Archimedes Development Ltd (formerly West Pharmaceuticals Services Drug Delivery & Clinical Research Centre Ltd) relating to licences for intranasal drug delivery technology.

On 1 March 2005, the company refocused its research and development activities on later stage projects and substantially reduced its investment in pipeline projects. As a result, the company served notice of redundancy of eighteen positions on that date, reducing the number of employees to thirty-one scientists and business professionals upon completion of the redundancy process in second quarter 2005.

On 30 June 2005, the company entered into agreements with the Landlord and its affiliates to assign the property lease relating to its facility on the Cambridge Science Park to Trinity College upon completion of the planned merger or sale of the company and the Company relocated its operations to an office facility in the centre of Cambridge.

On 5 July 2005, the company and its shareholders entered into a binding agreement to effect the sale of the entirety of the share capital of the company to Vernalis plc to facilitate further development and commercialisation of the company's candidate products and projects. As a result, the company served notice of redundancy of sixteen positions in the period 7-8 July 2005 with the effect that eleven positions terminated on 8 July 2005 and the remaining five positions will terminate on completion of the sale. Consequently, it is intended that seven scientists will remain employed by the company following completion of the sale to Vernalis plc.

Dividends
The directors do not recommend the payment of a dividend (2003: £nil).

Directors
The directors of the company who served during the year ended 31 December 2004 are listed below:

Executive directors	
Mr A Sandham	(President & CEO)
Dr P Birch	(Resigned 6 April 2004)
Non-executive directors	
Dr P Fellner	(Chairman)
Dr L Bruce	(Appointed 2 November 2004)
Dr A Hayes	
Dr E Moses	
Ms C Petty	

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Biographical details of the non-executive directors of the company as at 31 December 2004 are shown below:

Dr Peter Fellner
Peter was CEO of Celltech Group plc from 1990-2003 and was Chairman of Celltech prior to sale of the company to UCB Pharma in 2004. During the past decade Celltech has evolved into one of the largest European-based biopharmaceutical companies. Previously, he served as CEO of Roche UK from 1986 to 1990. From 1984 to 1986 he was Director of the Roche UK Research Centre and focused its programmes in the anti-viral field. From 1980 to 1984 he was a Director of Research at the Searle UK Research Centre. Peter has a number of other appointments, including chairmanships of Vernalis plc and Astex Technology, and membership of the UK Medical Research Council.

Dr Lennart Bruce
Lennart is currently Senior Vice President, Corporate Development at Biovitrum AB, which he co-founded in 2001. Dr Bruce has held management positions in clinical development, international marketing and business development within the pharmaceutical industry since 1975, and has extensive experience in project, product and company evaluations, as well as in contract negotiations that led to a large number of licensing deals. Before joining Biovitrum, he was Vice President Global Licensing at Pharmacia. He holds a Ph.D in Zoo Physiology from the University of Lund, Sweden.

Dr Ann Hayes
Ann worked with GlaxoWellcome from 1979-2001, initially in research, with particular expertise in the areas of CNS and pain. Latterly, she had served as Director in Drug Discovery, with particular expertise in determining long-term discovery strategy, in portfolio management and in discovery project management. Ann currently consults on CNS disease strategy, drug discovery, preclinical and clinical development strategy and portfolio management for private and public biotechnology and pharmaceutical companies in Europe.

Dr Edwin Moses
Edwin was previously Chief Executive Officer and then Executive Chairman of Oxford Asymmetry International plc (OAI). He was responsible for the successful development of the company into a worldwide leader in sophisticated drug discovery and development chemistry solutions. He oversaw the merger of EVOTEC BioSystems AG and OAI in 2000. Before joining OAI Edwin held positions at Raggio-Italgene SpA, Italy, Enzymatix Ltd, BRL and Amersham International. He also serves as chairman of Avantium Technologies, BioImage AS, Inpharmatica Ltd, Paradigm Therapeutics, ProImmune Ltd and Prolysis Ltd and he is a non-executive director of Evotec OAI AG.

Ms Cathrin Petty
Cathrin joined Apax Partners healthcare team in 2000 and was appointed a partner in 2003 and a Director in January 2004. She works with biotechnology companies at all stages of the investment life cycle. Cathrin previously worked with Schroders Ventures Life Sciences in London, investing in the US and Europe in biotechnology, medical devices and healthcare services. Prior to venture capital she was a buy side investment analyst at Schroders Investment Management. She also serves as a non-executive director of Intercell Ag, Lorantis Ltd and Medeus Pharma.

