

50198780

ProStrakan Group plc

Annual Report 2010

Year ended 31 December 2010

THURSDAY



\*SU33JU0Z\*

SCT

09/06/2011

1050

COMPANIES HOUSE

## Who we are

ProStrakan Group plc is a fast growing international specialty pharmaceutical company built on a diversified business model. Headquartered in the UK, our shares are listed on the main market of the London Stock Exchange.

## What we do

We are focused on the development and commercialisation of patient-friendly prescription medicines for the treatment of unmet therapeutic needs in major global markets. We have an established EU sales & marketing operating and a developing US business. Outside these core geographic areas our products are marketed by our network of partners.

Highlights of the year	3
Chairman's statement	4
Business review	6
Board of Directors	19
Executive management team	21
Corporate governance	22
Director's report	26
Remuneration report	29
Independent Auditors' report	34
Consolidated income statement	35
Consolidated statement of comprehensive income	36
Balance sheet	37
Consolidated statement of changes in equity	38
Company statement of changes in equity	39
Statement of cash flows	40
Notes to the financial statements	41
Investors' information	68

## **HIGHLIGHTS OF THE YEAR**

### **Financial Highlights**

- Total revenues of £100.2m (2009: £79.0m)
  - Continued strong European performance
  - Partnering income of £13.4m including £8.1m milestone payment on US approval of Fortesta (2009: £5.2m)
- EBITDA of £10.8m (2009: £5.1m loss)
- Operating profit of £6.1m (2009: £9.6m loss)
- Pre-tax loss reduced to £0.6m (2009: £15.0m)
- Closing cash position of £19.4m (31 December 2009: £19.0m)

### **Operating Highlights**

- Continued European growth
  - European revenues up 21% to £80.0m
  - Abstral a key driver of growth
  - Adcal-D3 sales up 14% to £23.2m
- US business experienced challenges and successes
  - Sancuso sales of £6.8m despite manufacturing interruption
  - Fortesta approved by FDA
  - Abstral approved by FDA in early January 2011
- Worldwide partnering programme made a significant contribution
  - Partnering product sales revenues of £2.4m
  - Fortesta FDA approval triggered £8.1m (\$12.5m) milestone payment (cash received January 2011)
  - 13 approvals and 5 new product country launches through partners
- Refinancing of the Group's borrowing facility in January 2011
  - New strategic relationship with Paladin Labs Inc. announced
  - Reduced rate of borrowing and capital repayments extended until January 2014
  - Exclusive out-license distribution agreement for Canada and certain emerging territories

## **CHAIRMAN'S STATEMENT**

2010 was a year of challenges and opportunities for ProStrakan from which the business emerged strongly having reached the £100m turnover milestone for the first time, assisted considerably by the £8.1m US approval milestone for Fortesta. The Company recorded its first ever profit at both EBITDA and EBIT levels and achieved two US product approvals.

It was undoubtedly a year of two contrasting halves as the business flourished in the first six months of the year, with Abstral displaying continued strong growth in Europe and contributing to an EBITDA positive first half. However the second half of the year began less encouragingly with ongoing approval delays to both Fortesta and Abstral in the US and an interruption in manufacturing for Sancuso in the US. By the end of the year, thanks to the persistence and diligence of the team at ProStrakan and our partners, we responded successfully to these challenges, achieving the US approval of Fortesta and the recommencement of Sancuso's manufacture. The US approval of Abstral followed in the early days of January 2011. Our US partner for Fortesta, Endo Pharmaceuticals Inc. ("Endo"), launched Fortesta at the end of February 2011 and we will shortly launch Abstral through our own US sales force.

In addition, we announced in December a new strategic relationship with Paladin Labs Inc. ("Paladin") of Canada which saw Paladin adopt ProStrakan's existing £50.0m secured debt facility, now denominated in Canadian dollars, with the addition of certain conversion rights, and extending any capital repayments due on the facility until 2014. As part of the agreement, approved by shareholders in January 2011, Paladin have been granted the exclusive option to distribute all of ProStrakan's products in certain territories including Canada, Latin America, Sub-Saharan Africa and Israel.

We also saw board changes at ProStrakan, with the Group's Chief Executive, Dr Wilson Totten, resigning from ProStrakan in September. I took on the additional role of Acting Chief Executive upon Wilson Totten's resignation and, on behalf of the whole Board I would like to take this opportunity to acknowledge the significant role that he has played in the development of ProStrakan during his time with the company. Since the end of 2010, Jonathan Goodman, Chief Executive of Paladin, has joined the Board of Directors of ProStrakan, as a consequence of our new strategic relationship with Paladin, and I would also like to welcome Jonathan to the Board.

Since the turn of the year, the Board has received an offer from Japanese pharmaceutical company, Kyowa Hakko Kirin Co., Ltd. ("KHK"), to acquire ProStrakan and the Board of ProStrakan has recommended that shareholders accept this offer. This process is ongoing and, assuming it is approved by shareholders, ProStrakan's acquisition by KHK will mark a new chapter in the ProStrakan story which, I believe, will be beneficial to all concerned – shareholders and staff alike.

This proposed transaction is being made through a Scheme of Arrangement and the Scheme Document was posted to ProStrakan shareholders on 8 March 2011. There will be a court meeting and general meeting of shareholders on 31 March 2011 with the transaction expected to complete on or around 21 April 2011, subject to certain conditions outlined in the Scheme Document.

ProStrakan's progress thus far, and specifically in the face of significant challenges during 2010 is a testament to the hard work, energy and enthusiasm of its people, at head office, across Europe and in the US, and I wish to record the Board's thanks and admiration for the manner in which our people have risen to these challenges. They have achieved a great deal, of which they can be justifiably proud.

Peter Allen  
Chairman & Acting Chief Executive  
ProStrakan Group plc  
17 March 2011

## **BUSINESS REVIEW**

### **Overview**

ProStrakan completed 2010 strongly as it pushed through the £100m revenue mark and received two key product approvals in the US.

This result demonstrates success in fulfilling the Group's strategy of in-licensing and developing late-stage, patient-friendly products for unmet medical needs; promoting these products through our own sales forces in Europe and the US; and out-licensing these products to high quality partners in non-core areas.

The Group made significant progress in each of these three key areas. It demonstrated success in developing Abstral in the US by working closely with the US Food and Drug Administration ("FDA") in meeting its requirements for a Risk Evaluation and Mitigation Strategy ("REMS") programme, so enabling approval to be made in early January 2011. The Group successfully promoted its existing products in its EU and US markets, making particular progress in Europe through the success of Abstral, which grew significantly in its first full year of commercial availability. Finally it created significant value by working closely with Endo, its partner in the US for Fortesta, which was approved by the FDA late in the year and triggered a significant registration milestone.

Total revenues for 2010 increased by 27% (29% at constant currency) to £100.2m (2009: £79.0m). Included within this, product sales grew by 20% (22% at constant currency) to £89.2m (2009: £74.4m). Other income, from licensing and royalty receipts, grew by 140% to £11.0m (2009: £4.6m) helped largely by the £8.1m (\$12.5m) milestone payment receivable from Endo upon the approval of Fortesta. ProStrakan saw further growth from its portfolio of European products, continued growth from Abstral in Europe and another strong growth performance from Adcal-D3 in the UK. The US business grew sales of Sancuso prior to the reduced stock availability due to the interruption in its manufacturing in October. Partnering income increased significantly due to both increased product sales to business partners and increasing income from license receipts including the milestone from Endo discussed above.

The revenue growth helped improve profitability considerably and after posting its first ever EBITDA positive performance in the six months to 30 June 2010, the Group concluded the year positively by being profitable at both EBITDA and EBIT levels for the full year. Full year EBITDA was £10.8m for 2010 compared with a loss of £5.1m in 2009 and operating profit was £6.1m compared to a loss of £9.6m in 2009.

## **Segmental Revenue Analysis**

The business is managed on a geographical basis and has three key operating segments around which the Board and management run the business. These operating segments are Europe, the US, and Partnering Income, each of which is considered separately.

### **Europe**

ProStrakan's European specialty pharmaceuticals business continued to be the principal driver of revenues for the Group in 2010.

Total European revenues in 2010 grew by 21% to £80.0m (2009: £66.5m). Approximately 45% of the Group's European revenues arise in the UK, with the majority of the remainder being Euro denominated incomes. Accordingly, foreign exchange movements can impact reported growth rates. Compared to 2009, Sterling strengthened slightly against the Euro in 2010, which reduced the reported growth rates within Europe. Excluding the impact of foreign currency fluctuations, revenue growth in Europe was 23%.

ProStrakan has a broad-based marketing and distribution capability across Europe and the company's products are promoted through its own sales forces in the UK, Germany, France, Spain and Italy. The Company also has marketing and distribution operations in Belgium, Holland, Luxembourg and Greece and a joint venture covering the Nordic region. Each country promotes a range of products, some of which are local to the specific country and referred to as "local products", whilst others are considered "Group products" as they are promoted in several different countries. Each of these Group products are reviewed in detail later in this report. Much of the revenue growth seen in Europe during 2010 came from the success of these Group products, benefiting from the increasing promotion and focus of the countries.

ProStrakan's biggest European business is the UK. The UK business experienced double digit growth due to good performance in several of its key products. Key local products include Adcal-D3 which is the market leading branded calcium and vitamin D3 oral supplement, used as an adjunct to specific therapy for the treatment of osteoporosis. Adcal-D3 is still ProStrakan's best-selling product and revenues grew by a further 14% in 2010 to £23.2m (2009: £20.4m). In addition, the UK business also markets Isotard XL, a once-daily prophylactic treatment for angina. Good growth was seen in all other Group products sold in the UK, with Abstral and Rectogesic making a significant contribution to revenues.

Spain is the Group's second biggest European business. Spain also achieved double digit growth, with the increased revenues coming entirely from sales of Group products – primarily Abstral and Rectogesic. Local products include Pencial, indicated for the treatment of advanced prostate cancer and Tebetane, indicated for the treatment of mild benign prostatic hyperplasia. The growth of local products in Spain was impacted by government price reduction measures introduced in the second half of 2010 which reduced growth. During 2010 the company in-licensed three new country specific products for the Spanish market: Radiocare; Dragul; and Devazol, products operating in oncology and urology which complement the activities of the sales force.

The Group's French business grew strongly during 2010. The key driver of growth was Abstral which performed very strongly and greatly increased the sales of Group products in that market. Local product sales reduced. The main local product is Insuplant, indicated for diabetes and when the use of an implantable insulin pump is indicated. Sales of this product are coming to an end as the technology used to deliver the insulin is being phased out.

In Germany, revenue growth was modest, partly due to lost revenues from two local products which were disposed of in 2009. Group product sales were strong again heavily influenced by sales of Abstral. The business completed a re-organisation during 2010 including a relocation of its office.

Other smaller European businesses also performed well. Italy saw excellent growth as the business entered its first full year of commercial operations, following its launch in 2009. The Italian business launched CD2, a treatment for oral mucositis, in January 2011 in its local market. Operations in the Netherlands performed well with increased sales from Tostran and local products. The Group's joint venture in Scandinavia performed well as we commenced rolling out Abstral across other Scandinavian countries during 2010, following its launch in Sweden in 2008.

### **United States**

In the last two years ProStrakan has expanded into the US, initially in the field of oncology support. 2010 US revenues were £6.8m compared with £7.3m in 2009, down 8% (down 9% at constant currency). All US revenues were generated by sales of Sancuso transdermal patch, and this performance was heavily impacted by a stock-out of Sancuso, now resolved, which greatly affected sales in the second half of 2010.

Sancuso has received considerable focus since its launch at the end of 2008 including the introduction of a number of initiatives designed to invigorate growth. These have included the launch of a specialty pharmacies distribution strategy; the introduction of a new co-pay assistance card; and a sharpened focus on specialist oncology hospitals and clinics with our primary target of achieving formulary or clinical pathway status for Sancuso. Sancuso's resultant performance in the first six months of 2010 also demonstrated growth of 28% over the second half of 2009.

In October 2010, stocks of Sancuso were exhausted following the decision by Aveva Drug Delivery Systems ("Aveva"), the manufacturer of Sancuso, to temporarily cease all manufacturing at its Florida facility in order to make changes to its own internal quality assurance systems. Aveva recommenced manufacture of Sancuso in December 2010 and ProStrakan recommenced distribution of this product at the end of January 2011. This supply interruption had an inevitable impact on revenues for Sancuso during 2010 and revenues for Sancuso in the second half of 2010 were only £2.2m (H2 2009: £3.6m).

Our strategy going forward includes an increased focus on oncologists that specialise in head and neck cancer, where the swallowing of tablets can be particularly difficult for patients. These initiatives have been supported by the launch of a suite of Sancuso promotional and instructional videos on YouTube, which are proving of interest to medical specialists and patients alike.

ProStrakan's US operation is headquartered in Bedminster, New Jersey. The US business focuses on sales & marketing, late stage development and marketed product support and currently accesses the US market via a sales force focused around major metropolitan areas across the US. This sales force focuses on oncologists and oncology support staff. In January 2011 the members of the US sales force became employees of ProStrakan, having previously been contracted through NovaQuest (Quintiles).

On 10 January 2011, ProStrakan announced the FDA approval of Abstral (for the management of breakthrough pain in cancer patients who are already receiving, and who are tolerant to, opioid therapy for their underlying persistent cancer pain).



Abstral will be launched in the US shortly and will be the only rapidly disintegrating sublingual tablet for breakthrough cancer pain on the US market, where the overall annual market value for immediate release fentanyl products is \$550m (Source: Wolters Kluwer, August 2010 MAT).

The combination of resumed manufacturing for Sancuso, and the approval of Abstral means that both products will be promoted from the second quarter of 2011 onwards.

### **Business Partnering**

Alongside ProStrakan's European and US sales and marketing operations, the third strand of ProStrakan's growth strategy is focused on capitalising on its high value medicines in non-core territories by entering into out-licensing arrangements with high quality partners with strong distribution capabilities in those markets. Partnering income increased in 2010 to £13.4m in comparison with 2009 (£5.2m), boosted significantly by the £8.1m US approval milestone for Fortesta.

Partnering income is made up of two types of revenue stream. Licensing income, together with royalties, made up a major component. Licensing income arises from third party distribution agreements entered into with business partners which often involves specific payments being made upon deal signature, receipt of registration, and or subsequent milestone payments once certain performance conditions are met. In addition to this, partnering agreements then require ProStrakan to source and manufacture stock which ProStrakan sells to business partners at an agreed price for them to then sell to customers in the relevant country markets.

Total revenues from Licensing including milestones and royalties were £11.0m (2009: £4.6m). The highlight in licensing activities in 2010 was the receipt, in December 2010, of an approval milestone of £8.1m (\$12.5m) for Fortesta received from our US partner, Endo. Endo launched Fortesta (branded as Tostran, Tostrex, Ilnogen and Fortigel in Europe, where it is marketed by ProStrakan) in February 2011. ProStrakan will exclusively supply Fortesta to Endo for the US and will receive an undisclosed royalty rate on sales generated there.

Also during 2010, Partnering income included a further £2.4m of product sales (2009: £0.6m), which included sales of Abstral, Xomolix, Rectogesic, Tostran and Sancuso to business partners. The largest single growth item within this was from Abstral sales which included sales to Gedeon Richter in respect of Central and Eastern Europe.

ProStrakan has a small but growing team dedicated to starting and managing these alliances. Notable events for this team during 2010 included the following:

- First product shipments of Sancuso to South Korea and Singapore
- Abstral launched in four of the seven CEE countries to which it has been out-licensed
- Five product launches through partners
- 13 regulatory approvals through partners for ProStrakan products

Bayer Schering Pharma has informed ProStrakan that it is handing back the right to develop and commercialise Tostran in 65 countries worldwide. The Group has also received notification that Solasia Pharma KK is handing back the rights to market and sell Sancuso in Japan, but that it will retain its rights in the other territories for which it has an interest. Any monies received to date from either partner are non refundable.

In December 2010 the Group announced that it proposed to enter into a new strategic relationship with Paladin Labs which provided them with an exclusive option to distribute certain of ProStrakan's products for Canada and certain emerging territories. This agreement builds on the relationship which already exists between the two companies under which Paladin had already in-licensed the rights to distribute Abstral and Sancuso in Canada. The new agreement, which was approved by shareholders in January 2011, broadens this existing partnership, with Paladin being granted exclusive option to distribute all of ProStrakan's products, including Abstral, Sancuso, Rectogesic, Xomolix and Tostran, in certain specific territories for which ProStrakan does not already have distribution agreements. These territories include: Canada, Latin America, Sub-Saharan Africa and Israel. Terms of the licence agreements are not disclosed but equate to arm's length commercial arrangements. In addition, Paladin will have the right for a certain period to license any new products acquired or licensed by ProStrakan for those same territories and on the same terms and conditions. Since the year end, Paladin has received approval for Abstral in Canada.

### **Group Products**

ProStrakan has five core products which it markets and distributes widely across the Group, whether in Europe, the US or via business partners in the rest of the world. As detailed earlier, these five core products are increasingly receiving the majority of our focus in channeling the Group's sales and marketing resources. Sales from these products grew by over 40% versus 2009 and generated the majority of the overall growth seen in ProStrakan's product sales.

**Abstral** is a new, sub-lingual (under the tongue) formulation of fentanyl, a long-established opioid used for the management of episodes of breakthrough pain experienced by cancer patients who are already receiving opioid analgesics for their chronic pain, licensed from Orexo AB in Sweden.

Abstral was launched in Sweden in August 2008 and in the UK, Germany, France and Spain during 2009. Abstral was launched in Italy in August 2010. Abstral was also launched in Norway, through our joint venture with Orexo AB. Abstral also generates significant revenues from sales to business partners in CEE, Canada, Slovenia and Ireland. In 2010, Abstral achieved sales across all areas of £17.3m (2009: £5.8m).

**Rectogesic** is indicated for the relief of pain associated with chronic anal fissure. This product is sold in Europe and by business partners in Turkey, Ireland, Israel and Slovenia. The product recorded further strong growth during 2010, with sales increasing to £9.3m (2009: £8.1m).

**Xomolix** (also branded as Droperidol) is a branded, injectable drug used primarily in hospitals for the prevention and treatment of post-operative nausea and vomiting. It is sold in Europe and by business partners. Total revenues grew to £7.8m during 2010 (2009: £7.5m).

**Tostran** (also branded as Tostrex, Itnogen, Fortigel and Fortesta) is a transdermal testosterone gel that utilises a metered dose delivery system for testosterone replacement therapy in male hypogonadism. This product is sold in Europe and by business partners, and was recently approved for sale in the US by our business partner there. 2010 saw sales of this product increase to £3.3m (2009: £2.1m) which included initial deliveries to Endo, our US partner.

**Sancuso** is a transdermal patch that delivers granisetron, an established 5-HT<sub>3</sub> receptor antagonist, steadily into the bloodstream for up to seven days. It helps to prevent the side-effects of nausea and vomiting in patients undergoing chemotherapy (CINV) for up to five consecutive days, without the need for daily injections or having to swallow pills. The majority of revenues are generated from sales by

ProStrakan in the US, however revenues were also received from sales by business partners in various Asian markets. Total revenues were £6.8m during 2010 (2009: £7.3m).

### **Product Development**

The main driver of activity during 2010 was focused on the approval of Abstral in the US which was successfully achieved in early January 2011. This product was initially expected to receive approval in June 2010 however the FDA announced in early June 2010 that it planned to extend the review period for Abstral.

This product is the first product to be approved in the US with the FDA mandated class-wide REMS for transmucosal immediate release fentanyl products. The Abstral REMS allows appropriate prescriptions to be filled at retail pharmacies as well as providing access to Abstral within hospitals.

The Group received a complete response from the FDA for Rectogesic in the US on 1 April 2010. This response concerned the statistical significance of pain relief demonstrated by the clinical trial data. The business entered into detailed discussions with the FDA over the most appropriate statistical analysis for a product treating the pain associated with chronic anal fissure. Following this, further work was done and on, 21 December 2010, ProStrakan re-filed Rectogesic (0.4% nitroglycerin ointment) for the treatment of pain associated with chronic anal fissure. The PDUFA goal date for this review is at the end of June 2011.

Following discussions with the European regulatory bodies over the registration of Sancuso in Europe, ProStrakan has re-filed Sancuso in the EU and this re-filing has been validated and approval is anticipated for this product in Q4 2011.

### **Manufacturing**

ProStrakan outsources all of its manufacturing operations to third party suppliers. It employs a core team at its corporate headquarters in Galashiels which manages these relationships and makes strategic decisions as to the most appropriate suppliers to use for each product in each market.

The team works closely with existing suppliers to maintain quality levels, ensure continuity of supply, influence pricing levels and control stock. The business is currently managing several transfers of existing products to new suppliers for varying reasons including quality, continuity of supply and cost.

In October 2010 the business experienced a major product interruption in the supply of its Sancuso transdermal patch product. This interruption was caused by Aveva, the manufacturer of Sancuso, ceasing all manufacturing at its Florida facility in order to make changes to its own internal quality assurance systems. This resulted in customers being without product for part of 2010. Aveva recommenced manufacture of Sancuso in December 2010 and ProStrakan restarted distribution of this product at the end of January 2011. The business is working closely with Aveva in order to ensure future continuity of supply.

