

COMMERCIALISING UNIVERSITY INTELLECTUAL PROPERTY

WEDNESDAY



AIJCHN2T

A20

14/02/2007

656

COMPANIES HOUSE

bioFusion

biofusion plc annual report
and accounts 2006

COMPANY NUMBER 5275732

portfolio companies

as at the date of this report, our portfolio comprised the following companies:

Axordia was founded by two of the world's leading stem cell scientists, Professors Peter Andrews and Harry Moore, to exploit human stem cells (hES). The company has unique patented cell lines and the bio-processing tools that are required by the major pharmaceutical companies to develop hES cells for both drug discovery and therapeutic applications. Axordia already has four stem cell lines in the UK Stem Cell Bank and its strategy is to develop hES cell technology for the pharmaceutical and biotechnology industries while pursuing longer term goals in regenerative medicine.

BioActa has discovered novel inhibitors of angiogenesis, a process important in diseases such as cancer, rheumatoid arthritis and diabetic retinopathy. Its product, Alphastatin™, was designed using BioActa's understanding of the proteins involved in regulating angiogenesis.

Biofusion Licensing is a vehicle for identifying, developing and licensing IP that would not otherwise be suitable for establishing spin-out companies.

Lifestyle Choices launched its first product, a new triple hormone ovarian reserve test called Plan Ahead, in January 2006. It believes this test offers the most accurate hormone based ovarian reserve test available to the public, enabling women to make more informed decisions about whether to try for a baby sooner rather than later. Developed by Professor Bill Ledger, Professor of Obstetrics and Gynaecology at the University of Sheffield, the Plan Ahead test gives a predictive assessment of a woman's ovaries compared to that expected for women of the same age.

Mantelum was formed to fund research focused on specific cell surface receptor targets, especially those related to the G-protein coupled receptor (GPCR) superfamily. GPCR's are involved in a wide range of disorders including allergies, cardiovascular disease, pain, depression, cancer, obesity, diabetes and a variety of central nervous system disorders.

Phase Focus is developing an alternative approach to microscopy and imaging that does not rely on sophisticated lenses and has applications in optical, X-ray and electron microscopy, amongst others. Professor John Rodenburg, a founder of Phase Focus, is the inventor of a process that can generate high definition images of an object without the need for the high quality lenses that account for a significant element of the cost of high-performance microscopes.

biofusion model for portfolio investment

start-up

Up to £200k investment

1 bioFusion
Management
work with portfolio
company to:

- Develop initial business plan
- Provide management expertise and contacts
- Provide initial funding

Adjuvantix intends to use proprietary adjuvants to develop a range of improved prophylactic and therapeutic vaccines. It aims to exploit this technology to develop adjuvant systems suited to a wide range of vaccine antigens, including proteins, peptides, polysaccharides and organic molecules that are designed to provide the desired antibody or cell-mediated immune response for any given clinical application.

Aperio is a spin-out company from Medipex, the NHS commercialisation company for Yorkshire and North Humberside, which is developing a medical device to detect pre-cancerous cells in the cervix. The patented device, which is currently at prototype stage, is targeting the worldwide colposcopy market and was developed in conjunction with University of Sheffield academics.

Asterion is developing novel proteins with the potential to treat a range of cytokine disorders and is based upon structural and cellular molecular biology. Asterion has developed its technology base using growth hormone as a model system, but its approach has applicability to many other cytokines. Its platform technology should enable it to produce products that exhibit delayed clearance, do not significantly alter ligand-receptor affinity and have a reduced likelihood of side effects and unwanted immune responses.

CellTran provides active wound care by delivering living cells for the treatment and active healing of burns and chronic wounds in skin. Its products deliver a wound treatment based on a patient's living skin cells by growing these cells outside of the body on a specially synthesised polymer layer. These cells are critical in the early stage healing of serious wounds and provide natural wound healing without immunological rejection issues. CellTran's technology leads a new generation of treatments that use living tissue for the regeneration of normal and healthy skin.

Diurnal and its development partner Phoqus plc have developed a tablet that utilises Diurnal's 'delayed and sustained release therapy' patent to deliver hydrocortisone in a manner that mimics the normal physiological circadian rhythm. This clearly defined rhythm, with high levels in the morning and low levels at night, is lost in patients with adrenal insufficiency. The product, which has successfully completed Phase 1 clinical studies, has received Orphan Medicinal Product designation from the European Medicines Agency, which affords ten years of market exclusivity after the grant of a marketing authorisation in Europe.

Genophrenix has identified several proteins and their genes that interact with a key component that is implicated in schizophrenia. By understanding which genes are involved in the disease and targeting these rather than attempting to treat the symptoms, Genophrenix believes that more specific and efficacious drugs can be developed with reduced side effects. Genophrenix will initially focus on developing targets and compounds to treat schizophrenia and aims to provide commercially viable licensing opportunities that will be attractive to the global pharmaceutical industry.

Simcyp develops software and databases specifically designed to inform the processes of drug discovery and development by simulating virtual patient populations to identify individuals at extreme risk. The company is supported and guided by a consortium of global pharmaceutical companies.

Simcyp is currently trading profitably and has long term contracts with many of world's leading pharmaceutical companies.

Plasso Technology is a surface engineering company that uses its proprietary technology to create novel chemical coatings to develop advanced labware consumables in cell culture, stem cell culture, glycomics and HTS. These coatings are applied to many different formats such as microarrays, lab-on-a-chip, microtitre plates and T-flasks used in life science research and diagnostics. Plasso's Directors estimate this market is worth US\$700m. Plasso's strategy is to develop its own product ranges of added value consumables.

exit

2 bioFusion 'University' Fund

Up to £500k cornerstone investment

- Recruit management
- Develop business
- Raise third party funding
- Reduce involvement
- Company growth period leading to exit

Rest of investment as required

Investment as required

3 bioFusion NPI Venture Side Fund

corporate statement

Biofusion plc was founded in 2002 to develop long term relationships with research intensive institutions in the UK and commercialise their intellectual property (IP).

Our commercialisation model works on the simple premise that all partnerships are more efficient and effective when the partners are able to concentrate on their core skills – so the university and their academics focus on IP creation and we focus on commercialising this IP through licensing and the creation of spin-out companies to generate value for our shareholders.

the Biofusion partnership model

IP creation

commercialisation

University

Tech Transfer

bioFusion

**bioFusion
Newco**

Sign long term pipeline agreements with universities and directly align their interest with an equity position in Biofusion.

Work with the existing tech transfer offices who use their relationships with academics to mine for and protect IP with commercial potential.

Biofusion selects IP and transfers it to a Newco 100% owned by Biofusion.

Biofusion makes investment in Newco and aligns academic team with an equity position in Newco.

highlights

- Signing a major £10m investment agreement with NPI Ventures Limited (NPI Ventures), part of Nikko Cordial Corporation, one of Japan's largest securities houses.
- Raising an additional £2.0m from NPI Ventures.
- Investing £1.7m (2005: £Nil) in a number of our portfolio companies, with a further £0.3m invested subsequent to the year end.
- Raising £2.1m (2005: £1.5m) in third party funding for a number of the portfolio companies which are moving towards the exit stage of their development.
- Creating four new portfolio companies.
- Developing relationships with other leading universities as we seek to expand the Biofusion IP commercialisation model.

corporate statement

portfolio companies

01 highlights

02 chairman's statement

04 chief executive's review

10 board of directors

12 corporate governance

14 report on directors' remuneration

18 directors' report

20 statement of directors' responsibilities

21 independent auditors' report

22 consolidated profit and loss account

23 consolidated balance sheet

24 company balance sheet

25 consolidated cash flow statement

26 notes to the financial statements

42 notice of annual general meeting

43 form of proxy

chairman's statement

"...this is an exciting time for university IP exploitation and we believe Biofusion is well placed to be at the forefront of this development."

I am delighted to present our results for the year ended 31 July 2006. This has been our first full financial year since our listing on AIM in February 2005 and we have had a busy and productive year.

We have made excellent progress in the first 18 months of our ten year commercialisation agreement with the University of Sheffield (Sheffield) by securing access to third party funding from a major Japanese securities house, investing in a number of our more mature portfolio companies to progress them towards an exit and creating four new companies from the high quality Sheffield pipeline.

During the year turnover increased to £279k (2005: £230k) and as expected, our losses increased to £607k (2005: £397k).

Our core strategy remains to generate value from a portfolio of companies by:

- establishing strong long term IP pipeline agreements with research intensive universities;
- investing in early stage spin-out companies from our pipeline agreements;
- providing management experience to help these companies through the start-up and early growth phases of their development;
- accessing third party funding to ensure that spin-out companies can quickly reach the higher value phase of their development; and
- exiting these portfolio companies whilst our shareholding remains high and the value of the company is increasing.

The University of Sheffield pipeline

The pipeline of potential IP that we can exploit from Sheffield continues to grow and we continue to enjoy excellent relationships with both Sheffield University Enterprises Limited (SUEL), Sheffield's technology transfer company, and directly with the key academic departments. We are confident that we will continue to meet, and hopefully exceed, our target of incorporating two to three companies per annum from Sheffield's pipeline.

Portfolio companies

We had an excellent year in building our portfolio of companies and we now own shareholdings in 14 companies (12 companies at 31 July 2006 and two more companies were added subsequent to the year end). We believe the portfolio has a balanced mix of short, medium and long term investments and we remain committed to, and focused on, achieving exits for these portfolio companies, at the appropriate time, to realise their value to our shareholders.

The NPI Ventures agreement

In March we signed a strategic partnership with NPI Ventures Limited, the technology investment business wholly-owned by Nikko Principal Investments Limited, the European principal finance arm of Nikko Cordial Corporation, which is listed on the Tokyo Stock Exchange. The key terms of the agreement were as follows:

- NPI Ventures established a £10m side fund (Side Fund) for the dedicated purpose of investing in Biofusion portfolio companies;
- NPI Ventures took an equity investment in Biofusion by subscribing for 1,496,445 new Ordinary Shares at 133.65p per new Ordinary Share and with a total subscription price of £2m (£1.93m, net of expenses) giving NPI Ventures 7.37% of the Enlarged Issued Share Capital; and
- warrants were granted to NPI Ventures with a total potential subscription value of £6.25m. The warrants are exercisable at prices between 150p and 220p.

Our core strategy is to generate value for our shareholders by:

- establishing strong long term IP pipeline agreements with research intensive universities;
- investing in early stage spin-out companies from our pipeline agreements;
- providing management experience to help these companies through the start-up and early growth phases of their development;
- accessing third party funding to ensure that spin-out companies can quickly reach the higher value phase of their development; and
- exiting these portfolio companies whilst our shareholding remains high and the value of the company is increasing.

The Directors believe that the Side Fund will have a number of significant benefits to Biofusion, including:

- increasing the ability of our portfolio companies to raise third party funding to support their expansion and growth;
- reducing the time it takes to raise third party funding; and
- significantly enhancing Biofusion's position within the university IP commercialisation market and in turn enhancing the group's prospects of reaching attractive agreements with other universities and research establishments.

In addition the agreement allows for a potential increase in the size of the Side Fund which we believe will be seen positively by other universities and research institutions.

Expansion of the Biofusion model

We have developed excellent relationships with a number of leading UK universities and remain committed to signing other university agreements. In the UK, the Directors believe the Biofusion model is the only commercialisation model that directly aligns the interest of the university and the commercialisation company by offering the university equity shareholdings in the public company itself; which is why we believe other universities will find our model attractive.

Directorate change

In March 2006 Simon Oakland became a Non-executive Director of the board. Simon is a Director of NPI Ventures and brings with him a wealth of corporate finance and investment experience. We welcome him onto the board of Biofusion.