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Directors' interests in shares
The beneficial interests of the directors in the shares of the company at 31 December 2004 were as follows:

Director	Ordinary shares of 1p each		'A' ordinary shares of 1p each	
	At 31 December 2004	At 31 December 2003	**At 31 December 2004**	At 31 December 2003
	Number	Number	**Number**	Number
Dr A Hayes	**8,109**	8,109	**553,180**	520,000
Mr A Sandham	**20,274**	20,274	**1,383,445**	1,300,000

Directors' interests in share options
Details of options over ordinary 1p shares in the company held by directors are shown below:

Director	Exercise price per ordinary share	Options at 1 January 2004 Number	Lapsed during the year Number	Options at 31 December 2004 Number	Date of grant	Note
Dr E Moses	10p	15,000	-	15,000	25 January 2002	i
	20p	2,647	-	2,647	15 August 2003	iii
		17,647	-	17,647		
Dr P Fellner	10p	100,000	-	100,000	14 June 2002	ii
	20p	17,647	-	17,647	15 August 2003	iii
		117,647	-	117,647		
Dr A Hayes	10p	91,765	-	91,765	15 August 2003	iv
Mr A Sandham	10p	229,412	-	229,412	17 December 2003	iv
Dr P Birch	10p	88,235	38,235	50,000*	17 December 2003	iv

* at date of resignation

Note i: 25% of these options were exercisable from 10 August 2002 with the remainder vesting on a straight-line basis over the following three years.
Note ii: 25% of these options were exercisable from 1 June 2003 with the remainder vesting on a straight-line basis over the following three years.
Note iii: 25% of these options are exercisable from 1 April 2003 with the remainder vesting on a straight-line basis over the following three years.
Note iv: 50% of these options are exercisable from 1 April 2003 with the remainder vesting on a straight-line basis over the following year.

Other than as shown above, no director had any interest in the shares of the company at 31 December 2004 or during the year.

Health and Safety policy
The company recognises that health, safety and the environment ('HS&E') is an integral part of its business performance and Ionix is committed to achieving the highest standards of HS&E performance. It will seek to achieve this by:

- setting and publishing a health, safety & environment policy;
- providing appropriate resource to implement the policy;

- ensuring the management of health and safety is a prime responsibility of line management, from senior executive to supervisory level;
- ensuring that all employees receive appropriate training and are competent to carry out their duties;
- implementing regular reviews of health and safety procedures, auditing systems and providing action plans for improvement; and
- ensuring that all business decisions take account of environmental considerations.

Employee involvement
The company is committed to the involvement of its employees in the company's affairs. This is achieved in a number of ways, including fortnightly meetings of its operations group and regular communications meetings involving all employees.

Approved and unapproved share option schemes have been established and all full time employees participate in these schemes.

Charitable and political donations
The company made no (2003: £nil) charitable or political donations during the year.

Statement of directors' responsibilities
Company law requires the directors to prepare financial statements for each financial year that 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. The directors are required to prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors confirm that suitable accounting policies have been used and applied consistently. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the year ended 31 December 2004 and that applicable accounting standards have been followed.

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

Auditors
The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office and a resolution concerning their re-appointment will be proposed at the Annual General Meeting.

By order of the Board

Mr Andrew Sandham
Director

22 July 2005

Ionix Pharmaceuticals Limited

Independent auditors' report to the members of Ionix Pharmaceuticals Limited

We have audited the financial statements which comprise the profit and loss account, the balance sheet and the related notes.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are 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 United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

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 is not disclosed.

Basis of audit opinion

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

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

Uncertainty – going concern

In forming our opinion we have considered the adequacy of the disclosures made in the financial statements concerning the basis of preparation. The financial statements have been prepared on a going concern basis and the validity of this depends on the company being able to secure its financial position. The financial statements do not include any adjustments that would result from a failure to secure such finance. Details of the circumstances relating to this fundamental uncertainty are described in note 1 to the financial statements. 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 at 31 December 2004 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Cambridge

22 July 2005

Ionix Pharmaceuticals Limited

Profit and loss account for the year ended 31 December 2004

	Note	2004	2003
		£	£
Operating expenses	2	**(8,707,624)**	(7,066,404)
Other operating income	3	**128,967**	-
Operating loss		**(8,578,657)**	(7,066,404)
Interest receivable and similar income	6	**124,717**	206,754
Interest payable and similar charges	7	**(18,394)**	(73,311)
Loss on ordinary activities before taxation	8	**(8,472,334)**	(6,932,961)
Tax credit on loss on ordinary activities	9	**785,285**	695,152
Loss for the financial year	21	**(7,687,049)**	(6,237,809)

All results relate to continuing operations.

The company has no recognised gains and losses other than those included in the results above, and accordingly no separate statement of total recognised gains and losses has been presented.