### **Other Financial Items**

#### **Gross profit**

Gross profit increased to £67.4m (2009: £52.6m), an increase of 28% over the prior year. The increase in gross profit was a result of the growth in product sales and the milestone receivable as a result of the Fortesta approval. Gross margins were consistent with the prior year at 67%. This stable margin

comprised a number of moving parts such as product cost savings delivered by the manufacturing team, the impact of government price cuts in certain EU markets, and product mix including the impact of higher levels of milestone receipts.

#### **Operating costs**

Operating costs decreased by 4% to £56.6m (2009: £58.8m). Within this, distribution costs saw a 6% increase as the Group invested in its selling and marketing activities. Distribution costs comprise the selling, marketing and distribution costs of the Group's commercial teams and increases here reflect on-going investment in the European Abstral brand, coupled with tight cost control in the US commercial operations to reduce the impact on profit of the Sancuso supply issue outlined above. Administration costs increased by 12% to £8.5m (2009: £7.6m), this increase being a result of one off project costs of £0.6m offset by a credit in respect of share-based payments contained within the 2009 overheads. Development costs decreased by 44% to £6.7m (2009: £12.0m) as a result of reduced clinical trial work on the Group's portfolio. This reduction reflected that the Group had several new drug application dossiers in preparation during 2009 and that efforts were concentrated on certain post approval commitments for Sancuso in the US. During 2010 the focus shifted to helping manage those new drug applications through the regulatory process. Foreign exchange movements had the impact of marginally reducing the sterling equivalent cost of overseas operations compared to prior year.

#### **Other gains/losses**

Other gains were £nil (2009: £1.1m) with gains in the prior year arising from the sale of three non-core products in Europe.

#### **EBITDA and Operating Profit**

As a result of the increased revenues and reduced overheads discussed above ProStrakan is pleased to report a positive EBITDA of £10.8m for the full year against an EBITDA loss of £5.1m for 2009. This is the first ever full year profit recorded at the EBITDA level and follows the maiden positive EBITDA reported in the unaudited results for the first half of the year.

Depreciation, amortisation and impairment costs increased by 4% to £4.7m (2009: £4.5m). 2010 includes an impairment charge of £0.7m (2009: £0.3m) in respect of writing down the book value of certain acquired technology which the Group is no longer likely to commercialise.

2010 reported operating profit £6.1m (2009: loss £9.6m) and demonstrates progress in the previously stated objective of firmly focusing on growing the business profitably.

#### **Net Finance Costs and Taxation**

Net finance costs including changes in fair value of warrants increased to £6.7m (2009: £5.4m). This was due to a combination of increased borrowing levels, a higher blended interest rate on the borrowings and a £0.4m charge (2009: £0.2m charge) in respect of changes to the fair value of warrants issued to the lenders in March 2007.

Taxation charges for the year were £0.4m (2009: £0.6m), including a £0.3m (2009: £0.5m) movement in the deferred tax assets created in 2008 and local corporation taxes payable. The Group has significant carried forward losses available to be to offset against future operating profits.

#### **Recognised loss for the financial year**

The loss from continuing operations was £1.0m (2009: £15.6m). As discussed previously the significant improvement was as a result of increased revenues from Group products and reduced overhead increases compared to previous years.

### **Loan Facility and refinancing**

During 2010 the Group continued its borrowing relationship with Fortress Investment Group, Morgan Stanley and Och-Ziff Capital Management Group. In April 2010, a further £8.0m was drawn from the facility bringing the total amount drawn to £46.6m. In line with the facility agreement the Group made a £0.2m repayment to the lenders during the year in relation to certain licensing activities together with the first £1.0m capital repayment in December 2010 making the total amount drawn £45.4m at 31 December 2010.

On 7 January 2011 at a general meeting of the company, shareholders approved the assignment of the Company's debt facility to Paladin and the assignment was completed on 12 January 2011. This included the conversion of the facility into Canadian dollars. In addition to the facility being assigned to Paladin, the facility was amended so that Paladin has a right, from July 2011, to convert all or part of the facility into ordinary share capital at £1.10 per share. Capital repayments are not due to commence until January 2014 at which point the value of the facility not converted is re-payable. The rate of interest on the revised facility is 10.5% compared with a blended rate of 11.9% on the original facility. The Group took the opportunity to draw additional funds from the facility as part of the assignment and, after fees, accrued interest and an early termination payment to the original lenders totalling £2.2m, the Group received a further £2.4m from the facility.

In addition to the assignment Paladin and the Group entered into an exclusive distribution and licence agreement in relation to the commercialisation of certain of ProStrakan's products in various territories (Canada / Latin America, Sub-Saharan Africa and Israel.)

### **Cash Flow**

Cash flow from continuing operations was an outflow of £0.7m versus an outflow of £7.2m during 2009, reflecting the improved trading position of the Group. The milestone from Endo, relating to the US approval of Abstral, was received in January 2011 and is therefore not reflected in the 2010 cash flows.

During the first half of 2010 the Group drew down £8.0m in capital from its debt provider, in December the Group made its first capital re-payment of £1.0m in line with the credit facility and a further £0.2m of re-payments to the lenders in relation to certain licensing activity during the year.

The items discussed above resulted in a £0.3m decrease in cash and cash equivalents during the year (2009: £17.1m decrease) which when combined with the impact of exchange losses, produced a closing cash balance of £19.4m (2009: £19.0m).

**Balance Sheet**

The Group's non-current assets at 31 December 2010 were £35.5m (2009: £40.2m). This total included intangible assets of £32.5m (2009: £36.7m) which comprised acquired product rights £22.2m (2009: £26.5m), goodwill £9.7m (2009: £10.0m) and other intangibles £0.6m (2009: £0.2m). Net current assets have decreased slightly due to an increase in trade and other receivables being offset by near term capital re-payments of £12.0m under the old loan facility which has since been delayed to January 2014 as part of the refinancing discussed above. Total borrowings increased to £44.4m (2009: £36.5m) and include funds drawn-down from lenders, less the value of cumulative accretion of loan warrants and the carrying value of facility set up costs. The balance sheet as at 31 December 2010 reflects the lending relationship that was in place at that time, with the arrangements with Paladin having been put in place in early January 2011 and as such having no impact in the closing balance sheet for 2010. The total equity position as at 31 December 2010 was negative £6.2m compared to a negative balance of £5.5m at 31 December 2009.

## **Key Performance Indicators**

The Group uses a wide range of key performance indicators ("KPIs") across its various businesses and at Group level. The most important of the financial KPIs at a Group level are as follows:

Key Performance Indicators	2010	2009	Definition, method of calculation and analysis
Growth in total revenues	+27%	+41%	Year-on-year total revenue growth expressed as a percentage. Revenues increased from £79.0m to £100.2m due to growth in the Group's commercial operations and growth in revenues from partnering income. Foreign exchange movements accounted impacted on part of this growth, and excluding this, growth was 29%.
Gross margin	67%	67%	Gross margin is the ratio of gross profit to total revenues. Gross margin remained consistent resulting from the overall impact of a number of differing factors such as product costs, selling prices and mix.
EBITDA	£10.8m	£(5.1)m	EBITDA is the loss for the year from continuing operations before interest, tax, depreciation and amortisation. This improvement over prior year losses is the result of increased revenues and reduced overheads.
Operating profit	£6.1m	£(9.6)m	Operating profit is the loss for the year from continuing operations before interest and tax. The 2010 profit versus a loss in 2009 is a result of the business growing its revenues and reducing the ratio of overheads to sales.
Cash used in continuing operations	£(0.7)m	£(7.2)m	This is operating cash outflow from continuing operations before capital expenditure, product licensing payments and injected capital. Operating cash outflow from continuing operations was £0.7m versus £7.2m in 2009. This improvement being a result of the trading performance of the Group.

## **Principal Risks and Uncertainties**

The Group is exposed to a number of risks in the operation of its business, the most important of which are discussed below.

### **Marketed products**

In the year ended 31 December 2010, the Group's product sales accounted for 89% (£89.2m) of total revenue versus 2009 at 94% and (£74.4m) respectively. Of the currently marketed products, the largest in-market sales were generated by Adcal-D3, Sancuso, Isotard XL, Tebetane, Pencial, Rectogesic, Abstral and Droperidol (Xomolix). There can be no assurance that this level of product sales from marketed products can be either maintained or increased in the future. Product sales may be affected by adverse market developments, including the market for a particular product not developing in the manner predicted by the Group, downward pressure on pricing from governments and other third parties to limit healthcare costs, increased competition and the withdrawal of a product for regulatory reasons or otherwise.

### **Commercial success in the US**

The Group has a strong track record of growth in Europe and commenced its commercial operations in the US during late 2007 ahead of the launch of its first US product, Sancuso. The Group has recently received approval to launch Abstral in the US. The commercial success of these two products in the US will be a key factor in the level of future success of the Group. There can be no assurance that the Group will be successful in the US.

### **Manufacturing**

ProStrakan outsources all of its manufacturing operations to third party suppliers. The Group cannot guarantee its ability to secure continuity of product supply from these third party suppliers. During 2010, the business experienced a major product interruption in the supply of one of its key products

which led to a material financial impact. The business is currently managing the transfer of several existing products to new suppliers which by its nature creates a risk to continuity of product supply.

#### **Competition and intellectual property risk**

The Group's business depends both on the continued successful commercialisation of existing pharmaceutical products and the in-licensing, product acquisition and/or development, obtaining and maintaining marketing authorisations and subsequent successful commercialisation of new pharmaceutical products. The risks faced by the Group in relation to each of its products and product candidates differ substantially depending on whether they are in the market, seeking marketing authorisation(s) or in clinical development. Due to the inherent risk in the development of pharmaceutical products, it is probable that not all of the product candidates in the Group's portfolio will successfully complete development, obtain market authorisations, achieve satisfactory price reimbursement and be launched. Further, the Group's products may have to be removed from the market for regulatory reasons after approval has been given.

#### **Products seeking marketing authorisations**

The Group is currently seeking a marketing authorisation for Sancuso in Europe and for Rectogesic in the US during 2011. There can be no assurance that any product for which a marketing authorisation is sought will receive such authorisation and price reimbursement (if applicable) in those territories for which market authorisations are sought or if they do, that they will be successfully commercialised in those territories.

#### **Clinical and regulatory risk**

Insufficient efficacy in the chosen indication or unacceptable side-effect profiles may cause a product candidate to fail in clinical development or limit its applicability should it reach a commercial stage. Lack of performance by third party clinical research organisations or an inability to recruit patients may cause undue delays in clinical trials. Clinical and regulatory issues may arise or changes to the regulatory environment may occur that lead to delays, further costs, reduction in the commercial potential of a product candidate or the cessation of programmes. Ethical, regulatory or marketing approvals may be delayed or withheld or, if awarded, may carry unacceptable conditions to further development or commercial success. As both the product and its manufacturer are subject to continual review there can be no assurance that such marketing authorisation, once granted, will not be withdrawn or restricted. If there are changes to the application of legislation or regulatory policies, or problems are discovered with the product or the manufacturer, or if the Group fails to comply with regulatory requirements, the regulators could take action which may negatively impact the Group's ability to sell the products or the Group may incur substantial additional expense to comply with the regulatory requirements. In addition, in certain territories, even after obtaining a marketing authorisation, the Group may decide to seek price reimbursement approval (if applicable), which may delay the marketing of the Group's products, limit their commercial potential or mean that the product cannot be commercialised at all.

#### **Commercialised product risk and development risk**

The Group's ability to compete effectively with other companies will depend in part on its ability to obtain and maintain patent and/or trademark protection for certain of its products and product candidates, preserve its trade secrets, defend and enforce its rights against infringement and operate without infringing the proprietary or intellectual property rights of third parties. The validity and enforceability of patents and/or trademarks may involve complex legal and factual issues resulting in a high degree of uncertainty as to the extent of the protection provided.

#### **Economic risk**

The successful development and commercialisation of pharmaceutical products carry a high level of risk



and the returns may be insufficient to cover the costs incurred. Restrictions on health budgets worldwide or on the prices that may be charged for new medicines through competitive or other pressures may limit a medicine's sales potential. The Group may not be able to adequately fund its own development or commercialisation activities to compete with larger, more established competitors and it may fail to attract partners on favourable terms or recruit the appropriate calibre of staff to help develop or commercialise its products. Furthermore, selected partners may fail to perform or commit the resources necessary to develop or commercialise the Group's products successfully.

#### **Financial risk**

The Group is currently loss making and sustainability is dependent upon generating cash flows from successful development and commercialisation of the Group's products. Until then, the Group will be dependent upon additional funding through completion of licensing deals or through injection of capital from debt or equity sources. There can be no assurances that such funding will be achieved on favourable terms, if at all. Failure to generate additional funding may lead to postponement or cancellation of programmes and/or a scale-back of operations.

Since the refinancing completed in January 2011 the Group has a Canadian dollar debt facility for approximately £50.0m upon which it currently pays interest at a rate of 10.5% on a quarterly basis and which will require capital repayment in January 2014 unless the lender elects to convert part or all of the outstanding capital sum into equity of the Group. The facility contains a number of covenants. If the Group is unable to meet these covenants at any point then the capital sum will become fully repayable.

The Group is exposed to a number of foreign exchange risks. The principal foreign exchange risk is associated with the debt facility described above which is denominated in Canadian dollars. Movements in the exchange rate between the Canadian dollar and Sterling will have an impact on both the pounds sterling cost of interest payments due and on the pounds sterling cost of repaying the outstanding capital sum when it falls due. The Group has only minor sources of income in Canadian dollars which it receives from its distribution partners. The Group has not entered into any hedging instruments for either the interest or capital elements of the facility due to the high cost of these instruments and as a result has a non-hedged foreign exchange exposure.

Further disclosure of financial risk factors can be found in Note 3.2 of the accounts.

## Outlook

ProStrakan is now well-positioned to make the next step forward in its development. Fortesta was launched by Endo at the end of last month; Abstral will be introduced to the US oncology support market through our own US sales force shortly and Sancuso is already re-establishing itself in this market. We continue to develop our European business, with continued focus on Abstral and on capitalising on the market positions of our other European products. Our business partnering team continue to seek out opportunities to generate revenues.

Meanwhile the offer from KHK to acquire ProStrakan at a significant premium will be considered by ProStrakan shareholders at a court meeting and a general meeting on 31 March 2011. Subject to shareholder and certain other approvals outlined in the Scheme Document, ProStrakan will become the European and US divisions of a significant pharmaceutical business that owns and develops a large and attractive portfolio of pipeline products in various therapeutic areas.



Peter Allen  
Chairman & Acting Chief Executive  
ProStrakan Group plc  
17 March 2011

## Board of Directors

A – member of the Audit Committee

R – member of the Remuneration Committee

N – member of the Nomination Committee

### **Peter Allen (55) <sup>N</sup>**

*Non-executive Chairman & Acting CEO*

Peter Allen was appointed Non-executive Chairman of ProStrakan Group plc in December 2007, having been a Non-executive Director of the Group since 2005. He took on the role of Acting Chief Executive in September 2010. He was CFO of Celltech Group plc between 1992 and 2004 (and Deputy CEO from April 2003). In addition to managing the company's 1993 flotation on the London Stock Exchange, he played a significant role in several strategic acquisitions, including Chiroscience, Medeva and Oxford Glycosciences. In May 2004, Peter was a key participant in the sale of Celltech to UCB and managed the integration of the businesses until he left in December 2004. In April 2005, he was appointed CFO of Abacus Group plc, the UK listed electronics distributor, where he played a key role in its sale in 2008. Peter is Chairman of Proximagen Neuroscience plc and of Chroma Therapeutics Limited.

### **Allan Watson (44)**

*Chief Financial Officer*

Allan Watson joined ProStrakan as Chief Financial Officer (CFO) in September 2009. He joined the Company from medical technology business, Optos plc, where he had been CFO since 2003. A pharmacy graduate, he has held a number of finance positions with companies both within and outside the healthcare sector since qualifying as an accountant.

### **Peter Cawdron (67) <sup>A R N</sup>**

*Senior Independent Director*

Peter Cawdron is a qualified chartered accountant and spent 14 years from 1983 as Group Strategy Director with Grand Metropolitan. Previously, he spent six years in the US as Chief Financial Officer of a major advertising agency preceded by seven years in merchant banking at SG Warburg. He currently serves on the Board of a number of public companies including Punch Taverns plc as Non-executive Chairman and BUPA as a Non-executive Director.

### **Dr Michael Asbury (67) <sup>A</sup>**

*Non-executive Director*

Michael Asbury is medically qualified and obtained an MRCP (UK) in 1973. He has held numerous general management and marketing positions in the pharmaceutical industry. In particular, he was International Marketing Director with Zeneca Pharmaceuticals and Vice President of Global Licensing at AstraZeneca. He has wide international experience of the development and marketing of ethical pharmaceuticals and all forms of corporate activity in the pharmaceutical industry. In addition, he is the Non-executive Chairman of Photopharmica.

**Dr Frank Fildes (66) <sup>N</sup>**

*Non-executive Director*

Frank Fildes was, until 2002, Senior Vice President, Head of Global Development with AstraZeneca where he had responsibility for the development, registration and support of the company's worldwide product range. A physical chemist by training, he started his pharmaceutical career with ICI Pharmaceuticals and carried out a range of senior R&D management roles with ICI and its successors, Zeneca Pharmaceuticals and AstraZeneca. He is now a Non-executive Director of a number of healthcare companies and advises the pharmaceutical and biotech industries and venture capital funds. Frank is a Fellow of the Royal Society of Medicine and the Royal Society of Chemistry.

**Dr Simon Turton (43) <sup>R</sup>**

*Non-executive Director*

Simon Turton is a Managing Director in the Healthcare group at Warburg Pincus, the global private equity firm. Before joining Warburg Pincus in 2002, he was a Principal at Index Ventures in Geneva. Previously, Simon worked for Servier, the French pharmaceutical company, where he managed Northern Asia operations in Tokyo and Paris. He also worked for a pharmaceutical strategic alliances consultancy where he was in charge of business development. Simon has an MBA from INSEAD, which he attended as a Sainsbury Management Fellow in the Life Sciences, and a PhD in Pharmacy from the University of London. He is a director of The Haemochromatosis Society.

**Jonathan Ross Goodman (43)**

*Non-executive*

*Director*

Jonathan Ross Goodman is the founder, President & CEO of Paladin Labs Inc, a Toronto Stock Exchange listed, specialty pharmaceutical company with a market capitalisation in excess of \$600 million dollars. Paladin has achieved 15 consecutive years of record revenues and seven consecutive years of record financial results. Mr. Goodman teaches an MBA course at McGill on pharmaceutical entrepreneurship. Mr. Goodman holds a B.A. with Great Distinction, an LL.B. and an MBA from McGill University. Mr. Goodman is a member of the Bars of New York and Massachusetts.

## **Executive management team**

### **Dr Nigel Atherton**

#### *Head of Global Development*

Nigel Atherton has over 25 years' experience in healthcare, including seven years in the NHS, and is PhD and MBA qualified. Nigel has worked for Fisons, CIBA, Novartis and Shire. His achievements include the successful development and approval of multiple products for the US and Europe, M&A, partnering and portfolio management.

### **Abid Karim**

#### *President of Global Commercial Operations*

Abid Karim is responsible for the Group's sales and marketing operations across Europe and the United States. ProStrakan has businesses in most of the major territories in the EU and in the US. He has worked at ProStrakan for over nine years and prior to joining he held positions with Novartis, Pfizer, Parke Davis and Astra in various commercial roles.

### **Andrew McLean**

#### *Company Secretary and General Counsel*

After working for a City law firm, gaining valuable commercial experience in the pharmaceutical business for five years, Andrew McLean joined Shire as Head of Legal Affairs, seeing this company through to its flotation on the London Stock Exchange in 1996. He then joined Recordati SpA as its International Business Lawyer. He joined ProStrakan in October 1997.

### **Dr Tom Stratford**

#### *Executive Vice President Business Development*

Tom Stratford is responsible for the licensing activities of the Group. Since joining ProStrakan in 1997 he has previously held the posts of Discovery Director and Director of Business Development, based both in Boston MA and Scotland. Tom has a PhD in Molecular Developmental Biology from King's College, London. He has previously worked in research groups at Glaxo in Greenford and Ware and an academic placement at Tufts Medical School, Boston, US.

### **Beth Tope**

#### *Director, HR*

Beth Tope is responsible for building a Human Resource function which supports the needs of ProStrakan's growing global business. An MBA graduate from the University of Edinburgh, Beth has worked in both the United States and the UK. Beth has a solid background in leading HR within start-up organisations as well as playing key roles within a large multi-national.

# Corporate governance

## The Combined Code

The Board is committed to ensuring that the highest standards of corporate governance are maintained by ProStrakan Group plc and that it manages its affairs in accordance with the principles and provisions set out in the Combined Code on Corporate Governance published by the Financial Reporting Council in June 2008 (the Combined Code).

## Statement of Compliance

Having considered the provisions of the Combined Code, the Board believes that the Group has complied with best practice provision, unless identified below.