Outlook

This is an exciting time for university IP exploitation and we believe Biofusion is well placed to be at the forefront of this development. We have an excellent pipeline of IP, a growing portfolio of high quality companies, a dedicated Sheffield fund with cash of £5.9m, a £10m third party Side Fund that will enable us to fund many of our existing and future portfolio companies through to exit, and an exploitation model that we believe will be attractive to other universities.

We look forward to 2007 with considerable optimism.



Doug Liversidge CBE
Chairman
17 October 2006

chief executive's review

"...we remain committed to, and focused on, achieving exits for our portfolio companies, at the appropriate time, to realise their value to our shareholders."

This has been an excellent year for Biofusion during which we have invested considerable time and money in developing a number of our portfolio companies. We remain committed to, and focused on, achieving exits for the portfolio companies, at the appropriate time, to realise their value to our shareholders.

Our portfolio of companies

We began the year with eight portfolio companies in varying stages of development; from early stage drug based research requiring significant investment, to service based businesses that are trading profitably and require no further investment. During the year we developed these companies by a combination of our own investment, finding third party investment and where appropriate, management support. An update on each company is provided below:

Asterion Limited

Biofusion money invested during year	£250k*
Third party funds raised during year	£105k
Biofusion shareholding	38%

Asterion is developing specialised hormones (cytokines) which are implicated in a range of diseases including diabetes and cancer as well as obesity, growth and inflammatory disorders. Asterion has developed and patented a range of technologies to produce cytokine agonists and antagonists which have the potential to produce drugs which will lower dose requirements, increase stability and slow clearance from the bloodstream, all leading to potentially improved performance.

Asterion has established a research programme with Ipsen to develop growth hormone antagonists and agonists. In addition Asterion is expanding its research and technologies to further target hormones which include:

- established pharmaceuticals such as erythropoietin; and
- drug targets of the future such as the hormone Leptin, which has been implicated in multiple sclerosis.

* Biofusion invested £250k in Asterion in May 2006. The money was invested as cash in return for equity and raised Biofusion's shareholding to 38%.

Adjuvantix Limited

Biofusion money committed during year	£240k*
Third party loans converted during year	£75k
Biofusion shareholding	41%*

Adjuvantix has developed a new approach to stimulate the immune system safely and increase the effectiveness of a wide range of vaccine antigens including proteins, peptides, polysaccharides and small organic molecules and thus improve vaccines for any clinical application. The technology has the potential to improve drugs for cancer and inflammatory diseases as well as infectious diseases such as TB and AIDS.

Studies of influenza and other model antigens have shown it capable of increasing antibody responses up to 1,000-fold. This capability would allow the development of vaccines against diseases where current technologies fail or where the immune system is weakened, for example in AIDS or after radio or chemotherapy.

*Biofusion's investment of £240k will be made in two tranches, the first investment of £120k was made in July 2006 and took our shareholding to 41%. The second tranche of £120k is milestone dependent and, when fully invested, will take our holding in Adjuvantix to 49%.

Axordia Limited

Biofusion money committed during year	£529k*
Third party loans converted during year	£105k**
Biofusion shareholding	36%

Axordia is one of the UK's leading stem cell research companies and is one of only a few companies in the world able to derive its own human embryonic stem cells. It has had a busy and successful year:

- signed an exclusive agreement with Chemicon, a wholly-owned subsidiary of Millipore to co-develop new antibody markers from Axordia's proprietary human embryonic stem cell lines;

Celltran's active wound care product – MySkin™.

- had four cell lines accepted by the UK Stem Cell Bank and agreed terms for the derivation of clinical grade stem cell lines in the Centre for Stem Cell Biology's new £2.5m bespoke GMP stem cell facility and research laboratory at Sheffield University; and
- signed an agreement with a leading US company for the derivation of a GMP cell line. The line is licensed for a specific therapeutic application and the arrangement includes both upfront payments to Axordia and a royalty stream based on commercialisation revenues.

Subsequent to the year end Axordia also announced the following:

- significant support for its research programme, in £1.8m collaboration with Sheffield and Lombard Medical Technologies, which includes a £0.9m grant, from the DTI and MRC, for the development, through to clinical trials, of a regenerative stent – a new generation treatment for cardiovascular disease; and
- participation in the European Commission "ESTOOLS" programme. ESTOOLS is a world leading £12m stem cell research initiative that will advance the fundamental understanding and biomedical applications of human embryonic stem cells.

* Biofusion's investment in Axordia was provided in two parts. The first part was provided as convertible loan stock in two tranches, with £280k invested in January 2006 and a further £140k invested, subsequent to the year end, in August 2006. The second part involved Biofusion taking over a £109k loan due from Axordia to SUEL, in settlement of payments due from SUEL to Biofusion.

** White Rose Seedcorn Technology Fund converted an outstanding loan for £105k as part of the funding round.

Bioacta Limited

Biofusion money invested during year	£10k
Third party funds raised during year	£Nil
Biofusion shareholding	52%

Bioacta has IP in the field of angiogenesis which is key in the treatment of cancer, rheumatoid arthritis and ophthalmic diseases. After careful review of the company's progress the board has decided to fully impair the remaining unamortised value of goodwill generated on acquisition. In accordance with the terms of the agreement with Sheffield, we have released any liability associated with the purchase of Bioacta. As a result we have recorded an impairment charge of £420k and released the associated liability of £601k, resulting in a £181k credit to the profit and loss account.

This treatment demonstrates one of the strengths of our agreement with Sheffield, in that we only make payment for the companies we acquired, to the extent that Biofusion realises an income from the companies to which they relate.

Celltran Limited

Biofusion money committed during year	£775k*
Third party fund raised during year	£2.0m
Biofusion shareholding	24.1%

Celltran provides active wound care by delivering living cells for the treatment and active healing of burns and chronic wounds in skin. Its products deliver a wound treatment based on a patient's living skin cells by growing these cells outside of the body on a specially synthesised polymer layer. Celltran's technology leads a new generation of treatments that use living tissue for the regeneration of normal and healthy skin.

In August 2005 Biofusion helped Celltran raise £2.7m in a funding round involving South Yorkshire Fund Managers, Partnerships UK, Yorkshire Fund Managers and White Rose Seedcorn Technology Fund. As part of this round Biofusion committed to investing £775k.

chief executive's review

continued

In July 2006 Celltran announced that it was in exclusive talks with the Belgian company Innogenetics N.V. to merge the wound care activities of Celltran and Xcellentis, a wholly-owned subsidiary of Innogenetics N.V. The merger, which was completed subsequent to the year end on 2 October 2006, combines Celltran's specialist provision of wound treatment products and services with Xcellentis' clinical stage pipeline of lead candidates for the treatment of chronic, hard to heal wounds.

Biofusion holds 12.4% of the enlarged company.

* During the year Biofusion committed to investing £775k in Celltran. £77,500 was committed to be invested as equity and a further £697.5k was committed to be invested as a convertible loan with an option to convert at a future funding round. As at the year end £629k of this money had been invested and subsequent to the year end the remaining £146k was invested in September 2006.

Diurnal Limited

Biofusion money invested during year	£6k*
Third party funds raised during year	£Nil
Biofusion shareholding	60%

Diurnal seeks to develop means for the controlled and sustained release of novel and known compounds in a manner which mimics the circadian rhythm. The first product to be developed from its portfolio is 'Chronocort' that contains the steroid hydrocortisone. The marked circadian rhythm of hydrocortisone release, with high levels in the morning and low levels at night, is lost in patients with adrenal insufficiency. The Diurnal management believes that the product, being developed in collaboration with Phocus Group plc (Phocus) under a licence agreement, will offer a much needed improvement in steroid treatment for patients with adrenal insufficiency.

Plasso's first product – EpranEx™.

A Phase I clinical trial in human volunteers was successfully completed in April 2006 by Diurnal and Phocus, which showed the first data for potential circadian endocrine treatment for adrenal insufficiency. Subsequent to the year end, on 2 October 2006, Phocus announced that it had raised £3m to take Chronocort into Phase II trials, subject to approval by Phocus shareholders.

* Biofusion invested £6k in Diurnal in February 2006. The money was invested as cash for equity.

Plasso Technology Limited

Biofusion money invested during year	£Nil
Third party funds raised during year	£Nil
Biofusion shareholding	9%

Plasso Technology is a surface engineering company, that uses its patented technology to create novel surface coatings that can be used in microarrays, lab-on-a-chip and microtitre plates used in medical life sciences and diagnostics. Plasso's Directors estimate this market is worth US\$1.2b. Plasso's strategy is to forge long term commercial partnerships with the major suppliers in the bioinstrumentation, biosensors and diagnostics markets, as well as developing its own product ranges such as sugar chip and novel substrates for mass spectrometry.

Simcyp Limited

Biofusion money invested during year	£Nil
Third party funds raised during year	£Nil
Biofusion shareholding	24.9%

Simcyp develops algorithms, databases and software designed to inform the process of drug discovery and development by simulating virtual patient populations to identify individuals at extreme risk of drug reactions and interactions.

Simcyp and its Population Based ADME Simulator provides valuable information for key management decisions relating to clinical trial design, clinical trial avoidance, and data sheet statements as they relate to drug-drug interactions.

Lifestyle Choices, our first new spin-out company, launched its ovarian reserve test in January 2006.

In addition, the ADME Simulator identifies pivotal pre-clinical data requirements, which has proved valuable in redefining and optimising early drug development processes and procedures.

Simcyp is guided by an interactive consortium of global pharmaceutical companies and drug regulatory agencies, including the US FDA, providing a platform for continual refinement and discussion of the key scientific issues.

During its last financial year Simcyp turned over £1.48m (2005: £1.0m), made a net profit before tax of £385k (2005: £179k) and has signed further long term contracts with more of the world's leading pharmaceutical companies.

New portfolio companies

The quality of intellectual property coming out of Sheffield's medical life science pipeline is proving to be excellent and we have been able to create four new portfolio companies during the year (2005: none).

Lifestyle Choices Limited

Incorporated October 2005	
Biofusion money invested during year	£222k*
Biofusion shareholding	60%

Lifestyle Choices was our first new spin-out company from the University of Sheffield pipeline agreement. In January 2006 Lifestyle Choices launched its first product, a new triple hormone ovarian reserve test for women called Plan Ahead, developed by Professor Bill Ledger, Professor of Obstetrics and Gynaecology at the University of Sheffield. The test enables women to make more informed decisions about whether to try for a baby sooner rather than later. Lifestyle Choices is focused on capitalising on the initial take-up of the product to expand distribution of the product in the UK and developing its opportunities to sign up distribution partners overseas.

* Biofusion's investment of £222k was made in two tranches. The first tranche of £102k was provided to the company as a loan on start-up and the second tranche of £120k was invested for equity in April 2006, taking Biofusion's shareholding from 50% to 60%.

Genophrenix Limited

Incorporated January 2006	
Biofusion money committed during year	£140k*
Biofusion shareholding	60%

Based on the work of Dr Jamal Nasir, of the University of Sheffield Medical School, Genophrenix has identified several proteins and their genes that interact with a key component that is implicated in schizophrenia. By understanding which genes are involved in the disease and targeting these rather than attempting to treat the symptoms, Genophrenix believes that more specific and efficacious drugs can be developed with reduced side effects.

* Biofusion has committed to invest £140k in Genophrenix. The first £70k was invested in March 2006 as a loan and the second £70k will be invested, on completion of certain milestones, as a loan with the option to convert to equity at the next funding round.