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Balance sheet as at 31 December 2004

	Note	2004 £	2003 £
Fixed assets			
Intangible assets	10	-	-
Tangible assets	11	**2,761,390**	2,619,113
		2,761,390	2,619,113
Current assets			
Debtors	12	**1,448,877**	1,204,746
Short-term investments	13	**2,678,577**	3,511,553
Restricted cash deposits	14	-	444,073
Cash at bank and in hand		**114,156**	217,761
		4,241,610	5,378,133
Creditors: amounts falling due within one year	15	**(1,237,924)**	(1,151,792)
Convertible loan	16	**(6,000,000)**	-
		(7,237,924)	(1,151,792)
Net current (liabilities)/assets		**(2,996,314)**	4,226,341
Total assets less current liabilities		**(234,924)**	6,845,454
Creditors: amounts falling due after more than one year	17	**(365,726)**	(320,211)
Net (liabilities)/assets		**(600,650)**	6,525,243
Capital and reserves			
Called up share capital	19	**267,632**	262,632
Share premium account	21	**18,116,289**	17,623,157
Profit and loss account	21	**(18,984,571)**	(11,360,546)
Equity shareholders' (deficit)/funds	22	**(600,650)**	6,525,243

The financial statements on pages 9 to 26 were approved by the board of directors on 22 July 2005 and were signed on its behalf by:

Mr Andrew Sandham
Director

Ionix Pharmaceuticals Limited

Notes to the financial statements for the year ended 31 December 2004

1 Accounting policies

These financial statements have been prepared on the going concern basis, under the historical cost convention and in accordance with the Companies Act 1985 and applicable accounting standards. The principal accounting policies are set out below.

Basis of preparing the financial statements - going concern assumption
At 31 December 2004, the company had cash and short-term investments totalling £2,792,733.

The directors estimate that the cash and short-term investments at the date of approval of the financial statements are not sufficient to continue funding its trading activities for a further twelve months from the date of approval of the financial statements. Accordingly, the directors have considered the company's plans to secure the future financial position of the company. The directors are confident that this will be resolved within a timescale that will secure the future of the company for twelve months from the date of approval of the financial statements and therefore believe that it is appropriate that these financial statements are prepared on the going concern basis. This basis of preparation assumes that the company will continue in operational existence for the foreseeable future, the validity of which depends on the directors securing the financial position of the company.

If the company was unable to continue in operational existence for the foreseeable future, adjustments would have to be made to revise the balance sheet value of assets to their recoverable amounts, to provide for further liabilities that might arise, and to reclassify fixed assets as current assets.

Cash flow statement
The company has taken the exemption available to small companies under FRS 1 (revised 1996), 'Cash flow statements', not to prepare a cash flow statement.

Intangible fixed assets
Licences purchased for use in development are capitalised at cost and amortised on a straight-line basis over the terms of the licence agreements concerned. Provision is made against the carrying value of intangible fixed assets where an impairment in value is deemed to have occurred.

Tangible fixed assets
The cost of tangible fixed assets is their purchase cost, together with any incidental costs of acquisition.

Depreciation is calculated so as to write off the cost of tangible fixed assets, less their estimated residual values, on a straight-line basis over the expected useful economic lives of the assets concerned. The principal annual rates used for this purpose are:

Leasehold improvements	Term of the lease
Plant and machinery	3-8 years
Computer equipment and software	3-5 years
Fixtures, fittings and equipment	3-8 years

Depreciation is charged on assets in use from the date in which they are brought into use.

Contributions received from third parties for the purchase of fixed assets are held as deferred income and are recognised in the profit and loss account over the period in which the related fixed assets are being depreciated.

Options to acquire intellectual property
Amounts paid to acquire options over intellectual property, where the fair value can be readily ascertained, are charged to the profit and loss account over the option term unless there is no expectation that the option will be exercised. If a subsequent decision is made to not exercise the option, any outstanding amount is written off immediately.

Short-term investments
Bank deposits, which are not repayable on demand without penalty, are treated as short term investments.

Deferred taxation
Full provision is made for deferred taxation in accordance with FRS 19, 'Deferred tax', on all material timing differences. Deferred tax assets are recognised to the extent they are regarded as recoverable. Deferred tax assets and liabilities are not discounted.

Foreign currencies
Transactions denominated in foreign currencies are translated into sterling at the actual rate of exchange effective at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies have been translated at rates prevailing at the balance sheet date. Any difference arising from a change in exchange rates subsequent to the date of the transaction are taken as an exchange gain or loss to the profit and loss account in the year in which they arise and are included in operating profit.

Research and development expenditure
All research and development is charged to the profit and loss account in the year in which it is incurred.