## Board Composition and Role

The Combined Code provides that the boards of directors of UK public companies listed in the United Kingdom should include a balance of Executive and Non-executive Directors (and in particular Independent Non-executive Directors). Except for smaller companies such as the Group, at least half the board, excluding the chairman, should comprise Non-executive Directors considered by the board to be independent (a smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year). A smaller company should have at least two independent Non-executive Directors. The Combined Code states that the board should determine whether a director is independent in character and judgement and whether there are any relationships or circumstances which are likely to affect, or could appear to affect, the Director's judgement. Save as expressly noted herein, during 2010 the Directors either complied with the requirements of Section 1 of the Combined Code (to the extent that they apply to the Company) or, as indicated below, put in place the procedures required to comply with the internal control aspects of the Combined Code in accordance with the Turnbull Report.

During 2010 the Board comprised the Non-executive Chairman, Peter Allen, two Executive Directors, Wilson Totten (up until his resignation from the Board on 6 September 2010) and Allan Watson and four Non-executive Directors (Michael Asbury, Peter Cawdron, Frank Fildes and Simon Turton). Following Wilson Totten's resignation Peter Allen became acting Chief Executive Officer as well as continuing his role as Chairman. One of Peter Allen's roles as Chairman is to ensure good corporate governance. His responsibilities include leading the Board, ensuring the effectiveness of the Board in all aspects of the Board's role, setting the Board's agenda, ensuring effective communication with shareholders and ensuring that all Directors are encouraged and are enabled to contribute fully to the activities and decisions of the Board.

The Company regards Peter Allen, up until his appointment as acting Chief Executive Officer when he received a grant of options, Michael Asbury and Peter Cawdron as Independent Non-executive Directors within the meaning of "Independent" as defined in the Combined Code. In addition, the Company regards Frank Fildes as an Independent Non-executive Director notwithstanding his interest in options over ordinary shares on the basis that such options were awarded to him by a company subsequently acquired by ProStrakan and such an interest is unlikely to affect, or to appear to affect, his judgement and no further options will be granted to him. The Board does not regard Simon Turton as an Independent Non-executive Director by reason of his connection with Warburg Pincus, which is a significant shareholder in the Company.

The Combined Code recommends that the Board should appoint one of its Independent Non-executive Directors to be the Senior Independent Director. Peter Cawdron joined the Board on 1 July 2005 and fulfils that role. The Senior Independent Director is available to major shareholders if they have concerns that contact through the normal channels of Chairman, Chief Executive Officer or Chief Financial Officer has failed to resolve or for which such contact is inappropriate.

The Board considers that it maintains sufficient contact with its major shareholders to understand any issues or concerns that they may have. The Board receives feedback from the CEO and CFO following investor roadshows, typically after major events or presentations of financial results. Peter Cawdron, the Senior Independent Non-executive Director, has had direct contact with Warburg Pincus and is himself available to other major shareholders in compliance with the provisions of the Combined Code.

## The Board of Directors

The Board of Directors has overall responsibility for the Group. Its aim is to represent the interests of shareholders and to provide leadership and control in order to ensure the growth and development of a successful business. The Board currently consists of a Chairman who is currently acting Chief Executive Officer, a Senior Independent Non-executive Director, three further Non-executive Directors, of which two are considered independent, and one Executive Director.

Under the combined code, provision A.2.1, the role of Chairman and Chief Executive should not be performed by the same person, and as a result the Company was not in compliance in this regard throughout the year. However, a clear separation of the roles of Non-executive Chairman and Chief Executive Officer (CEO) existed for the period up until Wilson Totten's resignation. The Chairman is responsible for overseeing the running of the Board, ensuring that no individual or group dominates the Board's decision-making and ensuring that the Non-executive Directors are properly briefed on developments. He also has a joint responsibility for defining Company strategy and evaluating significant merger and acquisition or licensing transactions. The CEO has responsibility for implementing the strategy of the Board and managing the day-to-day business activities of the Group through his chairmanship of the Executive Committee.

The Board meets on average every two months to discuss matters specifically reserved for its consideration: setting and monitoring the Group's strategy and financing arrangements, appraising investment opportunities, approving major transactions, reviewing the operating performance of the Group and reporting to shareholders. The Board met nine times in 2010. All acting Directors attended each meeting. The Board, through the Company Secretary at the direction of the Chairman, receives advice on matters of corporate governance and information in a timely manner, in a form and of a quality to enable it to discharge its duties. Newly elected members of the Board receive an induction into the Company and the Group's business.

The Board has access to independent professional advice at the Company's expense should they determine it necessary to perform their duties whether as a Director or as a member of a committee. The Board has access to the advice and services of the Company Secretary at any time. At the direction of the Chairman, the Board annually undertakes a formal review internally of its effectiveness as a whole and that of its committees and individual Directors. The

review produced a number of minor observations, which the Chairman has noted.

The Non-executive Directors are appointed for three-year terms of office, subject to re-election. A Director can be appointed or removed from office by ordinary resolution of the Company.

Any Director appointed by the Board is subject to election by shareholders at the first opportunity after their appointment.

#### Board Committees

In accordance with the requirements of the Combined Code, the Board has established three committees: (i) an audit committee; (ii) a remuneration committee; and (iii) a nomination committee.

#### Audit Committee

The Company's audit committee terms of reference state that it should be made up of at least three members who are all Independent Non-executive Directors and should include at least one member with recent and relevant financial experience. The audit committee was chaired by Peter Cawdron and its other member was Michael Asbury. Peter Allen was also a member, up until he became acting CEO. The Company considers that both Peter Allen and Peter Cawdron have recent and relevant financial experience.

The Combined Code states that in smaller companies the Chairman of the Company may be a member of but should not chair the audit committee and the Board considers that Peter Allen's recent and relevant financial experience continues to be of value to the audit committee and therefore that he should remain on the committee, albeit not as Chairman. As a result, while the composition of the audit committee has not complied throughout the year with its terms of reference, the Company considers that it has complied with provision C.3.1 of the Combined Code.

A charter detailing its terms of reference is regularly reviewed and amended as necessary. The current charter was adopted by the Board on 10 March 2005 and is available for inspection on the Company's website. The committee is scheduled to meet at least three times during the course of the year, which it did during 2010.

All members of the committee attended every meeting. Under its terms of reference, the committee has primary responsibility to:

- review the Group's financial statements before submission to the Board;
- review the accounting policies adopted and significant areas of judgement in the preparation of financial statements;
- review the tax strategy and affairs of the Group;
- review reports from the Group's auditors relating to the Group's accounting and internal controls;
- review the auditors' cost effectiveness, independence and objectivity together with making recommendations to the Board in connection with the auditors' appointment and/or reappointment; and
- evaluate and monitor the suitability and effectiveness of the Group's financial and non-financial internal controls.

PricewaterhouseCoopers LLP ("PwC") have been the company's auditors for many years. The Audit Committee considers that the relationship with the auditors is working well and remains satisfied with their effectiveness. Given the performance of the auditors, during the course of the financial year, a resolution is scheduled to be proposed at the 2011 AGM to reappoint PwC for 2011 and also allow the Board to set their remuneration. The Committee is satisfied that the external auditors remain independent.

The committee has direct and private access to the external auditors and is the forum through which external auditors report to the Board. Provision is made to meet with the auditors at least once a year without any Executive Director being present. The committee is authorised to seek such information of the Executive Directors and senior staff as it requires.

The ultimate responsibility for reviewing and approving the Annual Report and Accounts and the half yearly reports remains with the Board.

The Company considers that during 2010 the composition of the committee has complied with the Combined Code. The audit committee noted that there were £0.2m in audit fees and a further £0.2m in non-audit fees paid to PwC in 2010 but it was satisfied as to the objectivity and independence of the external auditor. The audit committee has been provided with a review by PwC of its own internal quality control procedures. PwC has advised the audit committee that it has the appropriate internal procedures in place to ensure that the provision of non-audit services in the future would not impair its independence or objectivity as auditors for the Company.

#### Remuneration Committee

The Company's remuneration committee terms of reference state that it should be made up of three members, all of whom are independent Non-executive Directors. The Combined Code states that in smaller companies this can be two independent Non-executive Directors. The committee was chaired by Michael Asbury until 1 July when Peter Cawdron replaced him and its other member was Simon Turton who was co-opted on to the Committee on 1 July. Peter Allen was also a member, up until he became acting CEO on 7 September 2010. The Company considers Michael Asbury, Peter Cawdron and Peter Allen (prior to becoming acting CEO) as independent. While the Company has not complied with the terms of reference for the remuneration committee in relation to its composition throughout the year, it considers that for the period up until 1 July 2010 the composition of the committee did comply with provision B.2.1 of the Combined Code.

A charter detailing its terms of reference was adopted on 10 March 2005 and is available for inspection on the Company's website. The committee is scheduled to meet at least twice a year, meeting seven times during 2010. All members of the committee attended every meeting. Under its terms of reference, the committee has primary responsibility to:

- consider the Group's policy on remuneration with a view to ensuring it attracts and retains staff at all senior levels in the organisation;
- make recommendations to the Board regarding, and to determine the remuneration package for, each of the Executive Directors and the Chairman and the rest of the senior management team and new recruits to the senior management team;

- to determine the terms of discretionary share schemes, including the award of share options and other incentives to Executive Directors and the rest of the senior management team; and
- to determine the terms of employment set out in the Executive Directors' service contracts.

The Chairman (after consultation with the Executive Directors) determines the remuneration of the Non-executive Directors. There have been no changes to the remuneration of the Non-executive Directors since 2005. No Director votes on their own remuneration.

The Remuneration Report for 2010 is included on pages 29 to 33.

#### Nomination Committee

In accordance with the requirements of the Combined Code, the majority of members of the nomination committee are Independent Non-executive Directors. The nomination committee is made up of at least three members. The committee was chaired by Peter Allen and its other members were Peter Cawdron and Frank Fildes.

A charter detailing its terms of reference was adopted by the Board on 10 March 2005 and is available for inspection on the Company's website. The committee is scheduled to meet at least twice a year, however it met only once in 2010 as the Committee felt there was no further need to do so. The committee has primary responsibility to:

- lead the process for Board appointments;
- make recommendations to the Board, amongst other issues, on Board composition and balance; and
- keep under review the leadership needs of the organisation and consider succession planning.

The Company considers that during 2010 the composition of the committee has complied with the Combined Code.

#### Executive Committee

In addition to the Board Committees referred to above, the Group operates an executive committee which has responsibility for the day-to-day running of the Group's operations and implementing the Board's operational strategy. It was chaired by the CEO, Wilson Totten until he left the Company and is now chaired by the acting CEO Peter Allen, and consists of Senior Executives of the Group. The committee meets frequently and at least once every six weeks.

#### Internal Control and Risk Management

The Board acknowledges its responsibility for safeguarding the shareholders' investments and the Group's assets. The Board recognises that it has overall responsibility for ensuring that the Group maintains a system of internal control to provide assurance regarding effective and efficient operations, internal financial control over financial reporting and compliance with laws and regulations.

The key features of the internal control system are:

- control procedures and environment: all employees are required to follow clearly laid out internal procedures and policies appropriate to the business and their position in it;
- identification and evaluation of risks: such identification and evaluation is a continuous procedure running in parallel with the progress of the Group's development portfolio;
- financial information: detailed management accounts are prepared each month which are compared to budgets and any variances investigated thoroughly and the Company has in place internal control and risk management systems in relation to the Group's process for preparation of the consolidated accounts;
- monitoring: the Board monitors the activities of the Group through the supply of monthly information from across the business; and
- the Executive committee performs a detailed review, taking corrective action if required. The Board, through the audit committee, reviews the effectiveness of the internal systems of control.

The internal control system is designed to manage rather than eliminate risk of failure to achieve business objectives and can provide reasonable assurance but not absolute assurance against material misstatement or loss.

The Board, through the audit committee, has kept the control environment and staff resourcing under review throughout the year. Enhancements to the control environment have been and continue to be made and the Board is of the belief that the Group is positioning itself in a way to maintain a sound system of internal control and at this moment in time does not require an internal audit function.

#### Corporate Social Responsibility Policy

The Board is conscious that everything the Company does impacts not just on the patients we treat but also on our employees, shareholders and our environment. These are integral to our long-term future success. To that end the Board adopted the following Corporate Social Responsibility Policy on 5 December 2006.

The Group aims to set, promote and maintain high standards of corporate social responsibility, which will ensure that:

- patient benefit and safety are the highest priority;
- safety, health and environmental issues remain a fundamental company consideration;
- the creative talents, commitment and energy that every employee brings to the business are fully valued and respected;
- high ethical standards are maintained in our development of new medicines in accordance with national and international regulations; and
- high ethical standards are maintained in our marketing and sales practices in all countries of operation.

Furthermore, the Company is committed to its involvement in the communities in which it operates and to supporting relevant initiatives and organisations. In 2010 the Company provided support to the Edinburgh International Science Festival and a number of youth-focused sporting organisations local to the Company's headquarters in Galashiels, Scotland. The Company also provided support in the US to MyLife.Org and Happy Chemo.

The Group makes efforts to reduce its carbon footprint by minimising business travel wherever possible and encouraging the use of telephone and video



conferencing between its various offices in the UK, Europe and US.

The Company actively supports the continuous training and development of its staff.

The Company encourages staff to recycle paper and plastics at its offices and to reduce electricity consumption by encouraging its staff to turn off lights and equipment outside office hours.

The Company does not manufacture any products itself but its staff monitor suppliers in an effort to ensure the most cost effective and environmentally friendly procedures are followed by its suppliers.

The Board is committed to reviewing its corporate social responsibility policy going forward to ensure that it is appropriate for the Company at each stage of its corporate evolution. The Corporate Social Responsibility policy is available for inspection on the Company's website.

#### Requirements from the Takeover Directive

Requirements from the takeover directive can be found within the Directors' Report on page 27.

#### Going Concern

The directors, having made enquiries, have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future, and that therefore it is appropriate to continue to adopt the going concern basis in preparing the accounts, refer to further disclosure in the Directors' Report on page 26.

By order of the Board,



A F McLean  
Company Secretary  
ProStrakan Group plc  
Galabank Business Park  
Galashiels TD1 1QH  
17 March 2011

# Directors' report

for the year ended 31 December 2010

The Directors present their Annual Report on the affairs of the Group together with the financial statements and Auditors' Report for the year ended 31 December 2010.

## Principal Activities

The Group is engaged directly and indirectly in the development, registration, manufacture, distribution and sale of pharmaceuticals and other similar products and related services. A review of the Group's activities is set out in the Chairman's Statement and the Business Review.

## Results and Dividends

The Group generated revenues of £100.2m (2009: £79.0m) and incurred a loss before income tax and discontinued operations for the year of £0.6m (2009: loss £15.0m), and a loss for the year of £1.0m (2009: loss £15.8m). The loss for the year in 2009 included a £0.2m loss from discontinued operations.

The Directors do not recommend payment of a dividend for 2010 (2009: £nil).

## Post Balance Sheet Events

On 12 January 2011 the Group completed the refinancing of its existing debt facility with Paladin Labs Inc. On 21 February 2011 the Board announced that it had reached agreement on the terms of the recommended cash acquisition of the Group by Kyowa Hakko Kirin Co., Ltd. Further details of both items can be found in Note 32 of the accounts: Post balance sheet events.

## Donations

The Group has made donations amounting to £50,000 (2009: £31,000) to local community groups and healthcare and medical support organisations.

## Policy and Practice on Payment of Creditors

The Group's payment policy is to settle all supplier liabilities in accordance with the terms and conditions agreed with the supplier when the transaction was concluded. During 2010, the Group took on average 35 days (2009: 36 days) to pay its suppliers.

## Directors

The Directors who served during the year were as follows:

### Non-executive Directors

P V Allen (appointed Acting CEO on 7 September 2010)

M J Asbury

P E B Cawdron

F J T Fildes

S Turton

### Executive Directors

J W Totten (resigned 6 September 2010)

A M Watson

The Directors' remuneration and their interests are detailed in the Remuneration Report.

## Business Review

The Company is required to set out in this Directors' report a fair review of the business of the Group and a description of the principal risks and uncertainties facing the Group (known as a "Business review"). The Business review is required to set out a balanced and comprehensive analysis of the development and performance of the Group's business during the financial year ended 31 December 2010 and of the position of the Group at the end of that financial year. The information that fulfils the requirements of the Business review can, in addition to that set out below, be found in the following sections: Chairman's statement on page 4; Business Review on pages 6 to 18 inclusive, which are incorporated in this report by reference.

## Going Concern

The Group's business activities, future development, performance and position are set out in the Business Review on pages 6 to 18. The Business Review also describes on pages 6 to 18 the financial position of the Group, its cash flows, and loan facilities. Note 3 to the financial statements covers in detail the objectives, policies and processes for managing the Group's financial risks. The borrowing facilities currently available to the Group, together with the financial covenants relating to them, are set out in Note 22 together with details of the loan facility refinancing as set out in Note 32 to the financial statements. As part of the year end accounts exercise, the Directors are required to satisfy themselves that it is reasonable for them to conclude whether it is appropriate to prepare financial statements on a going concern basis. The Directors of the Group have reviewed various aspects of the business including budget plans covering the periods for at least twelve months from the date of approval of the accounts, taking account of reasonably possible changes in trading performance, the current and forecast debt position, related covenants, other sources of capital and various external factors. Notwithstanding the Group's negative net asset position as at 31 December 2010, the Directors are satisfied after making these enquiries that the Group has adequate resources to continue in business for the foreseeable future and, accordingly, consider that it is appropriate to adopt the going concern basis in preparing this full year financial information.

### Substantial Shareholdings

In addition to Directors' interests as disclosed in the Remuneration Report on pages 29-33, the Company has been advised or is aware of the following individual interests which at 25 February 2011 exceeded 3% of the Company's issued share capital:

Nortrust Nominees Limited (Aberforth Partners)	14.03%
Norgine BV	14.22%
Warburg Pincus International Partners LP	11.59%
LMS Capital (Bermuda) Limited	8.61%
Warburg Pincus Private Equity VIII LP	7.36%
Schroder Investment Management Ltd	7.61%
Warburg Pincus Equity Partners LP	4.21%
JP Morgan Asset Management	3.03%

Warburg Pincus, through various entities, collectively holds 24.1%.

### Controlling Shareholder

On 25 May 2005, the Company entered into a Relationship Agreement with Warburg Pincus which continues to hold nearly 25% of the Company's issued ordinary shares. The Relationship Agreement was entered into between the Company and Warburg Pincus to ensure independence of the Company and that all the transactions and relationships between the Company and Warburg Pincus are carried out at arm's length on a normal commercial basis.

### Directors and Officers Liability Insurance

The Company has in place qualifying third party indemnity provisions for all Directors and officers.

### Employees

The Company seeks to involve its employees in its corporate objectives and performance through active and diverse communication, including regular meetings. The Directors consider that there is a good relationship between employees and management. The Group has encouraged employees to share in the growth of the Group through eligibility to participate in share option schemes.

The Group has a Recruitment and Selection Policy that states it is committed to the employment of people with disabilities. It guarantees an interview to people with disabilities who meet the minimum selection criteria for any vacancy.

The Equal Opportunities Policy contains a code of good practice on disability which states that an individual who becomes disabled whilst in employment will receive support to ensure, wherever possible, that they are able to continue in their role. This will involve whatever reasonable adjustments that can be made, in consultation with the individual. Again, in consultation with the individual, other positions will be considered where the individual's skills and abilities match the requirements of the role, making reasonable adjustments wherever possible.

The Company ensures that training and career development is equally available to people with disabilities, tailored where practicable for their specific needs.

The Company is committed to the principle of equal opportunities for all its employees including any with disability and will not tolerate harassment or discrimination.

### The Takeover Directive

Details of the share capital and structure can be found in Note 23 of the financial statements.

The Company has one class of share capital, ordinary shares. All the shares rank *pari passu*. There are no special control rights in relation to the Company's shares. The rules governing the appointment and replacement of Board Members and changes to the Articles of Association accord with usual Scottish company law provisions. There are no agreements providing for compensation for directors or employees on change of control. Options previously granted will vest on change of control, details of this have been set out in the Scheme Document circulated to shareholders on 8 March 2011.

The Company is not aware of any agreements between holders of securities that may result in restrictions on the transfer of securities. There are no significant agreements to which the Company is a party which take effect, alter or terminate in the event of change of control of the company except that the Company's and Paladin's bank facilities give Paladin the right to request repayment of the facility on a change of control and NovaQuest. Can require the Company to make a single acceleration payment in respect of NovaQuest's then remaining interest in the service fee payable by the Company under its agreement with NovaQuest can require the Company to make a single acceleration payment in respect of NovaQuest's then remaining interest in the service fee payable by the Company under its agreement with NovaQuest.

Subject to the provisions of the Companies Acts, the Company may, by ordinary resolution, from time to time declare dividends in accordance with the respective rights of the members, but no dividend can exceed the amount recommended by the Board.

### Directors' Conflicts of Interest

Under the Companies Act 2006, a director must avoid a situation where he has, or can have, a direct or indirect interest that conflicts, or may possibly conflict, with the Company's interest. The Companies Act 2006 allows directors of public companies to authorise conflicts and potential conflicts, where appropriate, where the Articles of Association contain a provision to this effect. The Companies Act 2006 also allows the Articles of Association to contain other provisions for dealing with directors' conflicts of interest to avoid a breach of duty. Amendments to the Company's Articles were adopted at the Annual General Meeting in 2008 to enable the Directors to authorise conflict situations and also to include other provisions to allow conflicts of interest to be dealt with in a similar way to the position prior to the relevant provisions of the Companies Act 2006 becoming effective.