Mantelum Limited

Incorporated June 2006	
Biofusion money committed during year	£50k*
Biofusion shareholding	100%

Mantelum is a new company formed to access research focused on specific cell surface receptor targets, especially those related to the G-protein coupled receptor (GPCR) superfamily. GPCRs are involved in a wide range of disorders including allergies, cardiovascular disease, pain, depression, cancer, obesity, diabetes and a variety of central nervous system disorders. They are attractive drug targets because their location on the cell surface makes them readily accessible to drugs and they are involved in every major mammalian physiological system.

* Biofusion has committed to invest up to £50k in Mantelum. The first £5k was invested as a loan, subsequent to the year end, in September 2006 and the remaining £45k will also be invested as a loan on completion of agreed milestones.

chief executive's review

continued

Phase Focus Limited

Incorporated June 2006	
Biofusion money committed during year	£200k*
Biofusion shareholding	60%

Phase Focus is developing an alternative approach to microscopy and imaging that does not rely on sophisticated lenses and has applications in optical, X-ray and electron microscopy, amongst others. Professor John Rodenburg, a founder of Phase Focus, has patent applications pending for a process that can generate high definition images of an object without the need for the high quality lenses that account for a significant element of the cost of high-performance microscopes.

* Biofusion has committed to investing £200k in Phase Focus. The first £10k was invested as a loan at start-up, a further £20k was invested in October 2006 and the remaining £170k will be invested on the completion of agreed milestones. All monies were invested as loans with an option to convert at the next funding round.

Subsequent to the year end we have started one more new company called Biofusion Licensing Limited and took over the University of Sheffield's 18% shareholding in Aperio Diagnostics Limited, a company developing a medical device to detect pre-cancerous cells in the cervix.

Business review

The group's financial performance was much in line with our expectations. The loss for the year of £607k was a 53% increase from the prior year (2005: £397k), however given that there was only six months of full trading in the prior year, following the company's listing on AIM in February 2005, the rate of operating loss has not significantly increased within the business in the period under review.

At £279k (2005: £230k), turnover showed a modest increase over the prior year when the majority of turnover related to the exit of Biofusion's share holding in Molecular Skincare Limited. Turnover in the current year relates

to services provided to associated and related companies. The nature of this turnover is reflected in the greatly improved gross profit of 91% (2005: 55%). In 2005 the cost of sales were higher because they included the costs of acquiring our shareholding in Molecular Skincare Limited.

Green fluorescent stained trophoblast cells, counterstained to show nucleus in orange.

Administrative expenses for the year, before exceptional items, were £1.2m (2005: £616k). This increase was due to the following:

- in 2005 the group was only fully trading for the period from January 2005 to July 2005 and hence only had full costs for six months of the year;
- administrative expenses for the year included £75k relating to the NPI Ventures transaction; and
- because expenditure incurred by subsidiaries, which the group consolidates, increased during the year to £269k (2005: £33k).

During the year we had net exceptional income of £181k. The exceptional income represents the net impact of the impairment of goodwill relating to the acquisition of Bioacta and the release of related loan notes and accrued interest. This credit demonstrates one of the strengths of our business model, in that the loans used to purchase our initial portfolio are only repayable to the extent that Biofusion realises an income from the companies to which they relate. Because of this mechanism, we have been able to write back the outstanding loan and accrued interest balances which were greater than the amortised goodwill, resulting in a net credit being taken to the profit and loss.

Interest income during the year increased 146% to £349k (2005: £142k). This was made up of both interest generated on the group's significant cash holdings and on interest relating to loans made to the group's portfolio companies. Interest payable of £102k (2005: £69k) relates, in the main, to interest accrued on the loan notes used to purchase the company's share holding in the portfolio companies acquired from Sheffield as part of the IPO in February 2005.

During the year we relocated to the new specialist bioincubator offices in Sheffield.

During the year the investments caption on the balance sheet increased to £3.4m (2005: £1.8m). The increase in the year was made up of both equity investments and convertible loan investments, plus accrued interest, in a number of our portfolio companies. The increases were as follows:

Company	Increase
Celltran	£697k
Axordia	£493k
Asterion	£250k
Adjuvantix	£120k

Amounts falling due greater than one year fell by approximately £445k to £2.04m (2005: £2.48m), despite an interest charge on long term loan notes during the period of £60k. The reduction was due to the release of the loan due to Sheffield in relation to Bioacta, as outlined above.

Total cash outflow before financing during the year was £2.27m (2005: £0.96m), however because of the NPI Ventures fundraising, the cash balance only reduced by £342k.

At the end of the year the company had £5.9m in cash (2005: £6.2m), which is sufficient to support its portfolio of companies, to promote the creation of new portfolio companies and to run its central overhead for the foreseeable future.

Fundraising

During the year Biofusion raised an additional £2m of equity in return for the issue of 1,496,445 shares to NPI Ventures. As well as making a direct investment of £2m, NPI Ventures also agreed to establish a £10m Side Fund dedicated entirely to investment in companies within the Biofusion portfolio. At the same time NPI Ventures was granted warrants to invest up to an additional £6.25m in the company at prices between £1.50 and £2.20 per share.

It is expected that a direct involvement by NPI Ventures in Biofusion's commercialisation activity will greatly reduce the amount of time required to raise funds for the group's portfolio companies, and will help facilitate the group's plans to expand its model to additional universities.


Post year end

Trading has continued in line with expectations since the year end.

In September the company announced its first investment in Phase Focus, as well as the merger of Celltran, its advanced wound care business, with Xcellentis, a wholly-owned subsidiary of Innogenetics. Xcellentis has invested approximately €20m in its Lyphoderm wound care technology, which will provide the new combined company with an enhanced position in the wound care market.

Also in September Biofusion's stem cell company, Axordia, announced significant support for its research programme, in a £1.8m collaboration with Sheffield and Lombard Medical Technologies, which includes a £0.9m grant from the DTI and MRC, for the development of their stent technology. The stem cell related IP generated by this programme will accrue to Axordia and further strengthens its position in the stem cell marketplace.

Finally in October Diurnal announced that Phoqus, its collaboration partner, had raised £3m to take Chronocort into Phase II trials, subject to approval by Phoqus shareholders.



David Baynes
Chief Executive
17 October 2006

board of directors

1

1. Doug Liversidge CBE Non-executive Chairman

Mr Liversidge was appointed to the board of Biofusion plc on 1 December 2004, having been a Director of Biofusion Trading since 28 November 2003. He was employed for 21 years at British Steel, before moving to G W Thornton Limited as Managing Director and subsequently Chief Executive. He guided the company through its flotation on the full list of the London Stock Exchange in March 1987. During that period, G W Thornton won two Queen's Award to Industry for Export Achievement and the Cutlery Acclaim Award for Corporate Growth.

In 1991 Mr Liversidge was awarded South Yorkshire Businessman of the Year. Mr Liversidge acts as a Senior Industrial Advisor to the University of Sheffield. He has played a pivotal role in establishing the Regional Innovation Strategy for Yorkshire and Humberside through his work with Government Office in Leeds.

He was appointed Chairman of the South Yorkshire Learning & Skills Council by Government Office, Leeds in July 2000 and was awarded the CBE in the 2000 New Year's Honours List for services to industry.

2. David Baynes Chief Executive

Mr Baynes was appointed to the board of Biofusion plc on 2 November 2004, having been a Director of Biofusion Trading since 2 January 2003. David worked at Celsis International plc (Celsis) from its incorporation to its flotation on the full list of the London Stock Exchange in July 1993, and was responsible for all elements of the company's finances during that period.

In August 1993, Mr Baynes co-founded Toad plc (now TG21 plc) and was then responsible for taking the company from start-up to 4.2 (now Ofex), then AIM and ultimately the full list of the London Stock Exchange. During this time, Mr Baynes led four Class 1 transactions, two Class 2 transactions and a reverse takeover. In the year Mr Baynes left the company, it employed 350 staff, had a turnover of approximately £34m and pre-tax profits in excess of £3m per year.

Mr Baynes left Toad plc to join Whereonearth Limited, where he obtained extensive exposure to the venture capital market and was responsible for all aspects of the company's venture capital funding. Following this, Mr Baynes joined Codemasters Limited as Chief Financial Officer and was responsible for all aspects of the company's finances and corporate finance activity until leaving in September 2004 to focus on Biofusion plc. Mr Baynes is a Non-executive Director of CellTran Limited, Diurnal Limited, Genophrenix Ltd, Lifestyle Choices Ltd, Mantelum Limited and Phase Focus Limited, all of which are group portfolio companies.

2

3

3. Dr Peter Grant Operations Director

Dr Grant was appointed to the board of Biofusion plc on 1 December 2004, having been a Director of Biofusion Trading since 2 January 2003. Having obtained an honours degree in Biochemistry, Mr Grant completed his PhD before joining Genzyme UK Limited (Genzyme) as a Senior Research Scientist working within the clinical diagnostics division.

Following a move to Celltech from Genzyme, Mr Grant was part of the start-up team at Enzymatix Limited (Enzymatix). During the next five years Enzymatix grew five independent research areas with Mr Grant as the Head of Research and Development. Two of these areas were later spun-out to form Chiros Limited (later Chiros Science, now merged with Celltech plc) and Celsis Ltd (Celsis), with Mr Grant as a co-founder and Research and Development Director. Following venture capital funding rounds, Mr Grant was an integral part of the team that successfully floated Celsis on the London Stock Exchange in July 1993 and gained significant experience in acquisitions, divestments and licensing through his role as Director of Business Development and Technology. Mr Grant is a Non-executive Director of Adjuvantix Limited, Asterion Limited, Axordia Limited, Diurnal Limited, Lifestyle Choices Ltd, Genophrenix Ltd, Mantelum Ltd and Phase Focus Ltd, all of which are group portfolio companies.

4. Stuart Gall Commercial Director

Mr Gall was appointed to the board of Biofusion plc on 27 April 2005, having been a founder shareholder of Biofusion Trading. Mr Gall has experience in both small company start-ups and public companies and specialises in marketing, communications and new business development. After starting work at British Airways plc, Mr Gall was a founder member of The Promotions Partnership Limited, a marketing consultancy, which was sold to Omnicom Inc in 1993 and renamed Anvil Limited. In 1994, Mr Gall joined Toad plc (now TG21 plc) as Head of Marketing and was involved in its 4.2 (now Ofex), AIM and full listing on the London Stock Exchange as well as running the group's retail operations, technical training and new business development. In April 1998 Mr Gall joined the board of Toad as Marketing Director and ran the group's marketing operations as well as all new business development projects. Mr Gall is a Non-executive Director of Lifestyle Choices Ltd, Genophrenix Ltd, Mantelum Ltd and Phase Focus Ltd, all of which are group portfolio companies.

4

5

5. Dr Edwin Moses

Non-executive Director

Dr Moses was appointed to the board of Biofusion plc on 1 December 2004. Dr Moses has extensive experience as a Non-executive Director for companies including Evotec OAI AG, Bioimage A/S, Inpharmatica Limited, Amedis Limited, Avantium Technologies BV, Paradigm Therapeutics and Clinphone Limited. He is currently the CEO of Ablynx N.V. a drug discovery company.

Since 2001, Dr Moses has been extensively involved in raising over £100m from venture capital companies and financial institutions as well as leading a range of corporate development activities.

While Chief Executive Officer and subsequently Executive Chairman of Oxford Asymmetry International plc, Dr Moses raised several rounds of venture capital financing and annual turnover increased from approximately £100k to £20m. He led the company's flotation on the full list of the London Stock Exchange in 1998 at a valuation of £120m and subsequently achieved the sale of the company to Evotec Biosystems AG in 2000 for £316m. During his time at Oxford Asymmetry, Dr Moses was instrumental in key multi-million pound deal negotiations with companies such as Pfizer, Bayer, Vertex Pharmaceutical and Monsanto.