Operating leases
Costs in respect of operating leases are charged to the profit and loss account on a straight-line basis over the term of the lease. Benefits, such as rent free periods, received or receivable as incentives to take on operating leases are spread on a straight line basis over the period to the first rent review.

Assets held under sale and finance leaseback agreements
Assets held under sale and finance leaseback agreements, in which the commercial substance of the underlying agreement is considered to be a secured loan, and that confer rights and obligations similar to those attached to owned assets, are capitalised as tangible fixed assets and depreciated over their useful economic lives. The capital element of the leasing commitment is recorded as a liability and is shown as obligations under finance leases. The lease rental payments are treated as consisting of both a capital and an interest element. The capital element is applied to reduce the outstanding obligations under the leasing commitments and the interest element is charged to the profit and loss account over the period of the agreement.

Pensions
The company makes contributions to the personal pensions held by some employees. The pension costs charged represent contributions paid by the company to individual pension plans and have been included as part of employment costs. The company provides no other post-retirement benefits to its employees.

Share options
When options over shares are granted to employees, a charge being the estimated market value of the share at the date of grant of the option less the exercise price of the option, is made to the profit and loss account in accordance with the Urgent Issues Task Force Abstract 17, 'Employee Share Schemes'. The charge is then credited back to reserves. When options are granted to non-employees, a charge reflecting the fair value of the services provided, to the extent that they are not paid in cash, is made to the profit and loss account and credited back to reserves.

Convertible debt
Convertible debt is initially stated at the amount of the net proceeds after deduction of issue costs, to the extent that any costs can be directly allocated to the loan notes issued. Interest that is contingent on uncertain future events is added to the loan notes once the event giving rise to interest has occurred. Convertible debt is reported as a liability until conversion occurs.

2 Operating expenses

	2004	2003
	£	£
Research and development costs	**6,886,930**	5,484,701
Administrative expenses	**1,820,694**	1,581,703
	8,707,624	7,066,404

3 Other operating income

Other operating income of £111,319 (2003: £nil) relates to rent and service charges receivable regarding the sub-let of laboratory and office space and the recognition of a contribution from the sub-tenants towards the purchase of leasehold improvements. The contribution is being recognised over the depreciable life of the fixed assets to which the contribution relates (see note 17).

Other operating income of £17,648 (2003: £nil) relates to a contribution of £100,000 received from Trinity College towards the purchase of leasehold improvements. The contribution is being recognised over the depreciable life of the fixed assets to which the contribution relates (see note 17).

4 Directors' emoluments

	2004	2003
	£	£
Aggregate emoluments	**321,295**	392,205
Company pension contributions to defined contribution schemes	**22,861**	29,020
Compensation for loss of office	**51,364**	-
Amounts paid to third parties for directors' services	**15,000**	15,000
	410,520	436,225

Retirement benefits are accruing to one director (2003: two) under a defined contribution scheme.

Highest paid director

	2004	2003
	£	£
Aggregate emoluments	**226,767**	225,244
Company pension contributions to defined contribution schemes	**17,080**	15,874
	243,847	241,118

5 Employee information

The average monthly number of persons (including executive directors) employed by the company during the year was:

	2004	2003
	Number	Number
By activity		
Research and development	**37**	34
Administration	**6**	6
	43	40

	2004	2003
	£	£
Staff costs (for the above persons):		
Wages and salaries	**2,198,661**	1,878,393
Social security costs	**261,342**	216,383
Other pensions costs (see note 23)	**195,770**	170,134
	2,655,773	2,264,910

6 Interest receivable and similar income

	2004	2003
	£	£
Interest receivable on short term investments	**124,717**	206,754

7 Interest payable and similar charges

	2004 £	2003 £
On finance leases	**8,259**	35,340
Redemption premium on finance lease	**7,500**	-
On loan note	-	36,302
Other interest payable	**2,635**	1,669
	18,394	73,311

8 Loss on ordinary activities before taxation

	2004 £	2003 £
Loss on ordinary activities before taxation is stated after charging:		
Amortisation of intangible fixed assets	**173,109**	60,309
Depreciation of tangible fixed assets:		
- owned assets	**568,976**	299,736
- under finance leases	**62,742**	189,757
Share option compensation charge	**63,024**	84,281
Auditors' remuneration:		
- audit	**11,500**	10,800
- non-audit services	**15,425**	7,845
Operating lease charges:		
- plant and machinery	**13,502**	5,332
- land and buildings	**1,053,354**	651,150
Loss on disposal of fixed assets	**6,642**	46,049

9 Tax credit on loss on ordinary activities

	2004	2003
	£	£
United Kingdom research and development tax credit at 16% (2003:16%):		
Current year	**785,285**	695,152

No corporation tax liability arises on the results for the year due to the loss incurred. A tax credit has arisen as a result of tax losses being surrendered in respect of research and development expenditure.