Under the Companies Act 2006 and the Articles, there are safeguards which apply when the Directors decide whether to authorise a conflict or potential conflict. Firstly, only Directors who have no interest in the matter being considered will be able to take the relevant decision, and secondly, in taking the

decision the Directors must act in a way they consider, in good faith, will be most likely to promote the Company's success. The Directors are able to impose limits or conditions when giving authorisation if they think this is appropriate.

The Company has adopted procedures for dealing with conflicts of interest which are in line with the guidance contained in the GC100 Guidance Paper on conflicts of interest and the Directors believe that these procedures have operated effectively to date. During the year, each Director has been asked to notify the Company regarding actual or potential conflicts. In taking any decision to authorise a conflict or potential conflict, the Board acts in accordance with the adopted procedures. Any authorisations that are granted by the Board will be reviewed at least annually to check it is appropriate for the relevant matter to remain authorised.

#### Disclosure of Information to Auditors

As required under section 418 of the Companies Act 2006, each of the Directors confirms that, so far as they are aware, there is no relevant audit information of which the Company's auditors are unaware and they have taken all the steps that they ought to have taken as Directors to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

#### Auditors

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

#### Corporate Governance

The Company's statement on Corporate Governance is set out on pages 22 to 25 of these financial statements and is deemed to form part of this Directors' Report.

#### Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual Report, the Directors' Remuneration 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 prepared the Group and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial statements are required by law to give a true and fair view of the state of affairs of the company and the Group and of the profit or loss of the company and Group for that period.

In preparing those financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state that the financial statements comply with IFRSs as adopted by the European Union; and
- prepare the financial statements on the going concern basis.

The Directors confirm that they have complied with the above requirements in preparing the financial statements.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and the Group and to enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

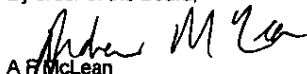
The Directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

#### Directors' statement pursuant to the Disclosure and Transparency Rules

Each of the Directors, whose names and functions are listed on page 19 to 20 confirm that, to the best of each person's knowledge and belief:

- the financial statements, prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and loss of the Group and company; and
- the Directors' report contained in the Annual Report includes a fair review of the development and performance of the business and the position of the company and Group, together with a description of the principal risks and uncertainties that they face.

By order of the Board,



A F McLean  
Company Secretary  
ProStrakan Group plc  
Galabank Business Park  
Galashiels TD1 1QH  
17 March 2011

Company Registration Number: SC198780

# Remuneration report

for the year ended 31 December 2010

The Principles of Good Governance relating to Directors' remuneration are described below. The remuneration report relates to the financial year ended 31 December 2010.

In accordance with the Companies Act 2006, a resolution is being put to the Company's shareholders at the 2011 AGM to approve the remuneration committee's report.

Those sections which our auditors, PricewaterhouseCoopers LLP, have audited have been specifically identified within this report.

## Remuneration Committee

The members of the remuneration committee (the committee) were Michael Asbury (Chairman) until he stepped down from the Committee and Peter Cawdron replaced him as Chairman from 1 July 2010, Peter Allen and Simon Turton who was co-opted on to the Committee in place of Michael Asbury. For the year period up until 1 July, it was the view of the Board that all members of the committee were fully independent. At the request of the committee, Wilson Totten, whilst he was Chief Executive Officer, attended one (1) meeting in 2010, except when his own remuneration was being discussed. The remit of the committee is to determine, on behalf of the Board, the remuneration and other benefits of all Executive Directors and senior management, including basic salary, benefits, bonus payments, share-based long-term incentives and service contracts.

During the year, the committee received advice from Hewitt New Bridge Street, an organisation appointed by the committee to provide advice on executive remuneration issues, incentive arrangements, employee share schemes and pensions. Hewitt New Bridge Street did not provide any other services to the Company during the year.

## Policy on Executive Director Remuneration

The committee is aware that it must both attract and retain individuals of the highest calibre. It therefore aims to ensure that remuneration packages of Executive Directors and senior management are competitive when compared with comparable, publicly listed companies and that they fairly and responsibly reward individuals for their contribution to the success of the Group in order to align their interests with those of shareholders. The committee believes that a significant proportion of Executive Directors' remuneration should be performance-related through an annual bonus scheme, share options and long-term incentive plan awards, and the performance conditions attached to these components have been structured such that they are specific to the Company.

## Components of Executive Directors' Remuneration

### Basic Salary and Benefits

In determining the basic salary of each Director, the committee takes into account the individual's responsibilities and performance. Pay levels are set in the light of independent assessment of market rates. Basic salaries for Executive Directors are reviewed annually and compared to salary levels in a group of comparably sized pharmaceutical and biotechnology companies. The committee also takes into consideration percentage increases for all employees when reviewing Executive Director salary increases. In the year under review, the average base salary increase for executive directors was 4.8%, for all other staff 1.7%. Salary reviews take account of all responsibility changes. Benefits offered to all Executive Directors comprise private healthcare, life assurance and permanent health insurance.

### Annual Bonus

Bonuses are based on a percentage of basic salary. For 2010, the maximum annual bonus payable for Executive Directors was between 60% and 100% of basic salary. The maximum bonus level can only be achieved for significantly outperforming budgeted targets.

Bonuses are paid at the discretion of the committee in recognition of the Directors' contributions to the success of the Group. Objectives are set that are considered to be both challenging and realistic. The performance metrics on which bonus payments are assessed are a mix of short-term financial, product development and business development targets.

For 2010, the bonuses awarded to Executive Directors were determined following an evaluation of Group and individual performance to agreed objectives.

### Pension

On 1 April 2006 the Company implemented a Group Personal Pension Plan Scheme. During 2010, the Company contributed 5% of each employee's salary dependent on each employee contributing at least 3% of base salary.

### Long-term Incentives

The committee principally seeks to incentivise Executive Directors by offering participation in share-based long-term incentive schemes, which are designed to encourage Executive Directors to focus their efforts on delivering sustained long-term performance to investors. Executive Directors currently participate in grants of share options under the Executive Share Option Plan ("the ESOP") and grants of nil cost options under the ProStrakan Group Performance Share Plan 2005 ("the PSP"), both of which were established at the time of the Company's listing, the ProStrakan Sharesave Plan 2005, under which savings plans were issued in 2005, 2006, 2008, 2009 and 2010 and the ProStrakan Group Share Incentive Plan ("SIP"). These plans and the performance conditions that apply to the options or awards under these plans (where relevant) are described in more detail below.

The Company has also put in place the ProStrakan Group International Sharesave Plan 2005 but did not utilise this scheme in 2010.

An individual may not be granted options under the ESOP in any financial year over ordinary shares having a market value in excess of 200% of his/her annual salary except in exceptional circumstances, such as recruitment or retention, when an individual may receive options in a financial year over ordinary shares worth up to 400%.

An individual may not be granted nil cost options under the PSP in any financial year over ordinary shares having a market value in excess of 150% of his/her annual salary except in exceptional circumstances, such as recruitment or retention, when an individual may receive awards in a financial year over ordinary shares worth up to 300% of his/her annual salary.

However, an individual may not be granted both nil cost options under the PSP and options under the ESOP in any financial year over ordinary shares having a combined market value in excess of 250% of annual salary except in exceptional circumstances, such as recruitment or retention.

A relative total shareholder return ("TSR") performance condition applies to the long-term incentive awards made under the ESOP and PSP. The committee currently believes that this approach ensures that rewards are only delivered under the ESOP and PSP as a result of the Company delivering returns to shareholders in excess of its industry peers. Full details of the condition are explained below.

#### ESOP

All Executive Directors are eligible to participate in the Company's ESOP.

The ESOP is divided into two parts of which Part A is approved by Her Majesty's Revenue and Customs (HMRC) and Part B is unapproved. The grant of options under the ESOP is at the discretion of the committee and their exercise is subject to performance conditions.

Grants made to Executive Directors in 2010 were subject to performance conditions relating to the performance of the Company's TSR measured against a comparator group of other companies within the industry ("the Comparator Group"). The Comparator Group consists of: Abcam, Allergy Therapeutics, Alliance Pharma, Antisoma, Ark Therapeutics Group, Asterand, Axis-Shield, BTG, Dechra Pharmaceuticals, Eco Animal Health Group, Epistem Holdings, E-Therapeutics, Futura Medical, Genus, GW Pharmaceuticals, Hikma Pharmaceuticals, Immupharma, IS Pharma, Lipoxen, Oxford BioMedica, Phytopharm, Proteome Sciences, Reneuron Group, Renovo Group, Silence Therapeutics, Sinclair Pharma, SkyePharma, Source Bioscience, Vectura Group, Vernalis and Verona Pharma.

The TSR condition seeks to align the interests of Executive Directors with the interests of shareholders by comparing the Company's TSR performance with other pharmaceutical and biotechnology companies. Under the ESOP, options will be exercisable in full if ProStrakan's TSR, over the three year performance period, ranks the Company in the upper quartile of the Comparator Group. 40% of awards vest if the Company's TSR is equal to the median TSR of the Comparator Group (an appropriate threshold level of vesting given the condition inherent in share options that the share price must increase from grant to deliver value) and no awards vest if the Company's TSR is below the median TSR of the Comparator Group. Between median and upper quartile performance, the number of options which may be exercised will be calculated on a straight line basis. The performance condition is measured over a single three-year period.

#### PSP

The grants of nil cost options are made, upon the recommendation of the committee, by the Trustees of the ProStrakan Group Employee Trust (the Trust) and comprise performance shares, being a right to acquire, at no cost, a fixed maximum number of shares in the Company that are owned by the Trust. The right to acquire shares only vests after three years and is subject to the satisfaction of a TSR performance condition. The Trust may acquire shares to satisfy PSP grants of nil cost options on the open market as required. Alternatively, the Company may settle any vested awards in cash.

All PSP nil cost options are subject to a performance condition relating to the performance of ProStrakan's TSR compared to the Comparator Group of other Pharmaceutical and Biotechnology companies over a single three-year period. For the grants made in 2010, this condition will apply and the comparator companies will be as detailed in the section on ESOP above. PSP nil cost options vest in full if the Company's TSR is such as to rank the Company in the upper quartile of the Comparator Group, prorated down to 25% vesting for a TSR equal to that of the median company in the Comparator Group. No awards will vest if the Company's ranking falls below the median. The performance condition is measured over a three-year period beginning at the date of grant.

#### Sharesave Plan

The Company also operates five HM Revenue and Customs approved Sharesave plans, which are available generally to all UK employees, provided they enter into savings contracts.

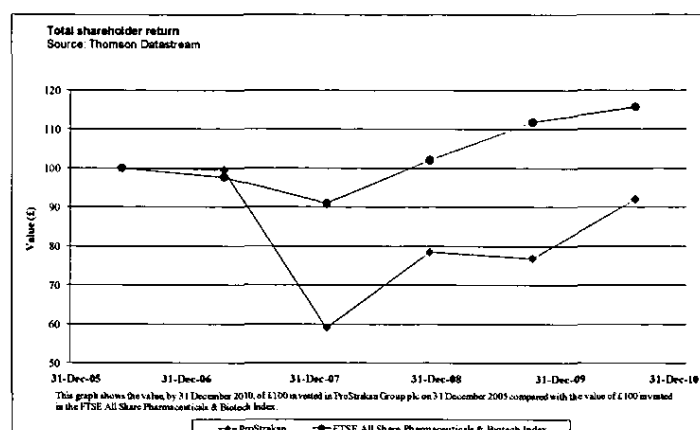
#### Share Incentive Plan

During 2010 the company also operated an HM Revenue and Customs approved Share Incentive Plan. Under the terms of the Share Incentive Plan employees may purchase shares up to the HM Revenue and Customs agreed limit in any tax year of £1,500 (or 10% of an employee's salary, if lower) and the Company matches the cash contribution by an employee. The trustee of the Share Incentive Plan then acquires shares on behalf of the employee in the open market, the shares attract favourable tax treatment if held by the trustee for a period of time specified by HM Revenue and Customs.

The Committee regularly reviews the Company's long-term incentive program to ensure its continued effectiveness and compliance with current investor best practice guidelines and general market practice. The committee observes the Company's short and long-term incentive programmes to ensure that they do not raise environmental, social or governance risks, nor does it encourage inappropriate operational risk-taking. The committee intends to operate the ESOP, Sharesave Plans, PSP and Share Incentive Plan in the forthcoming year in broadly the same manner as in previous years.

### Total Shareholder Return Performance Graph

The graph below shows the Company's performance, measured by total shareholder return ("TSR"), compared to the FTSE All Share Pharmaceuticals & Biotech Index for the period from 16 June 2005 (the date of IPO) to 31 December 2010.



This graph shows the value, by 31 December 2010, of £100 invested in ProStrakan Group plc on 16 June 2005 (the date of the IPO), compared with the value of £100 invested in the FTSE All Share Pharmaceuticals & Biotech Index.

### Directors' Service Contracts

Details of the service contracts of those who served as Directors during the year are:

Director	Contract Date	Notice Period
<b>Executive</b>		
J W Totten	15 September 2004 (resigned 6 September 2010)	12 months
A M Watson	9 September 2009	12 months
<b>Non-executive</b>		
P V Allen	1 January 2005	6 months
M J Asbury	2 March 2005	1 month
P E B Cawdron	1 July 2005	1 month
F J T Fildes	26 August 2004	1 month
S Turton	25 June 2007	1 month

The committee believes that, in the event of early termination of an Executive Director's contract, it is appropriate to examine the specific circumstances of each case. Where appropriate, the committee may agree to a phased payment of compensation over a fixed term. In relation to Wilson Totten's resignation as Chief Executive on 6 September 2010 the Committee determined that it was appropriate to pay him 12 months' salary in lieu of notice.

During this term, the Executive Director will be under an obligation to mitigate his loss and as such, if the Executive Director were to find a new position, the principle of mitigation would apply and payments would cease. The committee does, however, reserve the right to make a payment in lieu of any period of notice.

The Board believes that it is in the Company's best interests for Non-executive Directors to serve a minimum three-year term before retiring by rotation. Under the terms of their contracts, the current Non-executive Directors do not take any part of their fees in the form of ordinary shares.

### External Appointments

The committee recognises that Executive Directors may be invited to take up Non-executive Directorships or public service appointments and that these can broaden the experience and knowledge of the Director, from which the Company would benefit. Accordingly, subject to Board approval, they may accept Non-executive appointments, as long as these are not likely to lead to conflict of interest. They are also allowed to retain any fees paid under such appointments.

### Non-executive Directors' Fees and Terms

The Non-executive Directors' fees are determined by the Board on the basis of independent advice on current levels in similar businesses, taking into account their individual experience and time commitment. Fees are reviewed periodically. Non-executive Directors are not eligible for and do not participate in, pensions, incentives, bonuses or any similar payments, but are entitled to claim out-of-pocket travel and accommodation costs in connection with the performance of their duties.

# Directors' Remuneration (Audited)

The total remuneration of the Executive Directors for the year ended 31 December 2010 comprised salaries, benefits, bonuses and long-term incentive awards (as shown in the table below). Non-executive Directors received fees only. The Directors who served during the year and their remuneration for the year (or period of employment during the year if shorter) are shown below.

Director	Fees/ basic salary £'000	Compensation for loss of office £'000	Taxable benefits £'000	Annual bonus £'000	Pension contribution £'000	2010 total £'000	2009 total £'000
Non-executive							
P V Allen *	68	-	-	-	-	68	90
M J Asbury	32	-	-	-	-	32	36
P E B Cawdron	50	-	-	-	-	50	48
F J T Fildes	28	-	-	-	-	28	28
S Turton	-	-	-	-	-	-	-
Executive							
P V Allen *	79	-	-	45	-	124	-
A M Watson	188	-	1	70	26	285	77
J W Totten * resigned 6 September 2010	225	341	1	-	20	587	527
	670	341	2	115	46	1,174	806

\*P V Allen was appointed as acting Chief Executive Officer from 7 September 2010.

In 2010 the Company operated a Group Personal Pension Scheme under which the Company contributed 5% and each employee contributed at least 3% of salary. Details of the value of individual pension entitlements and information relating to the benefits available to the Executive Directors, as defined by schedule 8 of the Large and Medium-sized Companies and groups (Accounts and Reports) Regulations 2008 and sections 420 and 421 of the Companies Act 2006 and the Listing Rules are shown earlier in this report above. Allan Watson's and Wilson Totten's pension contribution include £13,875 (2009: £nil) and £6,800 (2009: £9,000) of salary taken as pension contribution. During the year Allan Watson and Wilson Totten had personal pensions to which the Company contributed, as noted in the table above.

In March 2010 options granted to or held by the Directors were tested on the third anniversary of grant. The Company's Total Shareholder Return (TSR) over the three year period was 3.8%. The median TSR for the Comparator Group was -42.2%. Accordingly, options vested at 85.82% of grant and nil cost options vested at 82.27%.

## Directors' Interests in Shares (Audited)

The Directors who served during the year had the following beneficial interests in the shares of the Company:

Name of Director	Number of options/awards			£0.05 ordinary shares		
	1/1/10 or date of appointment	Granted/ (surrendered)	31/12/10	Exercise price (options) Market price (awards)	1/1/10 or date of appointment	31/12/10*
P V Allen	-	1,000,000	1,000,000	£0.4650	50,000	50,000
M J Asbury	-	-	-	-	99,654	99,654
P E B Cawdron	-	-	-	-	20,000	20,000
F J T Fildes	86,090	-	86,090	£0.7762	18,000	58,000
S Turton**	-	-	-	-	4,800	4,800
A M Watson	750,000	-	750,000	£1.4920	10,000	47,426
	13,027	(13,027)	-	£1.1936		
	-	185,000	185,000	£0.9890		
	-	25,311	25,311	£0.6104		
J W Totten *	1,199,999	-	1,199,999	£1.6667	480,124	630,817
	70,325	-	70,325	£1.2300		
	537,588	-	537,588	£1.1200		
	20,008	-	20,008	£0.8184		
	763,044	(326,481)	436,563	£0.9200		
	1,700,000	-	1,700,000	£0.5285		
	300,000	(300,000)	-	£0.6175		

\* Or date of resignation if earlier.

\*\* Shares held on behalf of Warburg Pincus.



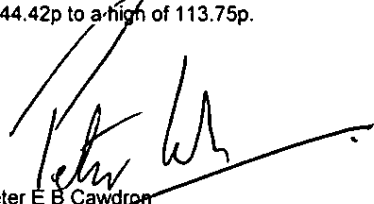
# Directors' Interests in Share Options (Audited)

Aggregate emoluments disclosed previously do not include any amounts for the value of options to acquire ordinary shares in the Company granted to or held by the Directors. Details of the Directors' share options in the Company at 31 December 2010 or date of resignation\* are set out below.

The options over ordinary shares, shown below, are exercisable between the following dates:

	Date of Grant	Number at 1 Jan 2010	Options/ Awards granted during 10	Options/ Awards* exercised during 10	Options/ Awards lapsed 10	Number at 31 Dec 2010	Exercise Price (options)/ Market Price (awards)	Date from which exercisable	Expiry Date
F J T Fildes	30-Dec-03	86,090	—	—	—	86,090	£0.7762	30-Dec-04	30-Dec-13
J W Totten*	15-Sep-04	1,199,999	—	—	—	1,199,999	£1.6667	15-Sep-05	05-Mar-11
J W Totten*	04-Oct-05	70,325	—	—	—	70,325	£1.2300	04-Oct-08	05-Mar-11
J W Totten*	31-Mar-06	537,588	—	—	—	537,588	£1.1200	31-Mar-09	05-Mar-11
J W Totten* (SAYE)	13-Oct-06	20,008	—	—	—	20,008	£0.8184	06-Sep-10	05-Mar-11
J W Totten*	25-Apr-07	508,696	—	—	72,133	436,563	£0.9200	25-Apr-10	05-Mar-11
J W Totten* (Nil cost options)	25-Apr-07	254,348	—	209,252	45,096	—	£0.9200	—	—
J W Totten* (Nil cost options)	20-Mar-08	600,000	—	—	—	600,000	£0.5285	06-Sep-10	05-Mar-11
J W Totten*	20-Mar-08	1,100,000	—	—	—	1,100,000	£0.5285	06-Sep-10	05-Mar-11
J W Totten* (Nil cost options)	30-Mar-09	100,000	—	—	100,000	—	£0.6175	—	—
J W Totten*	30-Mar-09	200,000	—	—	200,000	—	£0.6175	—	—
J W Totten*	26-Mar-10	—	340,000	—	340,000	—	£0.9890	—	—
A M Watson (Nil cost options)	11-Sep-09	250,000	—	—	—	250,000	£1.4920	11-Sep-12	11-Sep-17
A M Watson	11-Sep-09	500,000	—	—	—	500,000	£1.4920	11-Sep-12	11-Sep-19
A M Watson (SAYE)	01-Oct-09	13,027	—	—	13,027	—	£1.1936	—	—
A M Watson	26-Mar-10	—	185,000	—	—	185,000	£0.9890	26-Mar-13	26-Mar-18
A M Watson (SAYE)	22-Sep-10	—	25,311	—	—	25,311	£0.6104	01-Dec-15	31-May-16
P V Allen	20-Sep-10	—	1,000,000	—	—	1,000,000	£0.4650	20-Sep-13	20-Sep-20

The price of an ordinary share on 1 January 2010 was 86.5p and on 31 December 2010 was 103.52p. During the year the share price ranged from a low of 44.42p to a high of 113.75p.