6. Prof Tony Atkinson

Non-executive Director

Prof Atkinson was appointed to the board of Biofusion plc on 1 December 2004. As a founding Director of Generic Biologicals Limited and Kymed GB Limited (Kymed), Prof Atkinson was responsible for the merger of these two biopharmaceutical companies in 1998. Prof Atkinson subsequently led Kymed's reverse takeover of the Ofex-listed oncology company, Enzacta plc, to form Enact Pharma plc (Enact) in April 2000 and was appointed a Director and Chief Scientific Officer at the time of merger. Prof Atkinson became Chief Executive Officer of Enact in February 2001 and led the restructuring of the company and the board through a series of refinancing events, most recently including Enact's acquisition by Protherics plc (Protherics), a biopharmaceutical company listed on the full list of the London Stock Exchange in June 2003. In July 2003 Prof Atkinson was appointed Chief Scientific Officer of Protherics, where he was a Non-executive Director until April this year. Prof Atkinson was previously a Director of the Division of Biotechnology and Deputy Director, PHLs Centre for Applied Microbiology and Research, Porton Down.

Prof Atkinson is also a Director of, inter alia: Third Millennium Insight Limited, a technology transfer company involved in the financing of start-up and early stage companies; Thermophilic Micro Organisms Limited; Morvus Technology Limited, a biopharmaceutical company; New Sarum Enterprises Limited, a partner in the incubator developing the Porton Down Science Park (Tetricus Limited).

6

7

7. David Catton

Non-executive Director

Mr Catton was appointed to the board of Biofusion plc on 1 December 2004, having been a Director of Biofusion Trading since 14 August 2003. On 1 May 1998, David was appointed Managing Director of Unisheff Ventures Limited – since renamed Sheffield University Enterprises Limited. Prior to this, he worked for Ford Motor Company, British Leyland (now Rover), Rank Xerox Limited and Cambridge Consultants Limited. Mr Catton has co-founded and invested in three start-up companies: Artificial Intelligence Limited, Strand Software Technologies Limited and The Customer Engagement Company. Mr Catton is a Non-executive Director of Simcyp Limited, Asterion Limited and Bioacta Limited, all of which are group portfolio companies.

8. Simon Oakland

Non-executive Director

Mr Oakland was appointed to the board of Biofusion plc on 20 April 2006. Mr Oakland is a Principal of Nikko Principal Investments Limited (NPIL), the European principal finance arm of Nikko Cordial Corporation, and a Director of NPI Ventures. He joined NPIL in 1997 from the corporate finance department of Cazenove & Co., where he was responsible for providing corporate finance advice to UK utility clients and corporate valuations across the Cazenove client base. Previously, Simon was a management consultant at Accenture where he undertook a number of projects across a broad spectrum of large corporate clients. Simon has a BA in Mathematics from Oxford University and an MBA from Cranfield University. He is also a graduate of the Chartered Institute of Marketing. Simon has structured and executed many of NPIL and NPI Ventures' investments including, amongst others, Ceres Power, Honours Student Loans, Resolution Life, Menzies Hotels and European Directories SA and has been involved in NPI Ventures since its inception in 2002.

8

corporate governance

The company is committed to high standards of corporate governance. The revised Combined Code on corporate governance (Combined Code) was published in 2003. While the group is not required to report on compliance with the Combined Code since its shares are traded on AIM, we make every effort to comply, where relevant to a company of our size. The statement below describes how principles of corporate governance are applied to the group.

The workings of the board and its committees

The board

The board currently comprises five Non-executive Directors and three executive Directors and is responsible for the management of the group. As disclosed on page 16 Dr Edwin Moses, Prof Tony Atkinson and David Catton have some share options in the company, however the board considers them to be independent because of the amount of share options is not considered to be material. Simon Oakland, as a representative of NPI Ventures, is not considered to be independent. The Non-executive Directors are considered by the board to be independent. The board meets at least six times a year, setting and monitoring group strategy, reviewing trading performance, reviewing and agreeing on investments in spin-out companies and formulating policy on key issues. Day to day operational decisions are delegated to the executive Directors. Key issues reserved for the board include the consideration of potential investments, share issues and fund raising, the setting of group strategy, City public relations and the review and evaluation of significant risks facing the business. Briefing papers are distributed by the Company Secretary to all Directors in advance of board meetings. All Directors have access to the advice and services of the Company Secretary who is responsible for ensuring that board procedures are followed and that applicable rules and regulations are complied with. The appointment and removal of the Company Secretary is a matter for the board as a whole. In addition, procedures are in place to enable Directors to obtain independent professional advice in the furtherance of their duties if necessary, at the company's expense.

Biographies of the Directors including details of their experience and role within the group are set out on pages 10 and 11.

Attendance at meetings

The full board met six times in the financial year ending 31 July 2006 and with the exception of David Catton and Prof Tony Atkinson, who missed one meeting each, all of the Directors in office at that time were in attendance at these meetings.

Audit Committee

The Audit Committee comprises the Non-executive Chairman, Doug Liversidge, and two of the Non-executive Directors, Dr Edwin Moses and Prof Tony Atkinson. The Audit Committee's remit is set out in its terms of reference and is scheduled to meet with the auditors at least twice a year. The Committee assists the board in ensuring that the group's published financial statements give a true and fair view and that, where the auditors provide non-audit services, their objectivity and independence is safeguarded.

Remuneration Committee

The Remuneration Committee comprises the Non-executive Director, Doug Liversidge, and two of the Non-executive Directors, Dr Edwin Moses and Prof Tony Atkinson. The Committee is responsible for making recommendations to the board on the remuneration of all the Directors.

Nomination Committee

The Nomination Committee comprises the Non-executive Directors, and is chaired by the Chairman, Doug Liversidge. It will meet as necessary and will be responsible for making recommendations to the board on the appointments of executive and Non-executive Directors. When required, it will be the usual practice of the Nomination Committee to employ specialist external search and selection consultants to assist in the appointment process for new executive and Non-executive Directors.

Terms of reference

The terms of reference for the Audit, Remuneration and Nomination Committees are available on request from the Company Secretary.

Performance evaluation

Performance of each of the executive Directors will be evaluated on an ongoing basis by the Chairman and the Non-executive Directors, with a formal review held at least annually. The Non-executive Directors are responsible for the performance evaluation of the Chairman, taking into account the views of the other executive Directors. The Non-executive Directors will meet with the Chairman on an ad hoc basis but at least once a year to appraise the Chairman's performance. The performance of the Non-executive Directors and the sub-committees on which they serve are reviewed by the executive board on an ongoing basis.

Relations with shareholders

Key members of the executive board regularly visit institutional investors, and the full board is encouraged to make itself available for questions at all shareholder meetings it holds. The Chairman and Chief Executive plan to report back to the board views of investors obtained at analysts' and brokers' briefings. The board will use the Annual General Meeting to communicate with private and institutional investors and welcomes their participation. The Chairman aims to ensure that the Chairman of the Audit, Remuneration and Nomination Committees is available at Annual General Meetings to answer questions.

Internal controls


The Directors acknowledge that they are responsible for the group's system of internal control and for reviewing its effectiveness. Internal control systems are designed to meet the particular needs of the group and the risks to which it is exposed. In accordance with the guidance of the Turnbull Committee on internal control, the procedures will be regularly reviewed in an ongoing process to identify, evaluate and manage the significant risks faced by the group. The procedures are designed to manage rather than eliminate risk of failure to achieve business objectives and can only provide reasonable but not absolute assurance against material misstatement or loss.

The key procedures which the Directors have established with a view to providing effective internal control are as follows:

- **Management structure**
The board has overall responsibility for the group, and there is a formal schedule of matters specifically reserved for decision by the board. Each executive Director has been given responsibility for specific aspects of the group's affairs. The executive Directors meet weekly to discuss day-to-day operational matters.
- **Control environment**
The group's control environment is the responsibility of the group's Directors, and the internal controls were implemented in February 2005. The effectiveness of the group's internal controls will be reviewed annually to ensure they remain appropriate.
- **Main control procedures**
The Directors have established control procedures in response to key risks. Standardised financial control procedures operate throughout the group to ensure the integrity of the group's financial statements. The board has established procedures for authorisation of capital and revenue expenditure.
- **Monitoring system used by the board**
The board reviews the group's performance against budgets on a monthly basis. The group's cash flow is monitored bi-monthly by the board.
- **Internal audit**
The group does not have an independent internal audit function, as the board does not consider the current scale of operations warrants such a function. However, as the group continues to grow, the board will keep this under review, with a view to creating an internal audit function when it is warranted.

Going concern

After making enquiries, the Directors have a reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.



Doug Liversidge CBE
Chairman
17 October 2006

report on directors' remuneration

This remuneration report sets out the company's policy on the remuneration of executive and Non-executive Directors, together with detail of Directors' remuneration packages and service contracts.

Remuneration Committee

For the financial year ended 31 July 2006, remuneration policy for executive and Non-executive Directors and the determination of individual executive Directors' remuneration packages have been delegated to the board's Remuneration Committee comprising three Non-executive Directors, one of which is the Non-executive Chairman.

In setting the remuneration policy, the Remuneration Committee considers a number of factors including:

- (a) the basic salaries and benefits available to executive Directors of comparable companies;
- (b) the need to attract and retain Directors of an appropriate calibre;
- (c) the need to ensure executive Directors' commitment to the continued success of the company by means of incentive schemes; and
- (d) the need for the remuneration awarded to reflect performance.

Remuneration of the Non-executive Directors

All the Non-executive Directors, except for Simon Oakland, who represents NPI Ventures, received a fee for their services. This fee is agreed by the board following recommendation by the Chairman with a view to rates paid in comparable organisations and appointments. The Non-executive Directors did not receive any pension or other benefits from the company, nor did they participate in any bonus or incentive schemes other than share options. The Non-executive Directors each have a three year service contract with the company with three months' notice either side. After this time the appointment is reviewed annually.

Remuneration policy for executive Directors

The company's remuneration policy for executive Directors is to:

- (a) have regard to the Directors' experience and the nature and complexity of their work in order to pay a competitive salary that attracts and retains management of the highest quality;
- (b) link individual remuneration packages to the group's long term performance through the award of discretionary bonus schemes; and
- (c) provide employment related benefits including life assurance, insurance relating to the Director's duties and medical insurance.

Salaries and benefits

The Remuneration Committee meets at least once a year to consider and set the annual salaries for executive Directors having regard to personal performance and information regarding the remuneration practices of companies of similar size and of industry competitors. Executive Directors' salaries were last reviewed in January 2006.

Directors' service contracts

The service contracts of the executive Directors provide for six months' notice of termination. Other than the notice periods afforded to the executive and Non-executive Directors, there are no special provisions for compensation in the event of loss of office. The Remuneration Committee considers the circumstances of individual cases of early termination and determines compensation payments accordingly.

Details of individual Directors' service contracts are as follows:

	Effective contract date	Unexpired term at 31 July 2006	Notice period
D Liversidge (Chairman)	01 December 2004	16 months	3 months
D Baynes	26 January 2005	n/a	6 months
P Grant	26 January 2005	n/a	6 months
S Gall	01 April 2005	n/a	6 months
E Moses	01 December 2004	16 months	3 months
T Atkinson	01 December 2004	16 months	3 months
D Catton	01 December 2004	16 months	3 months

The Directors are required to retire by rotation once every three years. No Director is required to retire by rotation at the forthcoming Annual General Meeting.

Non-executive Directorships

With the permission of the Chairman, the executive Directors may accept appointments as Non-executive Directors. Where an executive Director accepts an appointment to the board of a company in which the group is a shareholder, the group retains the Directors' fees. Fees earned for Directorships of companies in which the group does not have a shareholding would be retained by the Directors.