At 31 December 2004, there were tax losses available for carry forward of £12,732,000 (2003: £8,119,000) subject to agreement with the Inland Revenue.

The value of the research and development tax credit for the year does not equal the value that would be produced by applying the UK standard rate of 16% for research and development credits to the loss before tax for the year. The reasons for the difference are set out in the table below:

	2004	2003
	£	£
Loss on ordinary activities before tax	**8,472,334**	6,932,961
Loss on ordinary activities multiplied by the standard rate for research and development tax credits of 16% (2003: 16%)	**1,355,573**	1,109,274
Effects of:		
Expenses not deductible for tax purposes	**245,373**	214,015
Carry forward of tax losses	**(776,776)**	(752,012)
Difference between capital allowances and depreciation	**(37,498)**	124,201
Other short term timing differences	**(1,387)**	(326)
	785,285	695,152

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10 Intangible fixed assets

	Licence fees
	£
Cost	
At 1 January 2004	336,800
Additions	173,109
At 31 December 2004	**509,909**
Amortisation	
At 1 January 2004	336,800
Charge for the year	173,109
At 31 December 2004	**509,909**
Net book value	
At 31 December 2004	**-**
At 31 December 2003	-

Licence fee payments of £173,109 (2003: £60,309) have been capitalised in accordance with FRS 10, 'Goodwill and intangible assets'. However, due to the early stage nature of the research programmes, the directors believe that it is appropriate to immediately write off the intangible assets created. Accordingly, net operating expenses in the year reflect a £173,109 (2003: £60,309) charge relating to the amortisation of these assets.

11 Tangible fixed assets

	Assets under construction £	Leasehold improvements £	Plant and equipment £	Computer equipment and software £	Fixtures, fittings and equipment £	Total £
Cost						
At 1 January 2004	18,500	1,313,922	1,479,973	290,449	183,521	3,286,365
Additions	327,974	14,894	183,382	257,151	12,704	796,105
Disposals	-	(35,281)	-	(1,287)	-	(36,568)
Transfers	(346,474)	243,716	102,758	-	-	-
At 31 December 2004	**-**	**1,537,251**	**1,766,113**	**546,313**	**196,225**	**4,045,902**
Depreciation						
At 1 January 2004	-	40,744	398,612	182,592	45,304	667,252
Charge for the year	-	80,913	329,067	186,490	35,248	631,718
Disposals	-	(14,113)	-	(345)	-	(14,458)
At 31 December 2004	**-**	**107,544**	**727,679**	**368,737**	**80,552**	**1,284,512**
Net book value						
At 31 December 2004	**-**	**1,429,707**	**1,038,434**	**177,576**	**115,673**	**2,761,390**
At 31 December 2003	18,500	1,273,178	1,081,361	107,857	138,217	2,619,113

The net book values of tangible fixed assets secured under sale and financing leaseback agreements (see note 15) included in the above figures for the company is £nil (2003: £443,381).

12 Debtors

	2004 £	2003 £
Other debtors	**169,233**	114,391
Corporation tax recoverable	**785,285**	695,152
Prepayments and accrued income	**494,359**	395,203
	1,448,877	1,204,746

Other debtors includes £36,955 (2003: £36,265) falling due after more than one year in respect of a rent deposit from sub-tenants that is being held by a third party. An equal amount has been recorded in other creditors falling due after more than one year.

13 Short-term investments

Short-term investments, which are stated at cost, relate to bank deposits which are not repayable on demand.

14 Restricted cash deposits

Restricted cash of £444,073 in 2003 related to escrow deposits that were to be applied against the cost of fixed assets for the part of the premises that were under construction and the acquisition of certain other fixed assets. There is no restricted cash at 31 December 2004.

15 Creditors: amounts falling due within one year

	2004	2003
	£	£
Trade creditors	**452,694**	226,296
Other taxation and social security	**75,049**	62,828
Other creditors	**75,840**	88,768
Accruals and deferred income	**634,341**	572,863
Obligations under finance leases	**-**	201,037
	1,237,924	1,151,792

During the year, the company settled all outstanding finance lease obligations for an early settlement payment of £7,500.

16 Convertible loan

On 10 May 2004, the company entered into a convertible loan option agreement with various Apax Europe V Fund partnerships, to provide a facility to borrow a minimum of £1,000,000 and a maximum of £6,000,000 between 10 May 2004 and 9 May 2005. £3,000,000 was drawn down on 10 May 2004 and a further £3,000,000 was drawn down on 1 December 2004.