  
Peter E B Cawdron  
Chairman of the Remuneration Committee  
17 March 2011

## INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF PROSTRAKAN GROUP PLC

We have audited the financial statements of ProStrakan Group plc for the year ended 31 December 2010 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated and Parent Company Balance Sheet, the Consolidated and Parent Company Cash Flow Statements, the Consolidated and Parent Company Statements of Changes in Equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

### Respective responsibilities of directors and auditors

As explained more fully in the statement of directors' responsibilities set out on page 28, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's and the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

### Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2010 and of the group's loss and group's and parent company's cash flows for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

### Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006;
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and

### Matters on which we are required to report by exception

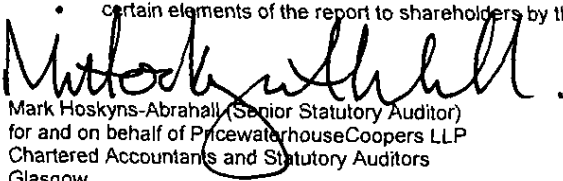
We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit; or
- a corporate governance statement has not been prepared by the parent company.

### Under the Listing Rules we are required to review:

- the directors' statement, set out on page 26, in relation to going concern;
- the parts of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the June 2008 Combined Code specified for our review; and
- certain elements of the report to shareholders by the Board on directors' remuneration.

  
Mark Hoskyns-Abraham (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Glasgow  
17 March 2011

# Consolidated income statement

for the year ended 31 December 2010

	Notes	Year ended 31 December 2010 £m	Year ended 31 December 2009 £m
Revenue	5	100.2	79.0
Cost of goods sold		(32.8)	(26.4)
<b>Gross profit</b>		<b>67.4</b>	<b>52.6</b>
Distribution costs		(41.4)	(39.2)
Administrative expenses		(8.5)	(7.6)
Development		(6.7)	(12.0)
Other gains – net	9	-	1.1
<b>Earnings before interest, taxation, depreciation and amortisation</b>		<b>10.8</b>	<b>(5.1)</b>
Depreciation, amortisation and impairment charges		(4.7)	(4.5)
<b>Operating profit/(loss)</b>		<b>6.1</b>	<b>(9.6)</b>
Finance income	10	0.1	0.2
Finance costs	10	(6.4)	(5.4)
Movement in fair value of warrants	22	(0.4)	(0.2)
<b>Loss before income tax</b>		<b>(0.6)</b>	<b>(15.0)</b>
Taxation	11	(0.4)	(0.6)
<b>Loss for the year from continuing operations</b>		<b>(1.0)</b>	<b>(15.6)</b>
<b>Discontinued operations</b>	6	-	(0.2)
<b>Loss for the year</b>		<b>(1.0)</b>	<b>(15.8)</b>

The loss for the parent company for the year was £5.1m (2009: £4.0m).

Earnings per share for loss attributable to the equity holders of the Company during the year

Basic and diluted earnings per share (expressed in pence per share)

From continuing operations	12	(0.5)	(7.7)
From discontinued operations	12	-	(0.1)
		(0.5)	(7.8)

The notes on pages 41 to 67 are an integral part of this consolidated financial information.

# Consolidated statement of comprehensive income

for the year ended 31 December 2010

	Notes	Year ended 31 December 2010 £m	Year ended 31 December 2009 £m
Loss for the year		(1.0)	(15.8)
Currency translation differences	25	-	2.5
<b>Total comprehensive income for the period, net of tax</b>		<b>(1.0)</b>	<b>(13.3)</b>

The notes on pages 41 to 67 are an integral part of this consolidated financial information.

# Balance sheet

as at 31 December 2010

	Notes	Group 31 December 2010 £m	Group 31 December 2009 £m	Company 31 December 2010 £m	Company 31 December 2009 £m
<b>Assets</b>					
<b>Non-current assets</b>					
Investment in subsidiaries	31	-	-	150.1	146.0
Intangible assets	13	32.5	36.7	-	-
Property, plant and equipment	14	1.1	1.2	-	-
Deferred tax assets	15	1.9	2.3	-	-
		35.5	40.2	150.1	146.0
<b>Current assets</b>					
Inventories	16	7.3	6.1	-	-
Trade and other receivables	17	23.7	12.8	0.2	0.6
Research and development tax credits receivable	18	0.1	-	-	-
Cash and cash equivalents	19	19.4	19.0	14.5	17.1
		50.5	37.9	14.7	17.7
<b>Liabilities</b>					
<b>Current liabilities</b>					
Trade and other payables	20	26.0	23.7	77.3	71.7
Provision for other liabilities and charges	21	0.8	0.4	-	-
Borrowings	22	12.0	1.0	-	-
Warrant liability	22	2.8	2.4	-	-
		41.6	27.5	77.3	71.7
<b>Net current assets/(liabilities)</b>		<b>8.9</b>	<b>10.4</b>	<b>(62.6)</b>	<b>(54.0)</b>
<b>Non-current liabilities</b>					
Other non-current liabilities	20	18.2	20.6	-	-
Borrowings	22	32.4	35.5	-	-
		50.6	56.1	-	-
<b>Net (liabilities)/assets</b>		<b>(6.2)</b>	<b>(5.5)</b>	<b>87.5</b>	<b>92.0</b>
<b>EQUITY</b>					
<b>Capital and reserves attributable to the Company's equity holders</b>					
Share capital	23	172.6	172.3	172.1	171.6
Other reserves	25	71.5	71.5	63.3	63.2
Retained earnings	24	(250.3)	(249.3)	(147.9)	(142.8)
<b>Total equity</b>		<b>(6.2)</b>	<b>(5.5)</b>	<b>87.5</b>	<b>92.0</b>

The notes on pages 41 to 67 are an integral part of this consolidated financial information.

The financial statements on page 35 to 67 were approved by the Board of Directors and signed on their behalf by:



P Allen  
Chairman  
17 March 2011

# Consolidated statement of changes in equity

for the year ended 31 December 2010

	Notes	Share capital £m	Other reserves £m	Retained earnings £m	Total equity £m
<b>Balance at 1 January 2009</b>		<b>172.2</b>	<b>69.9</b>	<b>(233.5)</b>	<b>8.6</b>
Other comprehensive income:					
Loss for the year	24	-	-	(15.8)	(15.8)
Currency translation difference	25	-	2.5	-	2.5
Total comprehensive income for the year		-	2.5	(15.8)	(13.3)
Transactions with owners:					
Employee share option scheme:					
- value of services provided	25	-	0.4	-	0.4
- leavers during year	25	-	(1.4)	-	(1.4)
- warrants issued	25	-	0.1	-	0.1
- options exercised	25	0.1	-	-	0.1
		0.1	(0.9)	-	(0.8)
<b>Balance at 31 December 2009</b>		<b>172.3</b>	<b>71.5</b>	<b>(249.3)</b>	<b>(5.5)</b>
<b>Balance at 1 January 2010</b>		<b>172.3</b>	<b>71.5</b>	<b>(249.3)</b>	<b>(5.5)</b>
Other comprehensive income:					
Loss for the year	24	-	-	(1.0)	(1.0)
Currency translation difference	25	-	-	-	-
Total comprehensive income for the year		-	-	(1.0)	(1.0)
Transactions with owners:					
Employee share option scheme:					
- value of services provided		-	0.6	-	0.6
- leavers during the year		-	(0.2)	-	(0.2)
Shares issued		0.4	(0.4)	-	-
Purchase of own shares by ESOP		(0.1)	-	-	(0.1)
		0.3	-	-	0.3
<b>Balance at 31 December 2010</b>		<b>172.6</b>	<b>71.5</b>	<b>(250.3)</b>	<b>(6.2)</b>

The notes on pages 41 to 67 are an integral part of this consolidated financial information.

# Company statement of changes in equity

for the year ended 31 December 2010

	Notes	Share capital £m	Other reserves £m	Retained earnings £m	Total equity £m
<b>Balance at 1 January 2009</b>		<b>171.6</b>	<b>58.3</b>	<b>(138.8)</b>	<b>91.1</b>
Other comprehensive income:					
Loss for the year	24	-	-	(4.0)	(4.0)
Currency translation differences		-	5.9	-	5.9
Total comprehensive income for the year		-	5.9	(4.0)	1.9
Transactions with owners:					
Employee share option scheme			0.4	-	0.4
- value of services provided		-	(1.4)	-	(1.4)
- leavers during year		-	(1.0)	-	(1.0)
<b>Balance at 31 December 2009</b>		<b>171.6</b>	<b>63.2</b>	<b>(142.8)</b>	<b>92.0</b>
<b>Balance at 1 January 2010</b>		<b>171.6</b>	<b>63.2</b>	<b>(142.8)</b>	<b>92.0</b>
Other comprehensive income:					
Loss for the year	24	-	-	(5.1)	(5.1)
Currency translation differences		-	(0.1)	-	(0.1)
Total comprehensive income for the year		-	(0.1)	(5.1)	(5.2)
Transactions with owners:					
Employee share option scheme			0.3	-	0.7
- value of employee services		-	(0.1)	-	(0.1)
- leavers during year		-	-	-	-
Shares issued		0.5	-	-	0.1
		0.5	0.2	-	0.7
<b>Balance at 31 December 2010</b>		<b>172.1</b>	<b>63.3</b>	<b>(147.9)</b>	<b>87.5</b>

The notes on pages 41 to 67 are an integral part of this consolidated financial information.

# Statement of cash flows

for the year ended 31 December 2010

	Notes	Group Year ended 31 December 2010 £m	Group Year ended 31 December 2009 £m	Company Year ended 31 December 2010 £m	Company Year ended 31 December 2009 £m
<b>Cash (used)/generated from operating activities</b>					
Continuing operations	26	(0.7)	(7.2)	(1.8)	14.3
Discontinued operations	26	-	(7.8)	-	(7.8)
<b>Cash (used)/generated in operating activities</b>		(0.7)	(15.0)	(1.8)	6.5
<b>Continuing operations:</b>					
Taxation paid		(0.1)	-	-	-
Finance income	10	0.1	0.2	0.2	0.2
Finance cost	10	(5.2)	(4.2)	(1.0)	(1.7)
		(5.2)	(4.0)	(0.8)	(1.5)
<b>Net cash (used)/generated in operating activities</b>		(5.9)	(19.0)	(2.6)	5.0
<b>Cash flows from investing activities</b>					
Purchase of intangible assets	13	(0.9)	(1.0)	-	-
Purchases of property, plant and equipment	14	(0.2)	(0.1)	-	-
Proceeds from sale of intangibles	26	-	1.4	-	-
<b>Cash flows (used)/generated in continuing operations – investing activities</b>		(1.1)	0.3	-	-
<b>Cash flows from financing activities</b>					
Proceeds from borrowings		7.9	5.0	-	-
Borrowings repaid		(1.2)	(3.4)	-	-
<b>Net cash generated by financing activities</b>		6.7	1.6	-	-
<b>Net (decrease)/increase in cash and cash equivalents</b>		(0.3)	(17.1)	(2.6)	5.0
Cash and cash equivalents at the beginning of the year		19.0	34.7	17.1	12.1
Exchange gains on cash and cash equivalents		0.7	1.4	-	-
<b>Cash and cash equivalents at the end of the year</b>	19	<b>19.4</b>	<b>19.0</b>	<b>14.5</b>	<b>17.1</b>

The notes on pages 41 to 67 are an integral part of this consolidated financial information.



# Notes to the financial statements

## 1. General information

ProStrakan Group plc (the "Company") and its subsidiaries (together the "Group") are engaged directly and indirectly in the development, registration, manufacture, distribution and sale of pharmaceuticals and other similar products and related services.

The Company reregistered as a public company on 2 March 2005 and was admitted to the London Stock Exchange on 16 June 2005.

The Company is incorporated and domiciled in the United Kingdom, with its registered office at Galabank Business Park, Galashiels, TD1 1QH, Scotland.

These Group consolidated financial statements were authorised for issue by the Board of Directors on 17 March 2011.

## 2. Summary of significant accounting policies

The financial information presented in these financial statements has been prepared on the basis of those International Financial Reporting Standards, International Accounting Standards, International Financial Reporting Interpretations Committee (IFRIC) and Standard Interpretation Committee (SIC) interpretations that are applicable to 2010 financial reporting.

The basis of preparation and the principal accounting policies adopted in the preparation of the financial information are set out below.

The following new standards, amendments to standards or interpretations became mandatory for the first time during the financial year beginning 1 January 2010. They either were not relevant for the Group or had no material impact on the financial statements of the group.

IAS 27 (revised), 'Consolidated and separate financial statements' (effective from 1 July 2009)

IFRS 3 (revised), 'Business combinations' (effective from 1 July 2009)

IAS 38 (amendment), 'Intangible Assets' (effective from 1 January 2010)

IFRIC 12, 'Service concession arrangements' (effective from 30 March 2009)

IFRIC 15, 'Agreements for construction of real estates' (effective from 1 January 2010)

IFRIC 16, 'Hedges of a net investment in a foreign operation' (effective from 1 January 2010)

IFRIC 17, 'Distribution of non-cash assets to owners' (effective on or after 1 July 2009)

IFRIC 18, 'Transfers of assets from customers' (effective on or after 1 July 2009)

IFRS 2 (amendment), 'Group cash-settled share-based payment transaction' (effective from 1 January 2010)

New standards, amendments to standards or interpretations that are not yet effective and have not been early adopted by the Group

At the date of approval of these financial statements, the following standards, amendments to standards and interpretations were in issue but have not been applied in these financial statements:

Amendments to IFRS 7, 'Financial instruments: Disclosures on derecognition' (effective from 1 January 2011)

IFRS 9, 'Financial instruments' (effective 1 January 2013)

Amendments to IAS 12, 'Income taxes' (effective 1 January 2012)

Amendments to IAS 24 (revised) 'Related party disclosures' (effective from 1 January 2011)

The Directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Group.

### 2.1 Basis of preparation

ProStrakan Group plc prepares consolidated statutory financial statements which comply with accounting standards as adopted for use in the EU.

This consolidated financial information is presented in millions of pounds and has been prepared under the historical cost convention as modified by the valuation of available-for-sale financial assets. The preparation of financial statements in conformity with IFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial information are disclosed in Note 4.

The Group's business activities, future development, performance and position are set out in the Business Review on pages 6 to 18. The Financial Review on pages 6 to 18 describes the financial position of the Group, its cash flows, and loan facilities. Note 3 to the financial statements covers in detail the objectives, policies and processes for managing the Group's financial risks. The borrowing facilities currently available to the Group, together with the financial covenants relating to them, are set out in Note 22 to the financial statements together with details of the loan facility re-financing as set out in Note 32. As part of the year end accounts exercise, the Directors are required to satisfy themselves that it is reasonable for them to conclude whether it is appropriate to prepare financial statements on a going concern basis. The Directors of the Group have reviewed various aspects of the business including budget plans covering the periods for at least twelve months from the date of approval of the accounts, taking account of reasonably possible changes in trading performance, the current and forecast debt position, related covenants, other sources of capital and various external factors. Notwithstanding the Group's negative net asset position as at 31 December 2010, the Directors are satisfied after making these enquiries that the Group has adequate resources to continue in business for the foreseeable future and, accordingly, consider that it is appropriate to adopt the going concern basis in preparing this full year financial information.

## 2.2 Consolidation

The consolidated financial information includes the results of all subsidiaries that have been owned at any point throughout the year. Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than 50% of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases. All subsidiaries operate the same financial calendar.

The Group uses the purchase method to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement (Note 2.7).

The Group's interest in jointly controlled entities are accounted for by proportionate consolidation. The Group combines its share of the joint ventures' individual income and expenses, assets and liabilities and cash flows on a line-by-line basis with similar items in the Group's financial statements. The Group recognises the portion of gains or losses on the sale of the assets by the Group to the joint venture that is attributable to the other venturers. The Group does not recognise its share of profits or losses from the joint venture that result from the Group's purchase of assets from the joint venture until it resells the assets to an independent party. However, a loss on the transaction is recognised immediately if the loss provides evidence of a reduction in the net realisable value of current assets, or an impairment loss.

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

In accordance with Section 408 of the Companies Act 2006, no profit or loss account is presented for the Company.

## 2.3 Segment reporting

The chief operating decision-maker has been identified as the Board of Directors. The Board reviews the group's internal reporting in order to assess performance and allocate resources. Management has determined the operating segments based on these reports.

The Board considers the business from a geographic perspective and assesses the performance of UK, EU (excluding the UK), US and Partnering income.

The Board assesses the performance of the operating segments based on a measure of adjusted earnings before interest, tax, depreciation and amortisation (EBITDA). This measurement basis excludes the effects of non-recurring expenditure from the operating segments. Finance income and expenditure are not included in the result for each operating segment that is reviewed by the Board. Other information provided to the Board is measured in a manner consistent with that in the financial statements.

## 2.4 Foreign currency translation

### (a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in sterling, which is the Company's functional and presentation currency for the year ended 31 December 2010.

### (b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except where these items are designated as hedges of overseas net investment, when exchange differences will be recognised initially in a separate component of equity and recognised in profit and loss on the disposal of the net investment.

When a gain or loss on items is recognised directly in equity, e.g. equities classified as available-for-sale, any exchange component of that gain or loss will be recognised directly in equity. Conversely, when a gain or loss on a financial asset is recognised in the income statement e.g. equity investments at fair value through profit and loss, any exchange component of that gain or loss will be recognised in the income statement.

### (c) Group companies

The results and financial position of all the Group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- (i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- (ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- (iii) all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

## 2.5 Property, plant and equipment

All property, plant and equipment are stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Depreciation on assets is calculated using the straight-line method to allocate their cost less their residual values over their estimated useful lives, as follows:

### Plant and equipment

– Plant and machinery	5 -10 years
– Other equipment	2- 5 years

### Furniture and fittings:

– Leasehold improvements	over period of lease
– Other furniture and fittings	5 -10 years

The assets' residual values and useful lives are determined by the Directors and reviewed and adjusted if appropriate at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.7).

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

## 2.6 Intangible assets

### (a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition and is included in intangible assets. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units (CGUs) for the purpose of impairment testing. Development is viewed as a separate CGU, along with each commercial territory under the control and guidance of a General Manager.

### (b) In-process research and development

Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will be a success considering its commercial and technological feasibility and costs can be measured reliably. Other development expenditures are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

In-process R&D acquired in a business combination is recognised separately as intangible assets if and only if it meets the definition of intangible assets in IAS 38 and their fair value can be measured reliably.

All development costs with a finite useful life that have been capitalised are amortised from the commencement of the commercial production of the product on a straight-line basis over the period of its expected benefit. Prior to commercial production of the product the asset is tested annually for impairment. Provision is made for any impairment.

### (c) Product rights

Product rights and other intangible assets are initially recorded at cost. Where these assets have been acquired through a business combination, they are recorded at fair value where they are separately identifiable and their value can be readily ascertained. Product rights are amortised over their useful life on a straight-line basis from the date of the first commercial launch. Estimated useful life is the lower of legal duration and economic useful life, up to a maximum of 10 years. Prior to their first commercial launch they are tested annually for impairment. Provision is made for any impairment.

### (d) Computer software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives (not exceeding three years).

Costs associated with developing or maintaining computer software programs are recognised as an expense as incurred. Costs that are directly associated with the production of identifiable and unique software products controlled by the Group, and that will generate economic benefits exceeding costs beyond one year, are recognised as intangible assets.

Computer software development costs recognised as assets are amortised over their estimated useful lives (not exceeding three years).

## 2.7 Impairment of assets

Assets that have an indefinite useful life or are not yet in use are not subject to amortisation and are tested annually for impairment. Assets that are subject to

amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (CGUs).

## 2.8 Financial assets

The Group classifies its investments in the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of their investments at initial recognition and re-evaluates this designation at every reporting date.

### (a) Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Assets in this category are classified as current assets if they are either held for trading or are expected to be realised within 12 months of the balance sheet date. During the year, the Group did not hold any investments in this category.

### (b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. During the year, the Group did not hold any investments in this category.

### (c) Available-for-sale financial assets

Available-for-sale financial assets are financial instruments that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

Purchases and sales of investments are recognised on trade-date; the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value. Realised and unrealised gains and losses arising from changes in the fair value through profit or loss category are included in the income statement in the period in which they arise. Investments are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and option pricing models refined to reflect the issuer's specific circumstances.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

## 2.9 Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, related contract manufacturing costs and other direct costs. It excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. Provision is made for obsolete, slow-moving or defective items where appropriate.

## 2.10 Trade receivables

Trade receivables are recognised at fair value, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognised in the income statement.

## 2.11 Cash and cash equivalents

Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet.