Directors' detailed emoluments

Details of individual Directors' emoluments for the year are as follows:

	Salary and fees £	Bonuses £	Pension contributions £	Benefits £	Total 2006 £	Total 2005 £
Executive						
D Baynes	125,000	—	12,500	152	137,652	66,000
P Grant	112,500	—	11,250	152	123,902	60,500
S Gall	112,500	—	11,250	152	123,902	40,334
Non-executive						
D Liversidge (Chairman)	24,000	—	—	—	24,000	16,000
E Moses	24,000	—	—	—	24,000	16,000
T Atkinson	24,000	—	—	—	24,000	16,000
D Catton	12,000	—	—	—	12,000	8,000
S Oakland *	—	—	—	—	—	—
	434,000	—	35,000	456	469,456	222,834

* Joined board on 20 April 2006, as part of the NPI Ventures agreement and is an unpaid Non-executive Director.

Remuneration in the year ending 31 July 2005 was only paid after the company listed on AIM on 2 February 2005 and hence relates to approximately six months' trading.

The pension contributions are paid into private pension plans nominated by the related Directors or can be included with the basic salary. At the year end an amount of £12,500 was accrued but unpaid.

No Director waived emoluments in the year (2005: £Nil).

report on directors' remuneration

continued

Directors' interests in share options

Details of options held by Directors over the company's Ordinary Shares of 1p are set out below:

The scheme	As at 31 July 2005	As at 31 July 2006	Exercise price	Earliest exercise date	Expiry date
E Moses	33,333	33,333	150p	28.01.08	28.01.15
T Atkinson	33,333	33,333	150p	28.01.08	28.01.15
D Catton	33,333	33,333	150p	28.01.08	28.01.15

The market price of the company's shares at the end of the financial year was 160.0p (2005: 116.5p) and the range of market prices during the year was 175.5p to 110.0p (2005: n/a).

Each option will vest monthly as to one thirty-sixth of the Ordinary Shares under option on the expiry of each month following the date of the grant until the third anniversary of the date of the grant when the option shall become fully vested. Any vested portion of the options will normally be exercisable between the expiry of the third month after the date of the grant and the 10th anniversary of the date of the grant. No performance conditions are required to be met. Options will become immediately exercisable in full on the death of the option holder for a period of 12 months from the date of death. If an option-holder ceases to be a Non-executive Director of the company for any reason other than death, his option (to the extent unexercised and unvested) will lapse. On a change of control or a voluntary winding-up of the company, options may be exercised in full for a fixed period. Options will lapse on the expiry of ten years from their date of grant.

Until options are exercised, the option-holders have no voting or other rights in respect of the Ordinary Shares under their options. Ordinary Shares issued pursuant to the Share Option Agreements shall rank *pari passu* in all respects with the Ordinary Shares already in issue except that they will not rank for any dividend or other distribution announced prior to the date of the exercise. Options are not transferable nor are they pensionable.

Directors' interests in shares

The Directors at 31 July 2006 and their interests in the share capital of the company, other than in respect of options to acquire Ordinary Shares, were as follows:

The company – Ordinary 1p Shares	31 July 2006
D Baynes	1,333,332
P Grant	1,333,332
S Gall	1,333,332
D Liversidge (Chairman)	—
E Moses	—
T Atkinson	—
D Catton	—
S Oakland	—

On 27 January 2005 David Baynes, Peter Grant and Stuart Gall granted an option to Doug Liversidge entitling him to acquire 97,756 Ordinary Shares from each of them at an aggregate exercise price of £44,000. The options can be exercised at any time prior to 27 January 2015. Doug Liversidge has undertaken to Biofusion to indemnify it from any PAYE and employers' national insurance contributions payable by the group as a result of the exercise of any or all of these options.

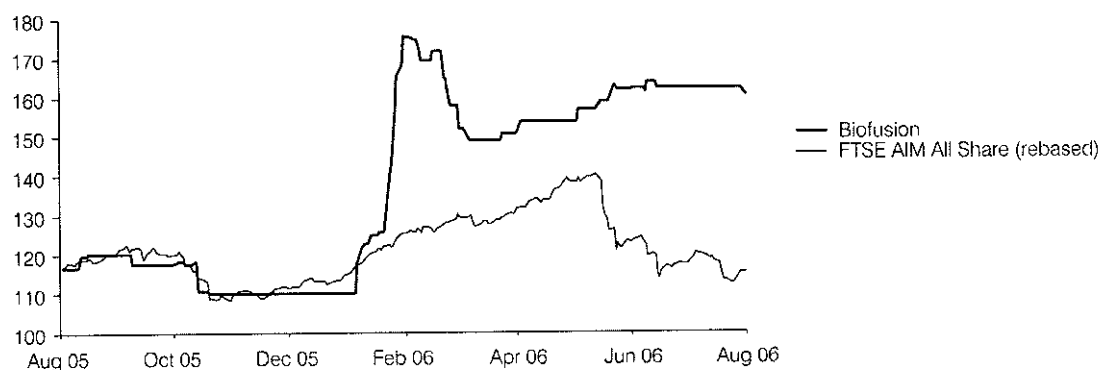
NPI Ventures, of which Simon Oakland is a Director, holds 1,496,445 Ordinary Shares and has warrants over 3,675,000 Ordinary Shares.

Apart from the interests disclosed above, no Directors held interests at any time in the year in the share capital or loan stock of the company or other group companies.

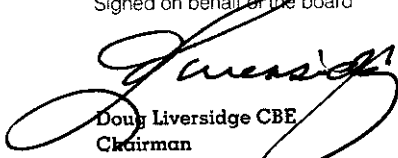
Total shareholder return

The following line graph shows for the financial year ended 31 July 2006, the total cumulative shareholder return on a holding of the company's Ordinary Shares compared with a hypothetical holding of shares made up of companies in the FTSE AIM All Share index, which the Directors believe reflects the most appropriate benchmark for the company's performance.

The company has never paid a dividend, and so the total shareholder return has been calculated as the weekly movement in the share price by reference to a base point of 31 July 2006.



Signed on behalf of the board


Doug Liversidge CBE
Chairman
17 October 2006

directors' report

The Directors present their report and the group financial statements for the year ended 31 July 2006.

Results and dividend

Group loss for the year after taxation and minority interests amounted to £607,340 (2005: loss £396,768). The Directors do not recommend the payment of a dividend (2005: £Nil).

Principal activity

The group's principal activity is the commercialisation of IP that is developed at universities and similar establishments.

Enhanced business review

The Companies Act 1985 (Operating and Financial Review) Regulations 2005 require that the Directors present an enhanced Directors' report. These enhancements are provided within the Chairman's statement and Chief Executive's review.

Directors

The names of the Directors who held office during the financial year are as follows:

Executive

D Baynes	appointed 02 November 2004
P Grant	appointed 01 December 2004
S Gall	appointed 27 April 2005

Non-executive

D Liversidge (Chairman)	appointed 01 December 2004
E Moses	appointed 01 December 2004
T Atkinson	appointed 01 December 2004
D Catton	appointed 01 December 2004
S Oakland	appointed 20 April 2006

Details of the interests of Directors in the share capital of the company, together with details of share options granted to them, are set out in the report on the Directors' remuneration.

International Financial Reporting Standards (IFRS)

In June 2002, the Council of Ministers of the European Union (EU) approved a regulation (the "Regulation") requiring all companies that are governed by the law of a member state of the EU and whose securities are admitted to trading on a Regulated Market of any member state to prepare their consolidated financial statements in accordance with IFRS as adopted by the EU. The Regulation is to be effective for each financial year starting on or after 1 January 2005 with respect to companies with listed equity securities.

From 12 October 2004, AIM operated as an exchange-regulated market, relinquishing its EU-regulated market status. This means that AIM companies fall outside the scope of the regulation.

However on 7 October 2004, the London Stock Exchange confirmed changes to the AIM rules which will require AIM companies to use IFRS for financial years commencing on or after 1 January 2007. IFRS will continue to be optional for financial years commencing on or after 1 January 2005.

The group will adopt any relevant standards issued by the UK Accounting Standards Board and the International Accounting Standards Board as they become applicable. The adoption of IFRS may have a material impact on the group's financial position and reported results, particularly measurement of the fair value of the group's financial instruments.

Financial risk management

The group's principal financial instruments comprise cash and loan notes. The main purpose of these financial instruments is to raise finance for the group's operations. The group has various other financial instruments such as trade debtors and trade creditors that arise directly from its operations.

Major interest in shares

As at 16 October 2005, according to the company's register, the following shareholders each held 3% or more of the company's issued share capital:

Name	Ordinary 1p shares	% Holding
University of Sheffield	9,333,324	45.94
Vidacos Nominees Limited	1,661,639	8.18
Barclayshare Nominees Limited	1,502,587	7.40
P Grant	1,333,332	6.56
D Baynes	1,333,332	6.56
S Gall	1,333,332	6.56
Vidacos Nominees Limited	1,150,000	5.66
Chase Nominees Limited	908,900	4.47

Creditor payment policy

The group's policy is to:

- (a) establish the payment terms with suppliers when agreeing the terms of supply;
- (b) ensure that suppliers are aware of the terms of payment; and
- (c) adhere to the agreed terms.

The group's average creditor payment period at 31 July 2006 was 37 days (2005: 32 days). The company has no trade creditors.


Charitable donations

During the year the group made no charitable donations.

Auditors

In accordance with Section 384 of the Companies Act 1985, a resolution for the reappointment of KPMG Audit Plc is to be proposed at the forthcoming Annual General Meeting.

By order of the board


David Baynes
Chief Executive
17 October 2006

statement of directors' responsibilities

The Directors are responsible for preparing the Directors' report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the group and the parent company financial statements in accordance with UK Accounting Standards.

The group and parent company financial statements are required by law to give a true and fair view of the state of affairs of the group and the parent company and of the profit or loss for that period.

In preparing these 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 financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the parent company will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have a general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

independent auditors' report

report of the independent auditors, KPMG Audit Plc, to the members of Biofusion plc

We have audited the group and parent company financial statements (the "financial statements") of Biofusion plc for the year ended 31 July 2006 which comprise the consolidated profit and loss account, the consolidated and company balance sheets, the consolidated cash flow statement, and the related notes. 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' responsibilities for preparing the annual report and the financial statements in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the Statement of Directors' responsibilities on page 20.

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 whether in our opinion the information given in the Directors' report is consistent with the financial statements. We also report to you if, in our opinion, 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 other information contained in the annual report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

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 judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and 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, in accordance with UK Generally Accepted Accounting Practice, of the state of the group's and the parent company's affairs as at 31 July 2006 and of the group's loss for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' report is consistent with the financial statements.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor
Leeds
17 October 2006

consolidated profit and loss account

for the year ended 31 July 2006

	Note	Continuing operations 2006 £	Acquisitions 2006 £	Total 2006 £	2005 £
Turnover	2	228,070	51,200	279,270	229,857
Cost of sales		(2,761)	(20,070)	(22,831)	(103,621)
Gross profit		225,309	31,130	256,439	126,236
Administrative expenses					
– Normal		(1,167,048)	(235,190)	(1,402,238)	(616,466)
– Exceptional	4	181,358	—	181,358	—
		(985,690)	(235,190)	(1,220,880)	(616,466)
Operating loss		(760,381)	(204,060)	(964,441)	(490,230)
Interest receivable and similar income	7			349,084	141,748
Interest payable and similar charges	8			(102,498)	(68,819)
Loss on ordinary activities before taxation	3			(717,855)	(417,301)
Tax on loss on ordinary activities	9			—	—
Minority interests	21			110,515	20,533
Loss for the financial year				(607,340)	(396,768)
Basic and diluted loss per share	10			(3.14p)	(2.47p)

All results relate to continuing operations.