The loan notes are convertible at the option of the holder, on the date of first closing of any Series 'C' fundraising, into fully paid conversion securities, being the securities in the company that are offered to new investors subscribing for securities in the company as part of the Series 'C' fundraising. Unless previously redeemed or converted, the loan and any interest accrued will be repaid on 9 May 2005.

If the loan notes are not converted at the Series 'C' fundraising price, interest accrues at the rate of 20% per annum, from the date of issue of the loan notes. If the loan notes are converted at the Series 'C' fundraising price, no interest is due. As the interest payable on the loan notes is contingent on uncertain future events, no interest has been accrued on the loan notes at 31 December 2004.

The convertible loan notes are secured by way of legal mortgage over all leasehold property charged to the company at the date of the convertible loan and by a fixed charge over all the company's assets.

17 Creditors: amounts falling due in more than one year

	2004	2003
	£	£
Other creditors	**169,567**	320,211
Accruals and deferred income	**196,159**	-
	365,726	320,211

Other creditors comprises an unamortised rent free period of £132,612 (2003: £183,946) and rent deposit of £36,955 (2003: £36,265). In 2003, other creditors also included an advance of £100,000 for the acquisition of fixed assets, the terms of which had not been finalised. This is now being amortised over the life of the assets to which the contribution relates and has been reclassified to accruals and deferred income (see below).

Accruals and deferred income comprises a contribution of £126,307 from the sub-tenants towards the fit out of the sub-let area and a contribution of £69,852 from the landlord towards the purchase of leasehold improvements, both of which are being amortised over the life of the assets to which the contributions relate.

18 Deferred taxation

No provision for deferred taxation has been made as it is probable that no liability will arise in the foreseeable future.

The company had potential deferred tax (liabilities)/assets as follows:

	Amounts recognised 2004	**Amounts not recognised 2004**	Amounts recognised 2003	Amounts not recognised 2003
	£	**£**	£	£
Tax effect of timing differences because of:				
Differences between capital allowances and depreciation	-	**(184,110)**	-	(260,602)
Losses	-	**3,819,690**	-	2,435,565
Short-term timing differences	-	**14,583**	-	6,395
	-	**3,650,163**	-	2,181,358

The potential deferred tax asset in respect of cumulative losses has not been recognised in these financial statements as there is no immediate prospect of these being utilised. The losses are available to be carried forward indefinitely under current law.

19 Called up share capital

	2004	2003
	£	£
Authorised		
8,000,000 (2003: 8,000,000) 'A' preferred ordinary shares of 1p each	**80,000**	80,000
35,714,286 (2003: 35,714,286) 'B' preferred ordinary shares of 1p each	**357,143**	357,143
4,640,750 (2003: 4,640,750) ordinary shares of 1p each	**46,408**	46,408
2,836,750 (2003: 2,836,750) 'A' ordinary shares of 1p each	**28,368**	28,368
1,000,000 (2003: nil) special interest shares of 1p each	**10,000**	-
	521,919	511,919

	2004	2003
	£	£
Issued, allotted, called up and fully paid		
8,000,000 (2003: 8,000,000) 'A' preferred ordinary shares of 1p each	**80,000**	80,000
14,285,715 (2003: 14,285,715) 'B' preferred ordinary shares of 1p each	**142,857**	142,857
1,140,750 (2003: 1,140,750) ordinary shares of 1p each	**11,407**	11,407
2,836,750 (2003: 2,836,750) 'A' ordinary shares of 1p each	**28,368**	28,368
500,000 (2003: nil) special interest shares of 1p each	**5,000**	-
	267,632	262,632

Authorised share capital
On 10 May 2004, the authorised share capital was increased from £511,919 to £521,919 by the creation of 1,000,000 special interest shares of 1p each.

Issued share capital
On 10 May 2004, 500,000 special interest shares of 1p each (nominal value: £5,000) were issued for consideration of £500,000. Issue costs of £1,868 were deducted from these proceeds.

Class rights
The company has in issue five classes of shares: 'A' preferred ordinary shares of 1p each, 'B' preferred ordinary shares of 1p each, ordinary shares of 1p each, 'A' ordinary shares of 1p each and special interest shares of 1p each.

Dividend rights
The 'A' and 'B' preferred ordinary shares rank pari passu in all respects as to dividends, and in respect of the amount payable, with the ordinary shares and the 'A' ordinary shares. No dividend may be declared or paid on the ordinary or 'A' ordinary shares without a like dividend being declared or paid on the 'A' or 'B' preferred ordinary shares. The special interest shares have no rights to dividends or distributions.