## 2.12 Discontinued operations

A discontinued operation is a component of the Group's business that represents a separate line of business or geographical area of operations. Classification as a discontinued operation occurs upon disposal or earlier, if the operation meets the criteria to be classified as held for sale, under IFRS 5 Non-current Assets Held for Sale.

## 2.13 Share capital

Ordinary shares are classified as equity.

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds. Incremental costs directly attributable to the issue of new shares or options, or for the acquisition of a business, are included in the cost of acquisition as part of the purchase

consideration.

Where any Group company or employee share ownership plan (ESOP) purchases the Company's equity share capital, the consideration paid, including any directly attributable incremental costs (net of income taxes), is deducted from equity attributable to the Company's equity holders until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's equity holders.

#### 2.14 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred using the effective interest method. Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date (Note 22).

Costs relating to the debt facility have been included in the financial instrument's initial measurement and will be amortised in the income statement over the instrument's life. Warrants issued as part of the debt facility have been recorded at fair value at initial recognition and are accounted for as a derivative financial liability. Movements in fair value are recognised in the income statement. The fair value of the debt element at initial recognition has been determined using the market rate of interest for a similar financial instrument that does not include a warrant component. Thereafter the debt is measured at amortised cost.

On 12 January 2011 the Group completed the assignment of its debt facility with Fortress to Paladin Labs Inc. details of which are described in Note 32 Post balance sheet events.

#### 2.15 Taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted at the balance sheet date.

Research and development tax credits are claimed where possible. The credits are calculated using the tax rates and laws applicable to the country in which the company carrying out the research and development is domiciled and recognised on an accruals basis.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the Group controls the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

#### 2.16 Employee benefits

##### (a) Pension obligations

The Company operates a Group Personal Pension Plan Scheme. This is a defined contribution plan where the Company pays fixed contributions into a separate entity. The Company has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employees' service in the current and prior periods. The contributions are recognised as employee expense when they are due.

##### (b) Share-based compensation

The Group operates an equity-settled, share-based compensation plan. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions (for example, profitability and sales growth targets). Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each balance sheet date, the entity revises its estimates of the number of options that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in profit or loss, and a corresponding adjustment to equity over the remaining vesting period.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

##### (c) Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed to either terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal or providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after the balance sheet date are discounted to present value.

##### (d) Bonus plans

The Group recognises a liability and an expense for bonuses, based upon agreed bonus plans in place at the balance sheet date.

## 2.17 Revenue recognition

Revenue comprises the fair value for the sale of goods and services, net of value added tax, after adequate provision for rebates returns and discounts and after eliminating sales within the Group. Consideration is given to the terms of the contract as a whole to ensure that all components represent fair value on an individual basis. The group recognises revenue when:

- there is evidence that an agreement or arrangement has been reached;
- products or services have been delivered or rendered as agreed; and
- the consideration is or can be determined, and collectability can be reasonably assured.

The principal revenue streams of the Group and the respective accounting policy applied are as follows:

### (a) Sales of product

Revenue for sales of product are recognised when a Group entity has shipped products to the customer or at the time of delivery depending on the terms of the sale.

### (b) Sales of services

Sales of services are recognised in the accounting period in which the services are rendered, by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

### (c) Licensing, development and milestone income

Licensing, development and milestone income comprise revenue generated from product out-licensing and contract R&D collaboration agreements.

Licence fees, which are non-refundable, permit the licensee to use freely the technology licensed and where the licensor has no remaining obligation to perform, are recognised as revenue when receivable.

Licence fees, even where they are non-refundable, are recognised as income over the period during which the Group is obliged to maintain an involvement in the technology, contribute to the market approval process or the period of collaboration, whichever is longer.

In circumstances where the initial licence is not for a defined period and there is no royalty arrangement related to the licensed product included in the agreement, revenue is deferred and recognised over the period to the expiry of the relevant patent to which the licence relates. Revenue from R&D collaboration agreements is recognised as the services are performed. Included in the terms of certain licensing and R&D agreements, the Group expects to receive non-refundable milestone income as certain technical or other performance-related targets are achieved. In these circumstances revenue is recognised on achieving such milestones.

Where the milestone income relates to clinical milestones, such as first patient entered into a clinical trial then revenue is recognised when the income is receivable.

If any licence or milestone income is creditable against royalty payments then it is deferred and released over the period in which the royalties are expected to be paid.

### (d) Royalty income

Royalty income relating to the sale by a licensee of licensed product is recognised on an accruals basis in accordance with the substance of the relevant agreement. In any period where the licensee does not provide the relevant information to calculate the royalty due, the Group will estimate sales based on the historical information available.

No revenue is recognised where the receipt is dependent on future events, performance or is subject to a refund arrangement.

### (e) Interest income

Interest income is recognised on a time-proportion basis using the effective interest method. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loans is recognised either as cash is collected or on a cost-recovery basis as conditions warrant.

### (f) Grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions. Government grants relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs that they are intended to compensate.

## 2.18 Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease, even if the payments are not made on such a basis.

Assets held under finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease, with a corresponding liability being recognised for the fair value of the lease asset or, if lower, the present value of the minimum lease payments. Lease payments are apportioned between the reduction of the lease liability and finance charges in the income statement so as to achieve a constant rate of interest on the remaining balance of the liability. Assets held under finance leases are depreciated over the shorter of the estimated useful life of the asset and the lease term unless ownership will be taken at the end of the lease when the assets are depreciated over their expected useful life.

## 2.19 Exceptional items

Exceptional items are material items which derive from events or transactions that fall within the ordinary activities of the reporting entity and which individually or, if of a similar type, in aggregate need to be disclosed by virtue of their size or incidence if the financial statements are to give a true and fair view.

## 3. Financial risk management

### 3.1 Exchange rates

The Income Statement was drawn up using exchange rates of 1.16708 Euro = £1 and 1.54557 US dollar = £1, which were the average exchange rates during the year ended 31 December 2010 (2009: 1.12069 Euro = £1 and 1.56206 US dollar = £1). At 31 December 2010 the exchange rates were 1.1671 Euro = £1 and 1.5657 US dollar = £1 and these exchange rates were used in the Balance Sheet (2009: 1.1255 = £1 and 1.6149 US dollar = £1).

### 3.2 Financial risk factors

The Group's multi-national operations expose it to a variety of financial risks that include the effects of changes in foreign currency exchange rates, equity securities prices, credit risks, liquidity and interest rates. It is the Directors' policy that no speculative trading in financial instruments shall be undertaken.

#### (a) Foreign exchange risk

The Group is exposed to currency risk due to operations in territories that have the Euro and US dollar as their functional currency. The Group earns a substantial proportion of its revenues in Euros as well as having a substantial proportion of expenses in Euros. The Group receives sales revenue, milestone and in-licence receipts in US dollars sufficient to cover its current US Dollar expenditure requirements.

Consequently, the Directors consider the exchange rate risk resulting from holding funds in these companies denominated in Euros and US dollars to be insufficient to warrant hedging against this risk. Gains and losses resulting from exchange rate movements relating to these structural currency exposures have been recognised in equity.

At 31 December 2010, if the Euro had weakened/strengthened by 5 cents against the UK pound, with all other variables held constant, losses for the year would have been £0.1m (2009: £0.2m) higher/lower.

At 31 December 2010, if the US dollar had weakened/strengthened by 5 cents against the UK pound, with all other variables held constant, losses for the year would have been £0.1m (2009 £0.1m) higher/lower.

Group borrowings are currently drawn down in Sterling. Following the assignment of the credit facility on 12 January 2011 to Paladin Labs Inc., as described in Note 32 Post balance sheet events, the Group borrowing became drawn in Canadian Dollars, the assignment occurred at an exchange rate of 1.54465 CAD\$ = £1.

Currency fluctuations between GBP and CAD\$ will impact the Group's results through fluctuating interest payments and the revaluation of the debt facility at period ends. If the CAD\$ weakens/strengthens by 5 cents against the UK pound the annual interest charge will reduce/increase by £0.2m and the carrying value of the debt facility will reduce/increase by £1.6m.

The Directors recognise that following the assignment of the credit agreement, the Group has created a new exposure to currency risk between GBP and CAD\$. The Directors have reviewed the various options available to them in order to hedge part or all of the borrowings and have determined that due to the costs of such instruments not to put in place foreign exchange hedging measures.

#### (b) Credit risk

The Group sells its products through selected pre-wholesalers and customers. The Group is exposed to a concentration of credit risk in respect of these wholesalers such that, if these were affected by financial difficulty, it would materially and adversely affect the Group's financial results. The Group has policies in place to ensure that sales of products are made to customers with an appropriate credit history. The amount of exposure to any individual counterparty is subject to a limit and is reassessed annually. Further detail regarding the location of the Group's customer base is disclosed in Note 17.

Financial instrument counterparties and cash transactions are limited to high-credit-quality financial institutions.

#### (c) Liquidity, funding and capital management

The Group's objective with respect to managing capital is to maintain a balance sheet structure that is both efficient in terms of providing long term returns to shareholders and safeguards the Group's ability to continue as a going concern.

In order to maintain or adjust the capital structure, the group may adjust the amount of dividends paid to shareholders, returns of capital to shareholders and issue new shares. The Group actively maintains a mixture of cash and cash equivalent facilities that are designed to ensure that the Group has sufficient available funds of the appropriate currency for operations and planned expansions. The facilities are represented in two ways, Fortress debt facility, assigned to Paladin Labs Inc. on the 12 January 2011 and a £5.0m currency exchange facility with Barclays Bank plc.

The key financial covenants attached to the debt facility are referred to in Note 22 Borrowings. The currency exchange facility with Barclays Bank plc requires the maintenance of a £0.5m (2009: £0.5m) facility to be held on deposit by the Bank through the duration of the facility as referred to in Note 19 Cash and cash equivalents.

The Group does not consider that the financial covenants contained in the facilities are restrictive to its operations.

At 31 December 2010 undrawn facilities under the debt facility was £nil (2009: £nil).

(d) Interest rate risk

The Group has both interest bearing assets and interest bearing liabilities.

The Group's policy is to maximise the return on cash held by placing it on the highest available variable interest rate bearing, risk free short term deposits. As a result of this the Group will have interest bearing assets at fixed rates from time to time. At the year-end £8.0m (2009: £17.0m) of interest bearing assets were at fixed rates.

The Group's primary funding is at a monthly fixed rate, based on the greater of one month LIBOR or 5% plus a margin of between 5.0% and 5.5%, as determined by the debt facility arrangement signed with Fortress on 27 March 2007. At the year-end £45.4m (2009: £38.6m) of interest bearing liabilities were at fixed rates. Upon assignment of the credit facility to Paladin Labs Inc., the Group's primary funding is at fixed 10.5% per annum.

At 31 December 2010, if the debt facility fixed interest rate, had been +/-1% higher/lower, with all other variables held constant, losses for the year would have been £0.4m (2009: £0.4m) higher/lower.

3.3 Fair value estimation

The fair value of financial instruments traded in active markets (being the available-for-sale securities acquired in a business combination) is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price.

The calculation of the fair value of warrants is disclosed in Note 22.

The nominal value less estimated credit adjustments of trade receivables and payables is assumed to approximate their fair value.

4. Critical accounting estimates and judgements

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Critical accounting estimates and assumptions

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(a) Useful lives of product rights

The Group's management determines the estimated useful lives and related amortisation charges for its product rights. This estimate is based on projected product life cycles. It could change significantly as a result of technical innovations and competitor actions within the market sector. Management will increase the amortisation charge where useful lives are less than previously estimated lives, or it will write down or write off technically obsolete or non-strategic assets that have been withdrawn or are no longer promoted.

(b) Estimated impairment of goodwill

The Group tests annually whether goodwill has suffered any impairment, in accordance with the accounting policy stated in Note 2.7. The recoverable amounts of cash-generating units have been determined based on value-in-use calculations. These calculations require the use of estimates.

(c) Revenue Recognition

The Group records revenues from various sources including the sales of products, sales of services, licensing income, development and milestone income, royalty income, interest income and grants. Judgments are made in considering the individual contracts which deliver these sources of revenue and considerations are given to the terms of each contract as a whole to ensure that all components represent fair value on an individual basis, in accordance with the accounting policy stated in Note 2.17.

5. Segment information

The chief operating decision-maker has been identified as the Board of Directors. The Board reviews the Group's internal reporting in order to assess performance and allocate resources. Management has determined the operating segments based on these reports.

The Board considers the business from a geographic perspective and assesses the performance of UK, EU (excluding the UK), US and Partnering income.

The Board assesses the performance of the operating segments based on a measure of adjusted earnings before interest, tax, depreciation and amortisation (EBITDA). This measurement basis excludes the effects of non-recurring expenditure from the operating segments. Finance income and expenditure are not included in the result for each operating segment that is reviewed by the Board. Other information provided to the Board is measured in a manner consistent with that in the financial statements.

Total assets exclude cash and cash equivalents which are managed on a central basis. These are part of the reconciliation to total balance sheet assets.



# Segmental Reporting

	2010 £m	2009 £m
<b>Revenue</b>		
UK	35.9	31.7
EU (excluding the UK)	44.1	34.8
Total European	80.0	66.5
US	6.8	7.3
Partnering income	13.4	5.2
	100.2	79.0

<b>Earnings before interest, taxation, depreciation and amortisation</b>		
UK	(1.3)	(0.1)
EU (excluding the UK)	8.4	(0.5)
Total European	7.1	(0.6)
US	(4.8)	(3.4)
Partnering income	8.5	(1.1)
	10.8	(5.1)

A reconciliation of total EBITDA is provided as follows:

	2010 £m	2009 £m
EBITDA	10.8	(5.1)
Depreciation, amortisation and impairment charges	(4.7)	(4.5)
Finance income	0.1	0.2
Finance cost	(6.4)	(5.4)
Revaluation of warrants	(0.4)	(0.2)
Discontinued operations	-	(0.2)
Taxation	(0.4)	(0.6)
Loss for the year	(1.0)	(15.8)

Total Assets:

	2010 £m	2009 £m
UK	6.2	6.0
EU (excluding UK)	23.0	23.4
Total EU	29.2	29.4
US	0.7	2.0
Partnering income	36.7	27.7
	66.6	59.1

Reportable segments' assets are reconciled to total assets as follows:

	2010 £m	2009 £m
Total segment assets	66.6	59.1
Cash and cash equivalents	19.4	19.0
Total assets per balance sheet	86.0	78.1

Capital expenditure:

	2010 £m	2009 £m
UK	0.2	0.2
EU (excluding the UK)	0.1	0.1
Total EU	0.3	0.3
US	0.1	-
Partnering income	0.7	0.8
	1.1	1.1

Analysis of revenue by category:

	2010 £m	2009 £m
Product sales <sup>1</sup>	89.2	74.4
Licensing income	10.8	4.2
Royalty income	0.2	0.4
	100.2	79.0

<sup>1</sup> Product sales represents 89% of total revenues (2009: 94%)

## 6. Discontinued operations

On 2 July 2009 ProStrakan reported it had agreed to make a payment in cash of £7.8m (€9.15m) in full and final settlement with Aventis against a €13.4m tax liability, incurred by Aventis, arising from the sale of ProSkelia SAS ("ProSkelia") by ProStrakan in December 2006. This settlement resulted in an additional charge of £0.2m against amounts already provided, which has been included under discontinued operations.

	2010 £m	2009 £m
Other losses	-	(0.2)
Loss for the year from discontinued operations	-	(0.2)

## 7. Expenses by nature

	2010 £m	2009 £m
Employee costs (Note 8)	22.1	18.7
Depreciation, amortisation and impairment charges (Notes 13 and 14)	4.7	4.5
Development services	4.1	8.9
Advertising and promotion costs	14.6	14.5
Other professional fees	3.7	4.5
Changes in inventories of finished goods and work in progress	32.1	25.9
Warehousing and distribution	2.0	1.7
Travel costs	4.2	3.9
Foreign exchange losses	0.3	0.2
Other expenses	6.3	6.9
Total cost of goods sold, distribution costs, development, administrative expenses, depreciation, amortisation and impairment	94.1	89.7

Services provided by the Group's auditor and network firms:

During the year the Group (including its overseas subsidiaries) obtained the following services from the Group's auditor at costs as detailed below:

	2010 £m	2009 £m
Total services:		
– parent company and consolidated financial statements	0.1	0.1
– fees in relation to audit of subsidiaries	0.1	0.1
– other regulatory	0.2	-
Total services	0.4	0.2

## 8. Employees and Directors

Staff costs for the Group during the year

	2010 £m	2009 £m
Wages and salaries including termination benefits £0.9m (2009: £0.3m)	18.2	16.5
Social security costs	2.9	2.6
Share options granted to Directors and employees	0.4	(1.0)
Pension costs	0.6	0.6
	22.1	18.7

The average monthly number of employees (including Executive Directors)

	2010 No.	2009 No.
By business group:		
Commercial	227	189
General and administration	38	38
Development	29	32
	294	259

Key management compensation (including Executive Directors)

	2010 £m	2009 £m
Salaries and short-term benefits	2.3	2.1
Termination benefits	0.3	0.2
Share options granted	0.4	0.1
Pension costs	0.1	0.1
	3.1	2.5

Directors

Aggregate emoluments of the Directors are disclosed in the Remuneration Report on page 32.

9. Other gains

	2010 £m	2009 £m
Other financial assets at fair value through profit or loss		
- income from grants	-	0.1
- profit on disposal of product rights <sup>1</sup>	-	1.0
	-	1.1

<sup>1</sup>The profit on disposal of product rights arose from the sale of three non core products from the Groups German subsidiary.

10. Finance income and costs

	2010 £m	2009 £m
<b>Finance income</b>		
Interest receivable on short-term deposits	0.1	0.2
	0.1	0.2
Interest payable on bank borrowings	(5.2)	(4.2)
Accretion of warrants on debt facility (Note 22)	(0.7)	(0.8)
Amortisation of set-up costs on debt facility (Note 22)	(0.5)	(0.4)
<b>Finance cost</b>	(6.4)	(5.4)

11. Taxation

	2010 £m	2009 £m
<b>Current tax:</b>		
Income tax charge	0.1	0.1
<b>Deferred tax:</b>		
Deferred tax charge	0.3	0.5
<b>Tax charge in income statement</b>	0.4	0.6

The tax on the Group's losses before tax differs from the theoretical amount that would arise using the standard rate of corporation tax in the UK. The differences are explained below.

	2010 £m	2009 £m
Loss before tax – continuing activities	(0.6)	(15.0)
Loss before tax – discontinued activities	-	(0.2)
<b>Total</b>	(0.6)	(15.2)
Tax calculated at rate of corporation tax in the UK of 28% (2009: 28%)	(0.2)	(4.3)
Expenses not deductible for tax purposes	1.0	0.9
Change in unrecognised deferred tax asset	(1.6)	4.0
Recognised deferred tax rate change adjustment	1.2	-
<b>Tax charge in income statement</b>	0.4	0.6

## 12. Earnings per share

### Basic

Basic earnings per share is calculated by dividing the loss attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year, excluding those held in the ESOP (Note 23), which are treated as cancelled.

	As at 31 December 2010	As at 31 December 2009
Loss attributable to equity holders of the Company (£m)	(1.0)	(15.8)
Basic earnings per share (pence per share)	(0.5)	(7.8)
Basic earnings per share from continuing operations		
Loss attributable to equity holders of the Company (£m)	(1.0)	(15.6)
Basic earnings per share (pence per share)	(0.5)	(7.7)
Basic earnings per share from discontinued operations		
Loss attributable to equity holders of the Company (£m)	-	(0.2)
Basic earnings per share (pence per share)	-	(0.1)
Weighted average number of ordinary shares	202.1	201.3

### Diluted

IAS 33 requires presentation of diluted earnings per share when a company could be called upon to issue shares that would decrease net profit or increase net loss per share. For a loss making company with outstanding dilutive potential ordinary shares, net loss per share would only be decreased by the exercise of such potential ordinary shares. Therefore diluted earnings per share is not presented.

## 13. Intangible assets

Group	Goodwill £m	Product rights £m	Other <sup>1</sup> £m	Total £m
At 1 January 2010				
Cost	10.0	51.1	1.0	62.1
Accumulated amortisation	-	(24.6)	(0.8)	(25.4)
Net book value	10.0	26.5	0.2	36.7
Year ended 31 December 2010				
Opening net book amount	10.0	26.5	0.2	36.7
Additions	-	0.3	0.6	0.9
Disposal	-	(0.1)	-	(0.1)
Amortisation charge	-	(3.6)	(0.1)	(3.7)
Impairment	-	(0.7)	-	(0.7)
Exchange differences	(0.3)	(0.2)	(0.1)	(0.6)
Closing net book value	9.7	22.2	0.6	32.5
At 31 December 2010				
Cost	9.7	50.1	1.5	61.3
Accumulated amortisation	-	(27.9)	(0.9)	(28.8)
Net book value	9.7	22.2	0.6	32.5
At 1 January 2009				
Cost	10.9	51.6	0.9	63.4
Accumulated amortisation	-	(21.0)	(0.7)	(21.7)
Net book value	10.9	30.6	0.2	41.7
Year ended 31 December 2009				
Opening net book amount	10.9	30.6	0.2	41.7
Additions	-	0.9	0.1	1.0
Disposals	-	(0.4)	-	(0.4)
Amortisation	-	(3.8)	(0.1)	(3.9)
Impairment	-	(0.3)	-	(0.3)
Exchange differences	(0.9)	(0.5)	-	(1.4)
Closing net book value	10.0	26.5	0.2	36.7

At 31 December 2009

Cost	10.0	51.1	1.0	62.1
Accumulated amortisation	-	(24.6)	(0.8)	(25.4)
Net book value	10.0	26.5	0.2	36.7

<sup>1</sup> Other intangibles include software and other costs.