There is no difference between the loss on ordinary activities before taxation and the loss for the years stated above, and their historical cost equivalents. The notes on pages 26 to 41 form part of these financial statements.

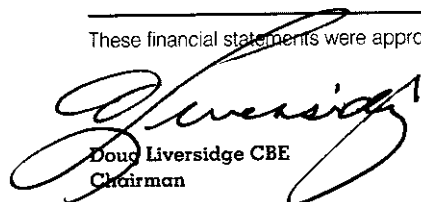
There were no recognised gains or losses other than those recognised in the profit and loss account for either year.

consolidated balance sheet

at 31 July 2006

	Note	2006 £	2006 £	2005 £	2005 £
Fixed assets					
Intangible assets	12		68,020		491,979
Tangible assets	13		24,708		17,446
Investments	14		3,370,063		1,809,183
			3,462,791		2,318,608
Current assets					
Stock	15	7,413		—	
Debtors	16	568,222		600,083	
Cash at bank and in hand		5,883,381		6,225,435	
		6,459,016		6,825,518	
Creditors: amounts falling due within one year	17	(196,727)		(237,055)	
Net current assets			6,262,289		6,588,463
Total assets less current liabilities			9,725,080		8,907,071
Creditors: amounts falling due after more than one year	18		(2,037,810)		(2,482,670)
Net assets			7,687,270		6,424,401
Capital and reserves					
Called up share capital	19		203,164		188,200
Capital reserve	20		2,079		2,079
Share premium	20		8,905,736		6,993,200
Capital redemption reserve	20		888		888
Profit and loss account	20		(1,369,670)		(762,330)
Shareholders' funds			7,742,197		6,422,037
Minority interest	21		(54,927)		2,364
			7,687,270		6,424,401

These financial statements were approved by the board of Directors on 17 October 2006 and were signed on its behalf by the Chairman:

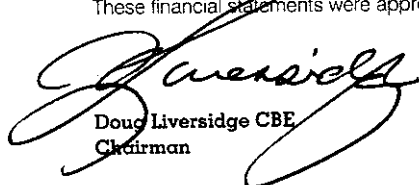

Doug Liversidge CBE
Chairman

company balance sheet

at 31 July 2006

	Note	2006 £	2006 £	2005 £	2005 £
Fixed assets					
Investments	14		921		921
			921		921
Current assets					
Debtors	16	8,916,557		7,181,367	
Net current assets		8,916,557		7,181,367	
Net assets			8,917,478		7,182,288
Capital and reserves					
Called up share capital	19		203,164		188,200
Share premium	20		8,905,736		6,993,200
Capital redemption reserve	20		888		888
Profit and loss account	20		(192,310)		—
Shareholders' funds			8,917,478		7,182,288

These financial statements were approved by the board of Directors on 17 October 2006 and were signed on its behalf by the Chairman:



Doug Liversidge CBE
Chairman

consolidated cash flow statement

for the year ended 31 July 2006

	Note	2006 £	2005 £
Net cash outflow from operating activities	24	(943,382)	(1,173,164)
Returns on investment and servicing of finance			
Interest received		349,084	141,748
Taxation		—	—
Capital expenditure and financial investments			
Payments for tangible fixed assets		(12,728)	(21,679)
Payments for fixed assets investments		(1,560,880)	—
Proceeds from sales of tangible fixed assets		300	—
Net cash outflow from capital expenditure and financial investment		(1,573,308)	(21,679)
Net cash outflow before financing and acquisitions		(2,167,606)	(1,053,095)
Acquisitions			
Payments to acquire investments in subsidiary undertakings		(127,500)	—
Net cash acquired with subsidiaries		25,552	94,532
Net cash outflow before financing		(2,269,554)	(958,563)
Financing			
Issue of ordinary share capital		2,000,000	8,229,996
Share issue costs		(72,500)	(1,048,626)
		1,927,500	7,181,370
(Decrease)/increase in cash in the period	24	(342,054)	6,222,807

notes to the financial statements

for the year ended 31 July 2006

1 Accounting policies

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

Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards, under the historical cost accounting rules and with the requirements of the Companies Act 1985, except as explained below.

Basis of consolidation

The consolidated financial statements include the financial statements of the company and its subsidiary undertakings made up to 31 July 2006. The acquisition method of accounting has been adopted. Under this method, the results of subsidiary undertakings acquired or disposed of in the year are included in the consolidated profit and loss account from the date of acquisition or up to the date of disposal.

Those investments that are associated undertakings are carried at cost in accordance with the group's normal policy and are not equity accounted as required by the Companies Act 1985. The Directors consider that as these investments are held as part of the group's portfolio with a view to the ultimate realisation of capital gains, equity accounting would not give a true and fair view of the group's interest in these investments. The effect of this is to reduce the loss for the financial year by £364,026 (2005: £277,456) and increase investments by £3,792,841 (2005: £2,072,472).

Merger accounting has been adopted to consolidate the subsidiary Biofusion Trading Limited under the provisions of Financial Reporting Standard 6 'Acquisitions and Mergers'.

Turnover

Turnover, comprising fees for various advisory and fund management services and proceeds from the sale of investments, is recognised in the profit and loss account when the related services are performed and when considered recoverable. All turnover is generated within the United Kingdom and is stated exclusive of value added tax.

Goodwill

Goodwill arising on the acquisition of subsidiary undertakings, representing the excess fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired is capitalised and written off on a straight line basis over its useful economic life, which is ten years. Provision is made for impairment.

Investments

Investments are stated at historic cost less any provision for impairment in value, and are held for long term investment purposes. Investments are classified as equity investments and loans which are convertible to equity in the future.

Provisions are based upon an assessment of events or changes in circumstances that indicate that an impairment has occurred. This includes the performance and/or prospects (including financial prospects) of the investee company being significantly below the expectations on which the investment was based, a significant adverse change in the markets in which the investee company operates or a deterioration in general market conditions and the value implied by third party external funding in the year.

Stocks

Stocks are stated at the lower of cost and net realisable value.

Fixed assets and depreciation

Depreciation is provided to write off the cost less the estimated residual value of tangible fixed assets by equal instalments over their estimated useful economic lives as follows:

Computer equipment	—	25% per annum
Office equipment	—	33.3% per annum

1 Accounting policies continued

Payments on account

Payments on account represent transfer of funds in advance to the University of Sheffield held on the balance sheet of Biofusion Trading Ltd. The payments on account are held at cost, less any amounts transferred to equity investments on account of the acquisition of interests in spin-out companies from the University of Sheffield Life Science department.

Pension commitments

The group makes defined contributions to employees' approved personal pension plans. Contributions are charged to the profit and loss account in the period in which payments are payable to the pension funds.

Deferred taxation

Provision is made in full for deferred tax liabilities that arise from timing differences where transactions or events, that result in an obligation to pay more tax in the future, have occurred by the balance sheet date. Deferred tax assets are recognised to the extent that it is considered more likely than not that they will be recoverable. Deferred tax is measured at the average tax rates that are expected to apply in periods in which the timing differences are expected to reverse based on the tax rates and laws that have been enacted or substantially enacted by the balance sheet date. Deferred tax assets and liabilities are not discounted.

Financial instruments

Currently the group does not enter into derivative financial instruments. Financial assets and financial liabilities are recognised and cease to be recognised on the basis of when the related titles pass to or from the group. Financial assets are stated at the lower of cost to the group, less provision for amortisation and impairment.

2 Turnover

Turnover and loss on ordinary activities before taxation are derived entirely from the principal activities within the United Kingdom.

3 Loss on ordinary activities before taxation

	2006 £	2005 £
Loss on ordinary activities before taxation is stated after charging/(crediting)		
Auditors' remuneration:		
Statutory audit	23,720	15,100
Depreciation and other amounts written off tangible fixed assets	4,082	4,933
Loss on sale of fixed assets	1,084	—
Amortisation of goodwill	55,401	54,664
Profit on deemed disposal of subsidiary (note 22)	(5,039)	—

notes to the financial statements continued

for the year ended 31 July 2006

4 Exceptional items

	2006 £	2005 £
Goodwill impairment	(420,521)	—
Waiver of loan note	550,858	—
Waiver of loan note interest	51,021	—
	181,358	—

Following an impairment review of the goodwill associated with the acquisition of Bioacta Ltd, the Directors have recorded an impairment charge of £420,521 representing the unamortised balance of that goodwill at 31 July 2006.

In accordance with the agreement dated 25 January 2005, Biofusion can return the shares in the companies purchased and cancel the debt and accumulated interest. Following agreement from the University of Sheffield that they agree to waive these amounts, the loan note and accrued interest have been credited to the profit and loss account.

5 Remuneration of Directors

	2006 £	2005 £
Directors' emoluments	434,456	207,667
Company contributions to money purchase pension schemes	35,000	15,167
	469,456	222,834

The aggregate of emoluments of the highest paid Director was £125,152 (2005: £60,000) and company pension contributions of £12,500 (2005: £6,000) were accrued for payment to be made into a money purchase scheme on his behalf.

	Number of Directors	
	2006	2005
Retirement benefits are accruing to the following number of Directors under:		
Money purchase schemes	3	3

6 Staff numbers and costs

The average number of persons employed by the group (including Directors) during the year, analysed by category, was as follows:

	Number of Directors	
	2006	2005
Directors	8	4
Staff	2	—
	10	4

The aggregate payroll costs of these persons were as follows:

	2006 £	2005 £
Wages and salaries	487,958	211,667
Social security costs	51,025	22,441
Other pension costs	35,000	15,167
	573,983	249,275

7 Interest receivable and similar income

	2006 £	2005 £
Bank interest receivable	261,250	141,748
Interest on loans to associated undertakings	87,834	—
	349,084	141,748

8 Interest payable and similar charges

	2006 £	2005 £
Interest on loans from related parties	98,571	68,819
Other interest payable	3,747	—
	102,498	68,819

notes to the financial statements continued

for the year ended 31 July 2006

9 Tax on loss on ordinary activities**Analysis of charge in year**

	2006 £	2005 £
Current tax		
UK corporation tax on loss of the period	—	—
Adjustments in respect of prior year	—	—
Tax on loss on ordinary activities	—	—

No deferred tax asset has been recognised in respect of trading losses carried forward due to the uncertainty of the availability of future taxable profits from which the trading losses can be deducted. The total amount unprovided at 31 July 2006 is £227,521 (2005: £97,254).

	2006 £	2005 £
Accelerated capital allowances	502	64
Tax losses carried forward	(228,023)	(97,318)
	(227,521)	(97,254)

Factors affecting the tax charge for the current period

Current tax on income for the period is lower (2005: lower) than the standard rate of corporation tax in the UK (19%) (2005: 19%). The differences are explained below:

	2006 £	2005 £
Current tax reconciliation		
Loss on ordinary activities before tax	(717,855)	(417,301)
Current tax at 19% (2005: 19%)	(136,393)	(79,287)
Effects of:		
Expenses not deductible for tax purposes	6,126	24,792
Capital allowances for period in excess of depreciation	(438)	(146)
Unutilised tax losses	130,705	54,641
Total current tax charge (see above)	—	—

10 Basic and fully diluted loss per ordinary share

	2006 No.	2005 No.
Number of shares		
Basic weighted average number of shares in issue	19,318,799	16,076,652
Loss retained in the year	(607,340)	(396,768)

The basic loss per share is based on the weighted average number of Ordinary Shares in issue during the year. This included 18,819,984 shares in issue throughout the year, and 1,496,445 shares issued on 23 March 2006 which were included for 4/12th of the year. In the year ended 31 July 2005 the number of shares in issue was restated to reflect the merger accounting for Biofusion Trading Ltd and the bonus issue in the year.