Return of capital
On a return of assets on a liquidation or otherwise, the surplus assets of the company remaining after payment of its liabilities shall be allocated between the shareholders as set out below. On a sale, the total of all and any consideration received in respect of the ordinary share capital will be reallocated between the sellers of such shares as follows:

a) first, in paying to the holders of any special interest shares an amount equal to one times the subscription price plus an amount equal to an annual rate of return of 20% on the subscription price paid by the relevant holder of the special interest shares, which shall accrue daily from day to day whilst such shares are outstanding, shall compound annually and shall be calculated on the basis of a 365 day year;

b) secondly, in paying to the holders of any 'B' preferred ordinary shares an amount equal to the subscription price on all shares together with all arrears (in proportion to the aggregate subscription price paid for such shares);

c) thirdly, in paying to the holders of any 'A' preferred ordinary shares an amount equal to the subscription price on all shares together with all arrears (in proportion to the aggregate subscription price paid for such shares by each of them); and

d) fourthly, the balance of the remaining assets (if any), or any remaining proceeds of a sale, shall be distributed amongst the holders of the ordinary shares, 'A' ordinary shares and 'B' preferred ordinary shares in proportion to the aggregate number of ordinary shares and/or 'A' ordinary shares and/or 'B' preferred ordinary shares held by each of them provided that the maximum amount which the holders of 'B' preferred ordinary shares shall be entitled to receive shall be one and one half times the subscription price of such 'B' preferred ordinary shares (plus any arrears).

Voting rights
Each shareholder shall have one vote for each share held at general meetings of the company. The holders of special interest shares shall not be entitled to receive notice of, attend general meetings or be entitled to vote at such meetings.

Ionix Pharmaceuticals Limited

20 Share options

The company has issued share options under the Ionix Enterprise Management Incentive Share Option Scheme and the Ionix Unapproved Share Option Scheme, both of which were established in August 2001.

Options have been granted over the following number of 1p ordinary shares:

Date granted	Exercise price £	Period when exercisable (Note i and ii)	Number of shares
17 December 2001	0.10	1 October 2002 to 16 December 2011	71,143
19 December 2001	0.10	9 July 2002 to 18 December 2011	326,425
25 January 2002	0.10	1 January 2003 to 24 January 2012	169,697
25 January 2002	1.00	25 January 2002 to 24 January 2012 (a)	10,000
15 February 2002	0.10	28 January 2003 to 14 February 2012	48,000
14 June 2002	0.10	1 June 2003 to 13 June 2012	100,000
14 June 2002	0.30	14 May 2003 to 13 June 2012	42,774
19 June 2002	0.10	29 April 2003 to 18 June 2012	100,000
19 June 2002	0.30	25 March 2003 to 18 June 2012	210,912
19 July 2002	0.30	1 July 2003 to 18 July 2012	65,000
20 August 2002	0.30	1 July 2002 to 19 August 2012	64,000
23 September 2002	1.00	1 October 2002 to 22 September 2012 (a)	10,000
15 August 2003	0.10	1 April 2004 14 August 2013 (b)	213,353
15 August 2003	0.20	1 April 2003 14 August 2013	63,763
15 August 2003	0.70	1 February 2003 14 August 2013	220,000
15 August 2003	0.35	1 April 2004 14 August 2013	20,000
17 December 2003	0.10	1 April 2004 16 December 2013 (b)	279,412
17 December 2003	0.20	1 April 2004 16 December 2013	294,237
4 June 2004	0.10	1 March 2005 3 June 2014	200,000
4 June 2004	0.20	1 March 2005 3 June 2014	65,000

Date granted	Exercise price £	Period when exercisable (Note i and ii)	Number of shares
15 June 2004	0.70	1 January 2004 14 June 2014(a)	20,000
Total			**2,593,716**

Note i: Except as stated in notes (a) and (b) below, 25% of these options are exercisable one year after the initial vesting date, with the remainder vesting on a straight-line basis over a remaining three year period.

Note ii: The options have been group according to their date of grant and exercise price. The period when exercisable represents the first and last dates that options can be exercised.

(a) All these options vest and are exercisable immediately.

(b) 50% of these options are exercisable from 1 April 2004 with the remainder vesting on a straight-line basis over the following year.