#### Impairment tests for goodwill

Goodwill arising from previous acquisitions is tested annually for impairment under IAS 36. No Goodwill impairment charges were required during the year. Goodwill is allocated to the Group's cash-generating units (CGUs) identified as follows:

- (a) Development is treated as a separate CGU.
- (b) Each commercial territory under the control and guidance of a General Manager is a CGU.

The goodwill arising from the acquisitions of Elfar SA and Arzneimittel Pharma GmbH was allocated to Spain and Germany Commercial respectively. The rationale for this is that the CGUs benefiting fundamentally from these acquisitions are these identifiable Groups and these CGUs are not larger than the Group's reported segments. The carrying amount of goodwill by division is as follows:

	Spain commercial £m	Germany commercial £m	Total £m
As at 1 January 2009	10.2	0.7	10.9
Exchange differences	(0.8)	(0.1)	(0.9)
As at 31 December 2009	9.4	0.6	10.0
As at 1 January 2010	9.4	0.6	10.0
Exchange differences	(0.4)	0.1	(0.3)
As at 31 December 2010	9.0	0.7	9.7

#### Measurement of recoverable amounts:

##### Spain and Germany Commercial

The value of the assets, being the ongoing trading of the Spanish and German Commercial CGUs, are valued on a discounted cash flow basis.

#### Key assumptions in the calculations are:

- (i) sales, gross margin and expenses based on approved budgets and forecasts for the next 10 years, being the average life of the products currently marketed;
- (ii) discount rates – 12%-14% pre tax, corresponding to the internal rate of return used within the Group; and
- (iii) growth rates – long term growth rates, in line with long term planning and forecasts, are assessed on an individual basis dependent on product portfolio maturity. Assumed rates are between 3% - 1% decreasing in outer years.

Management determined the budgeted gross margin based on past performance and its expectations for the market development. The weighted average growth rates used are consistent with the forecasts included in industry reports. The discount rates used are pre-tax and reflect specific risks relating to the relevant segments.

## 14. Property, plant and equipment

Group	Plant & equipment £m	Furniture & fittings £m	Total £m
At 1 January 2010			
Cost or valuation	0.9	1.6	2.5
Accumulated depreciation	(0.5)	(0.8)	(1.3)
Net book value	0.4	0.8	1.2
Year ended 31 December 2010			
Opening net book amount	0.4	0.8	1.2
Additions	0.2	-	0.2
Depreciation charge	(0.1)	(0.2)	(0.3)
Closing net book value	0.5	0.6	1.1
At 31 December 2010			
Cost or valuation	1.1	1.6	2.7
Accumulated depreciation	(0.6)	(1.0)	(1.6)
Net book value	0.5	0.6	1.1
At 1 January 2009			
Cost or valuation	0.8	1.6	2.4
Accumulated depreciation	(0.3)	(0.7)	(1.0)
Net book value	0.5	0.9	1.4
Year ended 31 December 2009			
Opening net book amount	0.5	0.9	1.4
Additions	0.1	-	0.1
Depreciation charge	(0.2)	(0.1)	(0.3)
Closing net book value	0.4	0.8	1.2
At 31 December 2009			
Cost or valuation	0.9	1.6	2.5
Accumulated depreciation	(0.5)	(0.8)	(1.3)
Net book value	0.4	0.8	1.2

## 15. Deferred tax assets

Deferred tax assets are recognised for certain subsidiaries, where the realisation of the related tax benefit thought the future taxable profit is probable.

Deferred tax assets are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and the taxes relate to the same fiscal authority.

The movement in deferred income tax assets during the year is as follows:

	Tax losses £m	Other timing difference £m	Total* £m
Balance at 1 January 2010	1.7	0.6	2.3
Credit to income statement	(0.3)	-	(0.3)
Exchange difference	-	(0.1)	(0.1)
Balance at 31 December 2010	1.4	0.5	1.9
Balance at 1 January 2009	2.3	0.1	2.4
Credit to income statement	(0.6)	0.1	(0.5)
Exchange difference	-	0.4	0.4
Balance at 31 December 2009	1.7	0.6	2.3

\* £0.5m of the deferred tax asset is expected to be recovered within 12 months.

The Group did not recognise deferred tax assets amounting to £58.3m (2009: £63.9m) because of the uncertainty of when those assets will be realised against future taxable income.

The Company did not recognise deferred tax assets amounting to £5.0m (2009: £5.8m) because of the uncertainty of when those assets will be realised against future taxable income.

This potential deferred tax asset is analysed as follows:

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
Tax losses	58.0	61.0	5.0	4.2
Accelerated capital allowances	0.2	0.2	-	-
Other short-term timing differences	0.1	2.7	-	1.6
	58.3	63.9	5.0	5.8

In his budget of 22 June 2010, the Chancellor of the Exchequer announced a decrease in the rate of UK corporation tax from 28% to 24% by 1% each year, from April 2011, which will be enacted annually. The effect of the reduction in the tax rate to 24% on the group's deferred tax asset will be to reduce the recognised deferred tax asset by £0.1m and the unrecognised deferred tax asset by £3.6m.

## 16. Inventories

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
Raw materials	0.1	0.2	-	-
Work in progress	2.9	2.1	-	-
Finished goods, at cost	4.3	3.8	-	-
	7.3	6.1	-	-

The provision for obsolete stock amounted to £1.0m at 31 December 2010 (2009: £1.2m).

## 17. Trade and other receivables

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
Trade receivables	20.3	10.1	-	-
Less: provision for impairment of receivables	(0.2)	(0.4)	-	-
Trade receivables – net	20.1	9.7	-	-
Amounts owed by Group undertakings	-	-	0.1	0.5
Accrued income	-	0.2	-	-
Other receivables	1.6	0.6	0.1	0.1
VAT	0.6	0.5	-	-
Prepayments	1.4	1.8	-	-
	23.7	12.8	0.2	0.6

All trade and other receivables are due within one year.

It is considered that there is no difference between the carrying amount of the receivables and their fair value.

The concentration of credit risk with respect to trade receivables is disclosed in Note 3.

The carrying amounts of the Group's trade and other receivables are denominated in the following currencies:

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
Sterling	5.7	4.9	0.2	0.1
Euro	8.2	5.9	-	0.5
US dollar	9.4	1.8	-	-
Other currencies	0.4	0.2	-	-
	23.7	12.8	0.2	0.6

Movements on the Group's provision for impairment of trade receivables are as follows:

	2010 £m	Group 2009 £m
At 1 January 2010	0.4	0.6
Provision for receivables impairment	-	-
Receivables written off during the year as uncollectible	(0.2)	(0.2)
At 31 December 2010	0.2	0.4

#### Credit quality of trade receivables

The table below analyses the total trade receivables balance per reportable segment into fully performing, past due and impaired.

	Fully performing £m	Past due £m	Impaired £m	Total £m
31 December 2010				
United Kingdom	4.2	-	-	4.2
European Union (excluding UK)	4.1	2.8	(0.2)	6.7
US	0.1	-	-	0.1
Other countries	9.0	0.1	-	9.1
	17.4	2.9	(0.2)	20.1

	Fully performing £m	Past due £m	Impaired £m	Total £m
31 December 2009				
United Kingdom	3.9	-	-	3.9
European Union (excluding UK)	2.7	2.0	(0.4)	4.3
US	0.8	-	-	0.8
Other countries	0.4	0.3	-	0.7
	7.8	2.3	(0.4)	9.7

Trade receivables are considered impaired if they are not considered recoverable. 65% of the amounts past due are less than 30 days past due (2009: 59%).

#### 18. Research and Development tax credits receivable

	2010 £m	Group 2009 £m	2010 £m	Company 2009 £m
Research and development tax credits receivable	0.1	-	-	-
Less non-current portion	-	-	-	-
	0.1	-	-	-

#### 19. Cash and cash equivalents

	2010 £m	Group 2009 £m	2010 £m	Company 2009 £m
Cash at bank and in hand	19.4	19.0	14.5	17.1

The effective interest rates on short-term bank deposits were 0.7% (sterling), 0.3% (euro) and 0.2% (US\$), (2009: 0.7% (sterling), 0.8% (euro) and 0.4% (US\$)); these deposits are available on demand.

Included in cash and cash equivalents is an amount of £0.5m (2009 £0.5m) which is held on deposit with Barclays Bank plc as security against currency exchange transactions.



## 20. Trade and other payables

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
Trade payables	7.4	6.8	0.7	0.1
Amounts owed to Group undertakings	-	-	74.4	69.4
Deferred consideration for product rights	11.4	12.4	-	-
VAT	1.0	1.1	0.8	0.6
Corporate Tax	0.1	-	-	-
Social security and other taxes	1.1	1.0	0.1	0.2
Accrued expenses	15.7	13.6	1.3	1.4
Deferred income	7.5	9.4	-	-
	44.2	44.3	77.3	71.7
Less: non-current portion	(18.2)	(20.6)	-	-
Current portion	26.0	23.7	77.3	71.7

All non-current payables are expected to fall due within six years from 2010 and consists of long-term deferred payments/income on product rights £18.0m (2009: £19.3) and accrued expenses £0.2m (2009: £1.3m). Accrued expenses includes defined benefit pension scheme liabilities of £0.2m (2009: £0.1m).

## 21. Provisions for liabilities and charges

Group	Restructuring and other termination costs £m	Provision for grants repayable £m	Total £m
At 1 January 2010	0.2	0.2	0.4
Additional provisions	1.2	0.1	1.3
Utilised in year	(0.9)	-	(0.9)
At 31 December 2010	0.5	0.3	0.8

	2010 £m	2009 £m
Analysis of total provisions		
Current	0.8	0.4

### Restructuring and other termination costs

Restructuring and other termination costs are in respect of the estimated cost of restructuring and other related costs in the Group.

### Grants repayable

Development grants have been received from Government entities which may be repayable should certain success criteria not be met. The status of these projects has been reviewed at the balance sheet date and grants received in relation to projects ongoing, but with uncertain outcome, have been carried forward in the balance sheet.

## 22. Borrowings

On 27 March 2007 the Group entered into a £50.0million debt facility with the initial advance being provided by funds managed by Fortress Investment Group, Morgan Stanley and funds managed by Och-Ziff Capital Management Group ("Fortress"). The administrative Agent is Morgan Stanley Bank International Limited. The debt facility is secured over the intellectual property of the Group and has strict requirements for drawing funds, compliance with covenants and reporting requirements.

Draw-down under the facility is made with reference to the level of sales from key products recorded by the Group in the previous twelve month period (borrowing base capability). The level of draw-down available at any one time is governed by financial covenants which define the minimum sales levels required versus year on year product growth targets and sales plans. Other financial covenants require that the Group must maintain a minimum cash level of £4.5m of which no more than £1.5m can be held by certain subsidiaries at any time. The Group is also required to provide regular monthly trading reports, as well as interim and full year accounts in a timely manner.

The Group drew down an additional £8.0m from the facility in April 2010 (£7.9m after fees) and repaid £0.1m in relation to the disposal of Zindaclin making the total amount drawn at the half-year of £46.5m. In the second half the Group re-paid a further £0.1m relating to the disposal of Zindaclin and made the first £1.0m capital repayment in December 2010 making the amount drawn at 31 December £45.4m.

Under the terms of the facility, interest is repaid on a monthly basis, with capital repayments due to commence in December 2010. From that time the Group will repay £1.0m per month until the end of February 2012, at which point the outstanding capital sum will be repaid in full.

The maturity of the amount drawn down as at 31 December 2010 is detailed below:

	2010 £m	2009 £m
Current	12.0	1.0
1-5 years	33.4	37.6
Total	45.4	38.6

Interest on the amount drawn is charged at a rate of (i) the greater of either one month LIBOR or 5% plus (ii) a margin of between 5.0% and 5.5%, whilst the unused line fees on the un-drawn amount, ranges between 0.25% and 0.5% depending on the un-drawn amount.

The lenders have been issued with warrants over 5,018,414 shares (representing 2.5% of current shares in issue). The warrants have a ten year life and an exercise price of 98.052p per warrant.

On 12 January 2011 the Group completed the assignment of its debt facility with Fortress to Paladin Labs Inc. details of which are described in Note 32 Post balance sheet events. The warrants issued on 27 March 2007 were unaffected by the refinancing.

(a) Debt instrument

The debt instrument and the warrant instrument have been accounted for separately.

The fair value of the debt element for initial recognition was measured at amortised cost. The fair value of the debt at initial recognition, represented the value of the cash received less the fair value of the warrants issued. No additional warrants were issued in relation to the £17.0m drawn down during 2008, the £5.0m drawn down during 2009 or the additional £8.0m drawn down during 2010. As the debt is subsequently measured at amortised cost, the initial £20.0m is accreted to the repayment amount of £20.0m at maturity, using the effective interest rate method. The effective interest rate was 11.35% (2009: 12.09%) for the year. The amortised cost of the debt at 31 December was £44.4m (2009: £36.5m).

	2010 £m	2009 £m
At 1 January 2010		
Net funds drawn	38.6	37.0
Cumulative accretion of loan warrants	(1.1)	(1.9)
Carrying value of set up costs	(1.0)	(1.4)
	36.5	33.7
Movements during the year		
Funds drawn less funds repaid	6.8	1.6
Capitalisation of additional set up costs	(0.1)	-
Net cash received	6.7	1.6
Accretion of loan warrants (Note 10)	0.7	0.8
Amortisation of set up costs (Note 10)	0.5	0.4
	7.9	2.8
At 31 December 2010		
Net funds drawn	45.4	38.6
Cumulative accretion of loan warrants	(0.4)	(1.1)
Carrying value of set up costs	(0.6)	(1.0)
	44.4	36.5
Less current portion	(12.0)	(1.0)
	32.4	35.5

(b) Warrant liability

The warrant instrument is a derivative financial liability.

The warrants have been accounted for as a current liability as the warrant agreement provides a choice to the lender over how and when the contract is settled.

The fair value of the warrants issued to the lenders on 27 March 2007 of £3.0m, was determined by the use of the Binomial Tree valuation model. The fair value of the warrants as at 31 December 2010 was £2.8m (2009: £2.4m) and resulted in an increase in value of £0.4m (2009: £0.2m) being recognised in the Income Statement. The significant inputs into the model were the share price for the period leading up to the grant date being the closing market price on those dates, the closing market value at 31 December 2010, exercise price of the grant, dividend yield of 0%, expected life of the warrants, and an annual risk-free interest rate based on UK Government bond yields-to-maturity as at valuation date. The volatility measured at the standard deviation of expected share price returns is based on the ProStrakan Group share value over the expected life (for 2010) whereas in previous years this was evaluated using a broad range of comparable companies.

	2010 £m	2009 £m
At 1 January 2010	2.4	2.2
Movement in fair value charged to income statement	0.4	0.2
At 31 December 2010	2.8	2.4

## 23. Share capital

	Number of shares m	Ordinary shares <sup>1</sup> £m	Share premium £m	Total £m
At 1 January 2010	201.3	10.1	162.2	172.3
Employee share option scheme - options exercised	1.0	-	0.4	0.4
Purchase of own shares by ESOP	-	-	(0.1)	(0.1)
	202.3	10.1	162.5	172.6
Own shares held by ESOP	(0.2)	-	-	-
At 31 December 2010	202.1	10.1	162.5	172.6

	m	Total m
Authorised <sup>1</sup>		
At 31 December 2009 and 2010	400.0	400.0
In issue at 1 January 2010	201.3	201.3
Employee share option scheme - options exercised	1.0	1.0
In issue at 31 December 2010	202.3	202.3
Own shares held by ESOP	(0.2)	(0.2)
	202.1	202.1

<sup>1</sup> The ordinary shares have a par value of 5 pence each.

### Share issue

All issued shares are fully paid.

The ProStrakan Group Employee Benefit Trust currently holds 154,314 (2009: 20,040) shares. The Trust will be used in conjunction with the share plans below, for the benefit of the employees and former employees of the Group and certain classes of their dependants. The trustee of the Trust will have the power to subscribe for ordinary shares in the Company or to acquire ordinary shares in the Company in the market or from treasury, but will not be permitted to hold more than 5% of the Company's issued share capital.

### Share options

Information provided in the following notes prior to the date of capital reorganisations and capitalisation on 16 June 2005 refers to the numbers and values at the time and not restated for any subsequent consolidation.

The agreement between employees of ProSkelia SAS and the Company, entered into in August 2004, continue in force after the disposal to Galapagos NV on 22 December 2006.

Prior to admission, the Group operated a number of share option plans into which there will be no further grants:

Strakan International Limited, registered in Bermuda, adopted an unapproved Share Option Scheme on 6 December 1996, amended with effect from 25 October 1999 and further amended with effect from 30 May 2003. On exercise of options granted under this scheme, the shares issued are those of ProStrakan Group plc. All options vest evenly over three years from the date of the original grant and can be exercised up to the tenth anniversary of the date of grant.

The Company adopted another Share Option Scheme on 2 February 2000, amended with effect from 18 August 2000 and further amended with effect from 20 May 2004, in two parts: Part A, which has been approved by the Inland Revenue, and Part B (with appendices). Part A options vest on the third anniversary of the date of grant, Part B options vest evenly over three years from the date of grant (with Appendix 1 applied) or four years from date of grant (with Appendix 2 applied). All can be exercised up to the tenth anniversary of the date of grant.

The Company has granted options under the Executive Management Incentive Scheme, introduced in the Finance Act 2000. These options vest evenly over three years from date of grant and can be exercised up to the tenth anniversary of the date of grant.

Individual option agreements were effected at the time of the reorganisation in February 2000 granting options vesting immediately over 1,500,000 shares at an exercise price of £0.6667 per share. These options lapse in February 2010. Individual option agreements have been granted to consultants: 100,000 options vesting immediately at an exercise price of £0.6667 and 5,800 options vesting evenly over the three years from date of grant at an exercise price of £0.90. On 26 January 2004, further individual option agreements were granted to the holders of certain existing warrants over shares in OTL Pharma SA in consideration for the waiver of such warrants: 56,704 options vesting immediately at an exercise price of £0.6667 per share. The number of ordinary shares in respect of which such options may be exercised and the exercise price per share may be subject to adjustment in certain circumstances. All these options can be exercised up to the tenth anniversary of the date of grant.

At completion of the acquisition of ProStrakan Holdings BV (formerly ProSkelia BV) in August 2004, the Company entered into agreements with the holders of certain existing options over shares in ProSkelia. These agreements will for a period of time entitle each holder of an existing option over shares in ProSkelia to require the company to acquire the shares in ProSkelia that the option holder acquires on an exercise of his existing options over shares in ProSkelia (the "Put Option"). Following the expiry of the period within which the Put Option can be exercised, the Company will be entitled for a further period of time to acquire the shares in ProSkelia that the relevant option holder acquires on an exercise of his existing options over shares in ProSkelia (the "Call Option"). The consideration due by the Company on the exercise of either the Put Option or the Call Option will be the issue of ordinary shares. The aggregate number of ordinary shares which may become issuable as a result of the options over shares in ProSkelia is calculated by multiplying individual option holdings (which in aggregate totalled 1,294,820 at completion of the acquisition of ProSkelia) by the exchange ratio 11.9570841 and rounding down any fractional entitlement. The number of ordinary shares in respect of which such options may be exercised and the exercise price per share may be subject to adjustment in certain circumstances. These options all have an exercise price of €5.57.

On 6 May 2005, with effect immediately prior to Admission, the Company adopted New Share Plans as follows:

ProStrakan Group Performance Share Plan 2005 (PSP) Awards vest on the third anniversary of the date of grant.

ProStrakan Group Executive Share Option Plan 2005 (Executive Plan) The Executive Plan is divided into two parts; Part A is approved by HM Revenue and Customs and Part B unapproved. Options vest on the third anniversary of the date of grant and are exercisable up to the tenth anniversary of the date of grant.

ProStrakan Group Sharesave Plan 2005, 2006, 2008, 2009 and 2010 (Sharesave Plans) The Company has obtained HM Revenue and Customs approval of the Sharesave Plans under the Income Tax (Earnings and Pensions) Act 2003. All employees and full-time Directors of the Group who are resident and ordinarily resident in the UK for tax purposes are eligible to participate.

ProStrakan Group Share Incentive Plan (SIP). In February 2010 the Company obtained HM Revenue and Customs approval of the SIP and the associated trust deed under the Income Tax (Earnings and Pensions) Act 2003 and has offered the Scheme to all UK employees effective from March 2010.

Additionally the following New Share Plans has been approved and adopted however, as at 31 December 2010, no grants have been made under this plan:

ProStrakan Group International Sharesave Plan 2005 (International Sharesave Plan). This plan will not benefit from HM Customs and Revenue approval and will be open to all employees and Directors of the Group in any part of the world.