The calculation of diluted loss per Ordinary Share is identical to that used for basic loss per share. This is because the exercise of options would have the effect of reducing the loss per Ordinary Share and is therefore not dilutive under the terms of Financial Reporting Standard 14 'Earnings per Share'.

11 Result for the financial year

As permitted by Section 230 of the Companies Act 1985, the company's profit and loss account has not been included in these financial statements. The company's result for the financial year was a loss of £192,310 (2005: £Nil).

12 Intangible fixed assets

Group	Goodwill £
Cost	
At 1 August 2005	546,643
Additions	59,450
Disposals	(7,487)
At 31 July 2006	598,606
Aggregated amortisation	
At 1 August 2005	(54,664)
Charge for the year	(55,401)
Impairment losses	(420,521)
At 31 July 2006	(530,586)
Net book value	
At 31 July 2006	68,020
At 31 July 2005	491,979

Intangible fixed assets relates to the goodwill generated on the acquisition of the subsidiaries, Bioacta Ltd, Diurnal Ltd and from additional investment in Lifestyle Choices Ltd. The Directors have performed an impairment review of the goodwill associated with each company and have written down in total the capitalised unamortised goodwill of Bioacta Ltd because of uncertainty relating to its future revenue streams. The remaining goodwill of £68,020 relates to Diurnal Ltd and Lifestyle Choices Ltd and will be amortised over the remainder of its useful economic life.

Additions in the year relate to negative goodwill of £200 generated on Biofusion's initial investment in Lifestyle Choices, and goodwill of £59,650 when Biofusion increased its shareholding in the same company from 50% to 60% in April 2006 for a consideration of £120,000 (see note 25).

The deemed disposal of £7,487 relates to the company's shareholding in Diurnal, as outlined in note 22.

notes to the financial statements continued

for the year ended 31 July 2006

13 Tangible assets

Group	Computer equipment £
Cost	
At 1 August 2005	23,779
Additions	12,728
Disposals	(2,070)
At 31 July 2006	34,437
Depreciation	
At beginning of year	(6,333)
Charge for year	(4,082)
Disposals	686
At end of year	(9,729)
Net book value	
At 31 July 2006	24,708
At 31 July 2005	17,446

The company has £Nil (2005: £Nil) fixed assets.

14 Investments

Group	Equity £	Loans £	Total participating interests £
Cost			
At 1 August 2005	1,809,183	—	1,809,183
Additions	433,239	1,127,641	1,560,880
At 31 July 2006	2,242,422	1,127,641	3,370,063
Provision for impairment			
At 1 August 2005 and 31 July 2006	—	—	—
Net book values			
At 31 July 2006	2,242,422	1,127,641	3,370,063
At 31 July 2005	1,809,183	—	1,809,183

Investments relate to shareholdings in portfolio companies below 50%. In accordance with the group's accounting policies these amounts are held at cost less any provision for impairment.

The value of participating interests comprises of investments in Associates £3,012,238 (2005: £1,451,358) and other investments £357,825 (2005: £357,825).

14 Investments continued

Company	Shares in group undertakings £
Cost and net book value	
At 1 August 2005	921
Additions	—
At 31 July 2006	921

Shares in group undertakings represent the company's investment in Biofusion Trading Ltd.

The group's interest in companies at the year end is as follows:

	Country of incorporation	Principal activity	Holding	Class of shares held
Subsidiary undertakings				
Biofusion Trading Ltd	United Kingdom	Holding company	100%	Ordinary
Phase Focus Limited*	United Kingdom	Lensless Microscopy	100%	Ordinary
Mantelum Limited*	United Kingdom	IP development company	100%	Ordinary
Lifestyle Choices Limited*	United Kingdom	Ovarian reserve measurement	60%	Ordinary
Diurnal Limited*	United Kingdom	Hormone replacement	60%	Ordinary
Genophrenix Limited*	United Kingdom	Identification of Schizophrenia targets	60%	Ordinary
Bioacta Limited*	United Kingdom	Angiogenesis compounds	52.4%	Ordinary
Participating interests				
Adjuvantix Ltd*	United Kingdom	Vaccine adjuvants	41.1%	Ordinary
Asterion Ltd*	United Kingdom	Cytokine therapies	38.0%	Ordinary
Axordia Ltd*	United Kingdom	Stem cell therapy	36.1%	Ordinary
Celltran Ltd*	United Kingdom	Chronic wound therapy	26.6%	Ordinary
Simcyp Ltd*	United Kingdom	Drug metabolism	25.0%	Ordinary
Other investments				
Plasso Technology Ltd*	United Kingdom	Surface chemistry	9.0%	Ordinary

* Held indirectly by Biofusion Trading Ltd.

notes to the financial statements continued

for the year ended 31 July 2006

15 Stock

	Group		Company	
	2006 £	2005 £	2006 £	2005 £
Finished goods and goods for resale	7,413	—	—	—

16 Debtors

	Group		Company	
	2006 £	2005 £	2006 £	2005 £
Trade debtors	84,569	4,039	—	—
Amounts due from associated undertakings	16,120	127,691	—	—
Amounts due from group undertakings	—	—	8,916,557	7,181,367
Other tax and social security	19,035	114,845	—	—
Other debtors	401	29,958	—	—
Payments on account	387,950	312,750	—	—
Prepayments and accrued income	60,147	10,800	—	—
	568,222	600,083	8,916,557	7,181,367

17 Creditors: amounts falling due within one year

	Group		Company	
	2006 £	2005 £	2006 £	2005 £
Trade creditors	87,153	128,734	—	—
Other creditors	20,500	18,032	—	—
Other tax and social security	474	15,918	—	—
Accruals and deferred income	88,600	74,371	—	—
	196,727	237,055	—	—

18 Creditors: amounts falling due after more than one year

	Group		Company	
	2006 £	2005 £	2006 £	2005 £
Amounts owed to related party	2,037,810	2,482,670	—	—

The amount of £2,037,810 due at 31 July 2006 includes £1,809,183 (2005: £2,428,857) that relates to loan notes and accrued interest of £167,570 (2005: £68,619) due to the University of Sheffield that arise from the purchase of the group's interest in its portfolio of spin-out companies. These amounts are repayable on the earlier of the sale by Biofusion of the underlying share capital in the company, or the company making dividend payments or ten years from the day of issue. These amounts are only payable to the extent that any gain or dividend is received by Biofusion, and can be cancelled by Biofusion by the return of the shares to which they relate to the University of Sheffield.

19 Called up share capital

	Number of shares	2006 £	Number of shares	2005 £
Authorised				
Equity: Ordinary Shares of £0.01 each	40,000,000	400,000	30,000,000	300,000
		400,000		300,000
Allotted, called up and fully paid				
Equity: Ordinary Shares of £0.01 each	20,316,429	203,164	18,819,984	188,200
		203,164		188,200
				Ordinary Shares £
Balance brought forward				188,200
Issue of shares				14,964
Balance carried forward				203,164

As part of the Side Fund Agreement dated 23 March 2006, Biofusion issued New Ordinary Shares to NPI Ventures which raised £2m before expenses. Under the terms of this agreement, Biofusion issued 1,496,445 Ordinary Shares of 1p each at £1.3365 per share. The costs of the issue with a total value of £72,500 were charged to the share premium account. These cost related to legal and brokerage fees incurred on the transaction.

Pursuant to this same Side Fund Agreement, NPI Ventures established a £10m Side Fund to make investment in Biofusion companies. This side fund is under the control of NPI Ventures, but can only be invested in companies within the Biofusion portfolio.

Further to the same agreement and under the warrant deed dated 23 March 2006, Biofusion issued the following Warrants to NPI Ventures as follows:

- (i) 1,225,000 Ordinary Shares with an exercise price of £1.50;
- (ii) 1,225,000 Ordinary Shares with an exercise price of £1.60;
- (iii) 612,500 Ordinary Shares with an exercise price of £1.80; and
- (iv) 612,500 Ordinary Shares with an exercise price of £2.20.

All of the Warrants are exercisable at any time commencing on the first anniversary of the associated Warrant Deed and on or before the tenth anniversary of the date of the Warrant Deed.

Any Ordinary Shares arising on the exercise of any Warrant will rank pari passu with the then issued Ordinary Share capital of the company at the date of exercise.

notes to the financial statements continued

for the year ended 31 July 2006

20 Reserves

Group	Profit and loss account £	Share premium account £	Capital redemption reserve £	Capital reserve £
Balance brought forward	(762,330)	6,993,200	888	2,079
Issued during the year	—	1,985,036	—	—
Cost of share issue	—	(72,500)	—	—
Retained loss for the financial year	(607,340)	—	—	—
Balance carried forward	(1,369,670)	8,905,736	888	2,079

The capital reserve represents differences on consolidation under merger accounting.

Company	Profit and loss account £	Share premium account £	Capital redemption reserve £
Balance brought forward	—	6,993,200	888
Issued during the year	—	1,985,036	—
Cost of share issue	—	(72,500)	—
Retained loss for the financial year	(192,310)	—	—
Balance carried forward	(192,310)	8,905,736	888

21 Minority interests

	2006 £	2005 £
Balance brought forward	2,364	—
Deemed disposal	(12,527)	—
Introduced at acquisition	6,100	22,897
Gain on dilution	59,651	—
Share of loss in the year	(110,515)	(20,533)
Balance carried forward	(54,927)	2,364

Minority interests of £54,927 represent the minority share of Bioacta, Lifestyle Choices, Phase Focus, Genophrenix and Mantelum's losses generated since the date of acquisition or incorporation of these companies, less any amount invested in these companies by the minority shareholders. The gain on dilution represents the calculated minority interest gain upon Biofusion's stepped investment in Lifestyle Choices.

22 Related party transactions

During the year Biofusion purchased administrative and other services from Sheffield University Enterprises Ltd (SUEL), a wholly-owned subsidiary of the University of Sheffield, totalling £6,750 (2005: £11,810). In addition, Biofusion provided support services to SUEL during the year of £180,000 (2005: £Nil). As part settlement of the above, Biofusion accepted loans due from Axordia and Lifestyle Choices to SUEL of £136,211. At 31 July 2006 the balance due from SUEL was £71,177 (2005: creditor £360).

In addition under the terms of the Agreement dated January 2005 Biofusion Trading Ltd paid the University of Sheffield £130,000 (2005: £332,750) as payments on account for intellectual property. Biofusion Trading Ltd purchased IP from the University during the year with a total value of £7,800. These payments were taken against payments on account.

During the year Biofusion has continued to accrue for interest due on loans in respect of the purchase of the original portfolio companies. Sheffield has agreed to waive amounts due in respect of the Bioacta purchase (note 4). Amounts outstanding are detailed in note 18.

During the year the company supplied management services to companies in which it held a participating interest totalling £48,070 (2005: £Nil). At 31 July 2006 £12,211 (2005: £Nil) remained outstanding.

During the year, the company subscribed for 6,000 shares in Diurnal at a price of £6,000 and the academics responsible for developing the company's core technology subscribed for 4,000 shares at £4,000. As Biofusion had originally been 100% shareholders in this company, the group effectively made a part disposal of the company. In accordance with Financial Reporting Standard 2 'Accounting for Subsidiary Undertakings' the group has recognised the profit arising, based on the carrying value of the net liabilities of Diurnal before and after the reduction including the related goodwill not charged to the profit and loss account. The calculated profit on deemed disposal was £5,039.