Reconciliation of movements in share options	Number of options
At 1 January 2004	2,465,165
Additions in year	285,000
Lapsed in year	(156,449)
At 31 December 2004	**2,593,716**

21 Reserves

	Share premium account £	Profit and loss account £
At 1 January 2004	17,623,157	(11,360,546)
Loss for the financial year	-	(7,687,049)
Premium on shares issued (net of issue costs of £1,868)	493,132	-
Reversal of share option compensation charge	-	63,024
At 31 December 2004	**18,116,289**	**(18,984,571)**

22 Reconciliation of movements in shareholders' (deficit)/funds

	2004	2003
	£	£
Loss for the financial year	**(7,687,049)**	(6,237,809)
Reversal of share option compensation charge	**63,024**	84,281
Net proceeds of issue of ordinary share capital	**498,132**	9,955,324
Net (deduction)/addition to shareholders' funds	**(7,125,893)**	3,801,796
Opening shareholders' funds	**6,525,243**	2,723,447
Closing shareholders' (deficit)/funds	**(600,650)**	6,525,243

23 Pensions

The company makes contributions to personal stakeholder pensions of certain employees. The pension cost for the year amounted to £195,770 (2003: £170,134). At 31 December 2004, there were outstanding contributions totalling £23,614 (2003: £21,318).

24 Financial commitments

At 31 December 2004, the company had annual commitments under non-cancellable operating leases expiring as follows:

	Land and buildings 2004	**Other 2004**	Land and buildings 2003	Other 2003
	£	**£**	£	£
Within one year	**6,833**	**-**	8,013	-
Between two and five years	**-**	**2,412**	-	2,412
After five years	**1,026,676**	**-**	1,026,676	-
	1,033,509	**2,412**	1,034,689	2,412

25 Capital commitments

Amounts contracted for future capital expenditure but not provided for in the financial statements are as follows:

	2004	2003
	£	£
Contracted but not provided for	**-**	444,389

26 Related party transactions

The Ann Hayes Consultancy Limited is a related party as Dr Ann Hayes is a director of that company. During the year, The Ann Hayes Consultancy Limited has provided consultancy services to the company to the value of £7,680 (2003: £17,280). No amounts were outstanding at 31 December 2004 (2003: £nil).

Inpharmatica Limited is a related party as Dr Edwin Moses is a director of that company. During the year, Inpharmatica Limited has provided ADME screening and consultancy services to the company to the value of £508,020 (2003: £137,645). £85,397 was included in creditors at 31 December 2004 (2003: £31,075).

Apax Europe V Fund partnerships are related parties as they are significant shareholders in Ionix Pharmaceuticals Limited. On 10 May 2004, the company entered into a convertible loan option agreement with various Apax Europe V Fund partnerships, to provide a facility to borrow a minimum of £1,000,000 and a maximum of £6,000,000 between 10 May 2004 and 9 May 2005. £3,000,000 was drawn down on 10 May 2004 and a further £3,000,000 was drawn down on 1 December 2004. See note 16 for further details.

27 Ultimate controlling party

Under the provision of FRS 8 'Related party disclosures, the ultimate controlling party of the company is deemed to be the partnerships of Apax Europe V Fund by virtue of their shareholding.

28 Post balance sheet events

On 22 February 2005, the company signed an agreement with Reckitt Benckiser Healthcare relating to a multi-product strategic alliance. The alliance involves collaboration on the development and commercialisation of IX-1003, intranasal buprenorphine for acute pain and expands the company's intranasal opioid development portfolio through the addition of IX-1004 for chronic pain and IX-1005 for opiate addiction. Under the agreement, the company and Reckitt Benckiser Healthcare will jointly develop all three products and Reckitt Benckiser Healthcare will be responsible for worldwide manufacture and marketing. The company has retained an option to co-promote IX-1003 in the United States and will receive a stream of revenues, including substantial milestone and royalty payments through the development and commercialisation of all three products. To support this strategic alliance, on 22 February 2005 the company expanded its agreements with Archimedes Development Ltd (formerly West Pharmaceuticals Services Drug Delivery & Clinical Research Centre Ltd) relating to licences for intranasal drug delivery technology.

On 1 March 2005, the company refocused its research and development activities on later stage projects and substantially reduced its investment in pipeline projects. As a result, the company served notice of redundancy of eighteen positions on that date, reducing the number of employees to thirty-one scientists and business professionals upon completion of the redundancy process in second quarter 2005.

On 30 June 2005, the company entered into agreements with the Landlord and its affiliates to assign the property lease relating to its facility on the Cambridge Science Park to Trinity College upon completion of the planned merger or sale of the company and the Company relocated its operations to an office facility in the centre of Cambridge.

On 5 July 2005, the company and its shareholders entered into a binding agreement to effect the sale of the entirety of the share capital of the company to Vernalis plc to facilitate further development and commercialisation of the company's candidate products and projects. As a result, the company served notice of redundancy of sixteen positions in the period 7-8 July 2005 with the effect that eleven positions terminated on 8 July 2005 and the remaining five positions will terminate on completion of the sale.