These New Share Plans operate over ordinary shares issued, ordinary shares in treasury or ordinary shares purchased by the Group in the market. No awards or options may be granted more than ten years after approval of the plan i.e. no later than 5 May 2015. In any ten-year period the Company may not issue more than 10% of the issued ordinary share capital under the New Share Plans and any other employee share plan adopted by the Company. Any ordinary shares issued, or which may be issued in the future, under awards or options granted before the Company was listed on the London Stock Exchange will not count towards this limit.

	2010 Average exercise price per share	Options (m)	2009 Average exercise price per share	Options (m)
At 1 January 2010	£0.8228	18.6	£0.8650	21.0
Granted	£0.3618	3.1	£0.7168	2.6
Exercised	£0.0029	(1.0)	£0.9335	(0.1)
Lapsed/expired/surrendered	£0.9740	(3.0)	£0.9465	(4.9)
At 31 December 2010	£0.7650	17.7	£0.8228	18.6

Out of the 17.7m (2009: 18.6m) outstanding options, 8.5m (2009: 7.4m) options were exercisable. Options exercised in 2010 resulted in 1.0m (2009: 0.1m) shares being issued at an average price of £0.0029 (2009: £0.9335) each.

Share options outstanding at the end of the year have the following expiry date and exercise prices:

	2010 Exercise price	Options ('000)	2009 Exercise price	Options ('000)
2010	£0.0000	-	£0.0000	922
	£0.8184	-	£0.8184	47
	£1.6667	-	£1.6667	612
	£1.6675	-	£1.6675	126
	£2.2500	-	£2.2500	142
2011	£0.0000	-	£0.0000	1,390
	£1.0000	1	£1.0000	5
	£1.6667	40	£1.6667	40
	£2.2500	2	£2.2500	2
2012	£0.0000	-	£0.0000	600
	£0.7728	108	£0.7728	165
	£0.8184	53	£0.8184	86
	£1.1646	1,580	£1.1646	1,693
	£1.6667	120	£1.6667	120
2013	£0.0000	-	£0.0000	-
	£0.7762	86	£0.7762	86
	£1.1646	851	£1.1646	851
	£1.1936	35	£1.1936	96
	£1.6667	123	£1.6667	129
2014	£0.6104	140	£0.6104	-
	£0.7728	176	£0.7728	263
	£1.6667	1,808	£1.6667	1,861
2015	£0.0000	309	£0.0000	-
	£1.1936	32	£1.1936	92
	£1.2000	23	£1.2000	33
	£1.2300	235	£1.2300	282
	£1.6667	442	£1.6667	475
2016	£0.0000	790	£0.0000	-
	£0.6104	125	£0.6104	-
	£1.0200	21	£1.0200	21
	£1.1200	813	£1.1200	852
	£1.1300	45	£1.1300	45
2017	£0.0000	500	£0.0000	-
	£0.7000	24	£0.7000	24
	£0.7500	127	£0.7500	239
	£0.9200	1,801	£0.9200	2,195
	£0.9300	22	£0.9300	22
2018	£0.0000	985	£0.0000	-
	£0.5285	3,245	£0.5285	3,325
	£0.5363	58	£0.5363	58
	£0.9660	20	£0.9660	20
2019	£0.6175	812	£0.6175	1,078
	£0.7646	20	£0.7646	20
	£1.2315	130	£1.2315	130
	£1.4920	500	£1.4920	500
2020	£0.4650	1,000	-	-
	£0.7630	30	-	-
	£0.9127	55	-	-
	£0.9890	392	-	-
		17,679		18,647

The fair value of options and awards granted to employees during the year determined using the Binomial Tree valuation model was £0.2m (2009: £0.5m). The significant inputs into the model were the share price for the period leading up to the grant date being the closing market price on those dates, exercise price of the grant, dividend yield of 0%, expected option or award life of 4 years 6 months, and an annual risk-free interest rate based on UK Government bond yields-to-maturity as at valuation date. The volatility measured at the standard deviation of expected share price returns is based on a broad range of comparable companies.

#### Warrants issued

##### NovaQuest

As part of the strategic alliance with NovaQuest signed 21 October 2007, warrants over 2.6 million new ordinary shares in the Group have been issued at 75.5p per share (representing 10% premium over the previous 30 days average share price) exercisable over 10 years.

The Group is required to measure the fair value of the services to be provided by NovaQuest. This can be assessed through the fair value of the equity instrument granted, provided the services are similar to employees providing a service, which, due to the nature of the agreement, being to provide a US sales force, is an acceptable method. The fair value of the warrant instrument at 21 October 2007 (date of signing of the agreement), has been calculated at £0.9m using the Binomial Tree valuation model. The significant inputs into the model are consistent with the share options as disclosed above. The warrants have now been fully amortised in line with the vesting periods. The amortisation recognised in the Consolidated Income Statement for the year ending 31 December 2010 was £nil (2009: £0.1m).

##### Fortress

As part of the funding arrangement, the lenders have been issued with warrants over 5,018,414 shares (representing 2.5% of current shares in issue). The warrants have a ten year life and an exercise price of 98.052p per warrant.

The fair value of the warrants issued to the lenders on 27 March 2007 of £3.0m, was determined by the use of the Binomial Tree valuation model. The fair value of the warrants as at 31 December 2010 was £2.8m (2009: £2.4m) and resulted in an increase in value of £0.4m (2009: £0.2m) being recognised in the Income Statement. The significant inputs into the model were the share price for the period leading up to the grant date being the closing market price on those dates, exercise price of the grant, dividend yield of 0%, expected life of the warrants, and an annual risk-free interest rate based on UK Government bond yields-to-maturity as at valuation date. The volatility measured at the standard deviation of expected share price returns is based on the ProStrakan Group share value over the expected life (for 2010) whereas in previous years this was evaluated using a broad range of comparable companies.

#### 24. Retained earnings

	Group £m	Company £m
Balance at 1 January 2009	(233.5)	(138.8)
Loss for the year	(15.8)	(4.0)
Balance at 31 December 2009	(249.3)	(142.8)
Balance at 1 January 2010	(249.3)	(142.8)
Loss for the year	(1.0)	(5.1)
Balance at 31 December 2010	(250.3)	(147.9)

## 25. Other reserves

	Currency translation reserve £m	Merger reserve £m	Other reserves* £m	Total £m
Balance at 1 January 2009	(1.8)	63.0	8.7	69.9
Currency translation differences	2.5	-	-	2.5
Employee share option scheme				
- value of services provided	-	-	0.4	0.4
- leavers during year	-	-	(1.4)	(1.4)
Warrants issued	-	-	0.1	0.1
Balance at 31 December 2009	0.7	63.0	7.8	71.5
Balance at 1 January 2010	0.7	63.0	7.8	71.5
Currency translation differences	-	-	-	-
Employee share option scheme				
- value of services provided	-	-	0.6	0.6
- leavers during year	-	-	(0.2)	(0.2)
Shares issued	-	-	(0.4)	(0.4)
Balance at 31 December 2010	0.7	63.0	7.8	71.5

	Fair value of options assumed <sup>1</sup> £m	Fair value of option & awards £m	Fair value of warrants issued <sup>2</sup> £m	Total £m
* Analysis of Other Reserves				
Balance at 1 January 2009	3.4	4.5	0.8	8.7
Employee share option scheme				
- value of services provided	-	0.4	0.1	0.5
- leavers during year	-	(1.4)	-	(1.4)
Balance at 31 December 2009	3.4	3.5	0.9	7.8
Balance at 1 January 2010	3.4	3.5	0.9	7.8
Employee share option scheme				
- value of services provided	-	0.6	-	0.6
- leavers during year	-	(0.2)	-	(0.2)
Shares issued	-	(0.4)	-	(0.4)
Balance at 31 December 2010	3.4	3.5	0.9	7.8

<sup>1</sup> Fair value of options assumed at the date of acquisition of ProStrakan Holdings BV (formerly ProSkelia BV) on 26 August 2004.

<sup>2</sup> Fair value of options issued to NovaQuest on 21 October 2007.

## 26. Cash generated from operations

### Continuing operations

	2010 £m	Group 2009 £m	2010 £m	Company 2009 £m
Loss for the year	(1.0)	(15.6)	(5.1)	(3.8)
Adjustments for:				
- tax (Note 11)	0.4	0.6	-	-
- depreciation (Note 14)	0.3	0.3	-	-
- amortisation (including write-down of product rights) (Note 13)	4.4	4.2	-	-
- profit on sale of products rights, property, plant and equipment (see below)	-	(1.0)	-	-
- net movement in provisions for liabilities and charges	0.4	(0.2)	-	-
- charges for share-based employee benefits	0.4	(0.9)	0.3	(1.0)
- finance income (Note 10)	(0.1)	(0.2)	(0.2)	(0.2)
- finance cost (Note 10)	6.4	5.4	1.0	1.7
- movement in fair value of warrants	0.4	0.2	-	-
- changes in working capital (excluding the effects of acquisition and exchange difference on consolidation):				
- inventories	(1.2)	0.9	-	-
- trade and other receivables	(10.9)	(0.5)	(5.6)	(2.3)
- trade and other payables	1.3	(7.2)	7.8	19.9
- deferred income	(1.5)	6.8	-	-
Cash (utilised)/generated from continuing operations	(0.7)	(7.2)	(1.8)	14.3

In the cash flow statement, proceeds from sale of property, plant and equipment comprise:

Net book amount (Note 13 and 14)	-	0.4	-	-
Profit on sale of product rights, property, plant and equipment	-	1.0	-	-
Proceeds from sale of property, plant and equipment	-	1.4	-	-

### Non-cash transactions

The principal non-cash transactions were the issue of equity instruments to employees and Directors as disclosed in Note 8.

### Discontinued operations

	2010 £m	Group 2009 £m	2010 £m	Company 2009 £m
Loss for the year	-	(0.2)	-	(0.2)
Adjustments for:				
- net movement in provisions for liabilities and charges	-	0.2	-	0.2
- changes in working capital (excluding the effects of acquisition and exchange difference on consolidation):				
- trade and other receivables	-	-	-	-
- trade and other payables	-	(7.8)	-	(7.8)
Cash utilised by discontinued operations	-	(7.8)	-	(7.8)



## 27. Commitments

### Capital commitments

There was no capital expenditure contracted for at the balance sheet for the Group and Company (2009: £nil).

### Operating lease commitments

The Group leases various offices, warehouses, vehicles and office equipment under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

The lease expenditure charged to the income statement during the year amounted to £0.6m (2009: £0.6m) for property, £1.1m (2009: £0.9m) for vehicles and equipment.

The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	2010 £m	2009 £m
Not later than 1 year	1.4	1.4
Later than 1 year and not later than 5 years	2.2	2.5
Later than 5 years	-	0.2
	3.6	4.1

## 28. Interest in joint venture

On 1 August 2007, the 100% owned subsidiary of the Group, known as ProStrakan AB entered into a 50% joint venture agreement with Orexo AB. ProStrakan Holdings BV, a subsidiary of Group and sole shareholder of ProStrakan AB made a direct issue of shares to Orexo AB resulting in Orexo AB becoming a 50% shareholder in ProStrakan AB.

ProStrakan AB market and sell various products throughout the Nordic region.

ProStrakan AB is incorporated in Sweden.

The following amounts represent the Group's 50% share of the assets and liabilities and sales and results of the joint venture, which have been included in the Balance sheet and Consolidated income statement:

	2010 £m	2009 £m
<b>Assets</b>		
Current assets	0.7	0.7
	0.7	0.7
<b>Liabilities</b>		
Short-term liabilities	0.2	0.2
	0.2	0.2
<b>Net assets</b>	0.5	0.5
<b>Income</b>	1.1	0.9
<b>Expenses</b>	(1.2)	(1.0)
<b>Loss after income tax</b>	(0.1)	(0.1)

## 29. Related-party transactions

### Group

During 2010 there were no related party transactions.

Key management compensation is disclosed in Note 8 and directors' remuneration in the Remuneration Report.

### Company

Related Party Transactions between the Company and Group subsidiaries.

Amounts due by the parent company from dealings with subsidiary companies are disclosed in Notes 17 and 20. Certain activities, including funding, expense recharges and annual management charges are provided by/to the parent company to/from subsidiary companies.

### 30. Contingent Liabilities

The Group has contingent liabilities in respect of legal claims arising in the ordinary course of business. It is not anticipated that any material liabilities will arise from the contingent liabilities other than those provided for (Note 21 and 32).

### 31. Principal subsidiaries and joint venture

Company	2010 £m	2009 £m
Fixed asset investments		
Subsidiary undertakings – shares	131.3	131.3
– loans	18.8	14.7
	150.1	146.0

Company	2010 £m	2009 £m
Subsidiary undertakings		
Investment in subsidiary undertakings, at cost, start of year	146.0	153.1
Net capitalisation/(repayment) <sup>1</sup>	4.1	(7.1)
Investment in subsidiary undertakings, at cost, end of year	150.1	146.0

<sup>1</sup> Capitalisation of intercompany loans outstanding at 31 December 2010 due to long term nature of the transaction/net (repayment) of the intercompany loans at 31 December 2009.

The company owns 100% of the equity of the following principal subsidiary undertakings with the exception of ProStrakan AB which is a 50% Joint Venture, as disclosed in Note 28.

Name of subsidiary	Country of registration	Nature of business
Strakan International Ltd	Bermuda	Licensing and commercialisation of pharmaceuticals
Strakan Pharmaceuticals Ltd*	England	Development and registration of pharmaceuticals
ProStrakan Ltd*	England	Registration, marketing and sale of pharmaceuticals
ProStrakan Pharma SAS*	France	Registration, marketing and sale of pharmaceuticals
ProStrakan Farmacéutica SLU*	Spain	Marketing and sale of pharmaceuticals
Arzneimittel ProStrakan GmbH*	Germany	Marketing and sale of pharmaceuticals
ProStrakan Pharma BV*	Netherlands	Marketing and sale of pharmaceuticals
ProStrakan srl*	Italy	Marketing and sale of pharmaceuticals
ProStrakan AB* (50%)	Sweden	Marketing and sale of pharmaceuticals
ProStrakan Inc*	US	Registration, marketing and sale of pharmaceuticals

\* investment held indirectly

## 32. Post balance sheet events

### (a) Refinancing

On 16 December 2010 the Company announced that it had entered into a strategic relationship with Paladin Labs Inc. ("Paladin"), the Canadian based international specialty pharmaceutical company, in which Paladin (through its wholly-owned subsidiary, Chimigen Inc.) would acquire, by way of assignment, ProStrakan's existing secured debt facility, with the addition of certain conversion rights, and would be granted an exclusive licence to ProStrakan's products for certain emerging territories. On the 7 January 2011 at a General Meeting of the Company, shareholders approved the assignment of the Company's existing debt facility with Fortress Investment Group, Morgan Stanley and funds managed by Och-Ziff Capital Management Group to Paladin. The assignment was completed on the 12 January 2011.

The agreement builds on the relationship which already existed between the two companies under which Paladin already had in-licensed the rights to distribute Abstral and Sancuso in Canada. The new relationship broadens this existing partnership, with Paladin being granted exclusive licence to distribute all of ProStrakan's products, including Abstral, Sancuso, Rectogesic, Xomolix and Tostran, in certain specific territories for which ProStrakan does not already have distribution agreements. These territories include: Canada, Latin America, Sub-Saharan Africa and Israel. In addition, during the term of the debt facility, Paladin have the right to license any new products acquired or licensed by ProStrakan for those same territories and on the same terms and conditions.

The £50.0m secured facility is provided by Paladin in Canadian Dollars at a rate of interest of 10.5% compared with a blended rate of 11.9% on the original facility. Paladin have the option to convert all or part of the outstanding principal debt into new ProStrakan shares at a price of £1.10 per ordinary share, but cannot convert during the initial six months of the life of the amended agreement. In the event of a change of control of ProStrakan during the initial six months (and providing Paladin requires repayment of the facility), Paladin are entitled to receive a payment equivalent to the balance of interest for the first year of the loan, together with an early repayment fee of £2.0m (CAD\$3.3m). Full details of the facility were set out in the circular sent to shareholders on 21 December 2010.

After fees and an early repayment interest payment paid to the original lenders, the Group received a further £2.4m in cash from the facility. Following the assignment and subsequent additional draw down, the amount outstanding to Paladin Labs Inc is CAD\$ 77.2m (£50.0m) with the assignment occurring at an exchange rate of 1.54465 CAD\$ = £1. The carrying value of the debt instrument will be re-valued at period ends and as such creates a foreign exchange exposure risk for the Group. The Group has reviewed the various options available to it in order to hedging part of all of the borrowings and have determined that due to the cost of such instruments not to put in place foreign exchange hedging measures.

The facility can be repaid at any time with Paladin's consent. It is also repayable on demand by Paladin on the occurrence of certain events of default and upon the Company being subject to a change of control. On 17 February 2011 the Company and KHK (as defined below) received a consent letter from Paladin consenting to the early repayment of the whole of the facility conditional upon completion of the proposed takeover of the Company by KHK as further described in section (b) below, which will result in the payments described above being made. Following repayment, Paladin's rights to license any new products acquired or licensed by ProStrakan for those same territories expires.

Paladin will be entitled, for so long as either any sums remain outstanding under the facility or Paladin holds at least 15% of the issued share capital of the Company, to appoint one non-executive director to the Board of ProStrakan. On 12 January 2011, Jonathan Goodman, Paladin's CEO, joined the Board of ProStrakan as a Non-executive Director.

### (b) Recommended cash acquisition of ProStrakan Group plc

On 21 February 2011, the boards of Kyowa Hakko Kirin Co., Ltd. ("KHK") and ProStrakan Group plc ("ProStrakan") announced that they had reached agreement on the terms of the recommended cash acquisition by KHK of the entire issued and to be issued share capital of ProStrakan (the "Acquisition"). Under the terms of the Acquisition, ProStrakan Shareholders will be entitled to receive 130 pence in cash for each ProStrakan Share, valuing the entire issued and to be issued ordinary share capital of ProStrakan at approximately £292 million (£39,420 million). The price of 130 pence per ProStrakan Share represents a premium of approximately 41 per cent. to the closing price of 92.5 pence per ProStrakan Share on 12 November 2010, being the last business day immediately prior to the start of ProStrakan's current offer period; and 100 per cent. to 64.9 pence, being the volume weighted average closing price per ProStrakan Share over the 6 months prior to 12 November 2010, being the last business day immediately prior to the start of ProStrakan's current offer period.

The Acquisition would represent a new opportunity for ProStrakan's continued development and could, through the complementary nature of ProStrakan and KHK, in terms of products, geography and infrastructure, allow ProStrakan to grow at a faster pace and to offer to patients and clinicians across Europe and the US, in time, a broader range of medicines.

In consideration for KHK making the Acquisition, ProStrakan has agreed to pay to KHK an inducement fee equal to one percent of the value of the Acquisition if, prior to the date upon which the Acquisition lapses or is withdrawn various events occur. In addition, ProStrakan has made various non-solicitation undertakings and has offered KHK the right, under certain circumstances to match a superior proposal if one should be received. Details of the Implementation Agreement agreed between the parties can be found in the Scheme Document sent to shareholders on 8 March 2011.

It is proposed that the Acquisition be implemented by means of a Scheme of Arrangement under Part 26 of the Companies Act 2006. Full details of the Acquisition are set out in the Scheme Document sent to shareholders on 8 March 2011.

The ProStrakan name, logo and the following trade marks are owned by or licensed to members of the ProStrakan group of companies: Abstral, Adcal, Adcal-D3, Amsalyo, Alfaprost, Belustine, CD2, Desuric, Devazol, Dragul, Droperidol, Flutamida, Fortigel, Hexastat, Insuplant, Isotard, Ilnogen, Ketensin, Meto APS, Pencial, Radiocare, Rectogesic, Sancuso, Simva APS, Sinovial, Tabphyn, Tebetane, Tostran, Tostrex, Urinorm, Xomolix.  
ProStrakan Group plc 2011

*Investors' information*

*Registrars: Capita  
The Registry  
34 Beckenham Road  
Beckenham  
Kent BR3 4TU*

*Independent Auditors:  
PricewaterhouseCoopers LLP*

*Solicitors:  
Shepherd & Wedderburn LLP*

*Principal Bankers:  
Barclays Bank plc*

*Joint brokers & advisers:  
JPMorgan Cazenove  
Numis Securities Limited*

*Secretary and Registered Office:  
Andrew McLean  
Company Secretary and General Counsel  
ProStrakan Group plc  
Galabank Business Park  
Galashiels  
TD1 1QH  
UK*

*Tel: +44 (0) 1896 664000  
Fax: +44 (0) 1896 664001*

*E-mail: [andrew.mclean@prostrakan.com](mailto:andrew.mclean@prostrakan.com)*

*Company Registration Number:  
SC198780*

*Investor Relations  
Callum Spreng, Corporate Communications  
Tel: +44 (0) 1896 664103  
Email: [callum.spreng@prostrakan.com](mailto:callum.spreng@prostrakan.com)*

*Company Logo*

*ProStrakan Group plc  
Galabank Business Park, Galashiels, TD1 1QH, UK  
Tel: +44 (0) 1896 664000, Fax: +44 (0) 1896 664001*

*[www.prostrakan.com](http://www.prostrakan.com)*