Diurnal, a 60% subsidiary of the group, has a licensing agreement with Phoqus Group Plc, a company of which Dr Edwin Moses, one of the group's Non-executive Directors is the Chairman.

notes to the financial statements continued

for the year ended 31 July 2006

23 Reconciliation of movements in shareholders' funds

	2006 £	2005 £
Group		
Loss for the financial year	(607,340)	(396,768)
Proceeds from share issue	2,000,000	8,229,996
Costs of share issue	(72,500)	(1,048,626)
Redemption of shares	—	(891)
Capital contribution	—	888
Net increase in shareholders' funds	1,320,160	6,784,599
Opening shareholders' funds/(deficit)	6,422,037	(362,562)
Closing shareholders' funds	7,742,197	6,422,037
Company		
Loss for the financial year	(192,310)	—
Proceeds from share issue	2,000,000	8,229,996
Costs of share issue	(72,500)	(1,048,626)
Redemption of shares	—	(891)
Capital contribution	—	888
Net increase in shareholders' funds	1,735,190	7,181,367
Opening shareholders' funds	7,182,288	921
Closing shareholders' funds	8,917,478	7,182,288

24 Notes to the cash flow statement

	2006 £	2005 £
(i) Reconciliation of operating loss to operating cash flow		
Operating loss	(964,441)	(490,230)
Amortisation of goodwill	55,401	54,664
Impairment of losses	420,521	—
Deemed profit on disposal	(5,039)	—
Depreciation	4,082	4,933
Loss on sale of fixed assets	1,084	—
Increase in stock	(7,413)	—
Decrease/(increase) in debtors	39,524	(566,650)
Increase in creditors	(487,101)	(175,881)
Net cash inflow/(outflow) from operating activities	(943,382)	(1,173,164)
	2006 £	2005 £
(ii) Reconciliation of net cash flow to movement in net funds		
(Decrease)/increase in cash in the period	(342,054)	6,222,807
Non cash movement on loan notes	444,860	(2,482,670)
Increase in net funds	102,806	3,740,137
Opening net funds	3,742,765	2,628
Closing net funds	3,845,571	3,742,765
(iii) Net funds		
Cash	5,883,381	6,225,435
Loan notes	(2,037,810)	(2,482,670)
Opening net funds	3,845,571	3,742,765

notes to the financial statements continued

for the year ended 31 July 2006

25 Acquisitions

During the year Biofusion established a number of new companies and increased its shareholding in one already established subsidiary.

On 16 November 2005, Biofusion incorporated Lifestyle Choices and took a 50% shareholding at that time for an investment of £1,500 resulting in negative goodwill of £200.

On 25 April 2006, Biofusion increased this shareholding to 60% with a further investment of £120,000.

The fair value and book value of assets acquired on 16 November 2005 and 25 April 2006 were:

	Book and fair value 16 November 2005 £	Book and fair value 25 April 2006 £
Tangible assets	—	1,799
Current assets		
Stock	—	6,789
Debtors	—	7,663
Cash at bank and in hand	3,400	21,522
	3,400	35,974
Creditors amounts falling due within one year	—	(51,035)
Net current assets/(liabilities)	3,400	(15,061)
Total assets less current liabilities	3,400	(13,262)
Creditors amounts falling due more than one year	—	(103,238)
Minority interest at date of acquisition	(1,700)	46,600
Groups existing share of net assets	—	58,250
Net assets/(liabilities)	1,700	(11,650)
Net consideration	1,500	48,000
Net (assets)/liabilities acquired	(1,700)	11,650
Goodwill arising on acquisition	(200)	59,650

On 20 February 2006, Biofusion incorporated Genophrenix a £1 wholly-owned subsidiary. On 28 February 2006 Biofusion reduced its holding in Genophrenix to 60% following further investment with the remaining 40% of the equity being subscribed at nominal value by the founding academic. Since this time Biofusion has agreed to invest up to £140,000 in the company as a convertible loan. This loan can be converted at a discount to the value of the next round at the option of Biofusion. No goodwill was generated on the establishment of this company.

On 23 June 2006, Biofusion incorporated Phase Focus. Biofusion took 100% of the share capital on incorporation for an investment of £1.

Since the year end Biofusion has agreed to advance up to £200,000 to the company on terms to be agreed. On 2 October 2006 Biofusion reduced its shareholding to 58.8% when the founders and managers of the business subscribed for 41.2% of the equity in the company at nominal value. No goodwill was generated on the establishment of this company.

On 26 June 2006, Biofusion incorporated Mantelurn. Biofusion took 100% of the share capital on incorporation for an investment of £1. Biofusion has agreed to advance a loan to this company of up to £50,000. No goodwill was generated on the establishment of this company.

26 Post balance sheet events

On 10 August 2006, and on the successful completion of the milestones set for Axordia, Biofusion invested the second tranche of £140,000 that was payable in accordance with the funding put in place in January 2006.

On 7 September, Biofusion acquired an 18% shareholding in Aperio Diagnostics from Sheffield. This shareholding was acquired in accordance with Biofusion's agreement with Sheffield that it should hold any Sheffield shareholding in life science related companies. Aperio Diagnostics is developing a cervical probe that it is hoped will be used as part of future cervical cancer screening programmes.

On 22 September 2006, the company invested £146,165 in Celltran as the last tranche of the funding put in place in August 2005.

On 26 September 2006, Biofusion announced that it had launched Phase Focus and was providing £200,000 as initial seed funding to the company. Phase Focus is developing an original method for microscopy that does not require the use of lenses, with applications in the area of optical, electron and X-ray microscopy. On 2 October 2006 Biofusion reduced its shareholding to 58.8% in the company when the founders and managers of the business subscribed for 41.2% of the equity in the company at nominal value.

On 2 October 2006, Axordia announced significant support for its research programme, in a £1.8m collaboration with Sheffield and Lombard Medical Technologies, which includes a £0.9m grant, from the DTI and MRC, for the development of their stent technology. The stem cell related IP generated by this programme will accrue to Axordia and further strengthens its position in the stem cell marketplace.

On 3 October, Celltran announced that it had merged its operations with Xcellentis, a wholly-owned subsidiary of Innogenetics N.V. Under the terms of this agreement Celltran acquired all of the assets and IP of Xcellentis in return for shares and warrants in Celltran that could ultimately see Innogenetics N.V. holding 51% of Celltran. As a result of the merger Biofusion's holding in Celltran is 12.4% on a fully diluted basis.

notice of annual general meeting

Notice is hereby given that the Annual General Meeting of Biofusion plc will be held at the offices of Ashurst, Broadwalk House, 5 Appold Street, London EC2A 2HA on Tuesday 19 December 2006 at 11 a.m., for the following purposes:

1. To receive the accounts (including the Directors' remuneration report) for the financial year ended 31 July 2006, together with the reports of the Directors and auditors thereon. (Resolution 1)
2. To re-appoint KPMG Audit Plc as auditors of the Company. (Resolution 2)
3. To authorise the Directors to set the remuneration of the auditors. (Resolution 3)

By order of the board

Richard Birtles
Company Secretary
17 October 2006



Registered Office:
Innovation Centre
217 Portobello
Sheffield
S1 4DP

Notes:

Proxies

1. A member entitled to attend and vote may appoint a proxy or proxies who need not be a member of the company to attend (and on a poll to vote) instead of him or her. Forms of proxy need to be deposited with the company's registrar Capita Registrars at The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU not later than 48 hours before the time of the meeting. Completion of a form of proxy will not preclude a member attending and voting in person at the meeting.

Documents on display

2. The register of Directors' interests in the share capital and debentures of the company, together with copies of service agreements under which Directors of the company are employed, and copies of the terms and conditions of appointment of Non-executive Directors are available for inspection at the company's registered office during normal business hours from the date of this notice until the date of the Annual General Meeting and will be available for inspection at the place of the Annual General Meeting for at least 15 minutes prior to and during the meeting.

Right to attend and vote

3. Pursuant to regulation 41 of the Uncertificated Securities Regulations 2001 (SI 2001 No 3755), the Company specifies that in order to have the right to attend and vote at the meeting (and also for the purpose of calculating how many votes a person entitled to attend and vote may cast), a person must be entered on the register of holders of the ordinary shares of the Company by no later than 11 a.m. on 15 December 2006, being 48 hours before the time fixed for the meeting. Changes to entries on the register after this time shall be disregarded in determining the rights of any person to attend or vote at the meeting.

form of proxy

Please read the notes below before completing this form.

Any amendments to this form should be initialised by the signatory.

I/We (name(s) in full)

of (address(es))

being (a) member(s) of the above-named company, hereby appoint the Chairman of the meeting, or failing him

as my/our proxy to vote for me/us on my/our behalf as directed below at the 2006 Annual General Meeting of the company to be held at the offices of Ashurst, Broadwalk House, 5 Appold Street, London EC2A 2HA on Tuesday 19 December 2006 at 11 a.m., and at any adjournment thereof.

Please indicate in the boxes below how you wish your votes to be cast.

	For	Against	Vote withheld
Resolution 1 To receive the accounts and reports of the Directors and auditors for the year ended 31 July 2006.			
Resolution 2 To re-appoint KPMG as auditors of the Company.			
Resolution 3 To authorise the Directors to set the remuneration of the auditors.			

Signature _____ Date _____

Notes to the form of proxy

1. You may appoint one or more proxies of your own choice, if you are unable to attend the meeting but would like to vote. If such an appointment is made, delete the words "the Chairman of the meeting" and insert the name(s) of the person or persons appointed as proxy/proxies in the space provided. A proxy need not be a member of the company. If no name is entered, the return of this form duly signed will authorise the Chairman of the meeting to act as your proxy.
2. In the case of a corporation, this form of proxy must be executed under its common seal or under the hand of a duly authorised officer or attorney.
3. In order that this form of proxy shall be valid, it must be deposited (together with any power of attorney or other authority under which it is signed or a notarially certified copy of such power or a copy certified in accordance with the Powers of Attorney Act 1971 or in some other manner approved by the Directors), at the company's registrars Capita Registrars at The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU, not later than 48 hours before the time appointed for the meeting. The completion and return of a form of proxy will not, however, preclude shareholders from attending and voting in person at the meeting or at any adjournment thereof, should they wish to do so.
4. If two or more persons are jointly entitled to a share conferring the right to vote, any one of them may vote at the meeting either in person or by proxy, but if more than one joint holder is present at the meeting either in person or by proxy, the one whose name stands first in the register of members in respect of the joint holding shall alone be entitled to vote in respect thereof. In any event, the names of all joint holders should be stated on the form of proxy.
5. The "vote withheld" option is provided to enable you to instruct your proxy not to vote on any particular resolution, however, it should be noted that a "vote withheld" in this way is not a vote in law and will not be counted in the calculation of the proportion of votes "for" and "against" a resolution.

third fold and tuck in

first fold

Business Reply
Licence Number
MB 122

Capita Registrars (Proxies)
PO Box 25
Beckenham
Kent BR3 4BR

second fold

company information and advisors

Company secretary
Richard Birtles

Company number
5275732

Registered office
Innovation Centre
217 Portobello
Sheffield S1 4DP

Independent auditor
KPMG Audit Plc
1 The Embankment
Neville Street
Leeds LS1 4DW

Solicitor
Ashurst
Broadwalk House
5 Appold Street
London EC2A 2HA

Banker
Barclays
Cambridge Business Centre
28 Chesterton Road
Cambridge CB4 3UT

Nominated advisor and broker
Nomura Code
1 Carey Lane
London EC2V 8AE

Registrar
Capita Registrars
34 Beckenham Road
Beckenham
Kent BR3 4TU

Public relations
Citigate
3 London Wall Buildings
London Wall
London EC2M 5SY

Biofusion plc
The Sheffield Bioincubator
40 Leavygreave Road
Sheffield
S3 7RD

www.biofusion.co.uk