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Leading experts in botanical drug development



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Phynova develops pharmaceuticals for areas of high unmet therapeutic need such as Metabolic Syndrome, Hepatitis C and MRSA. Its drug candidates comprise pharmacologically active polymolecular mixtures derived from medicinal plants that have a history of use as medicines in countries like China. In the United States these types of pharmaceutical drugs are referred to as Botanical Drug Products and have a regulatory standing equal to conventional single molecule and biological drugs. Phynova's business model is to develop its drug candidates quickly and cost effectively into proof of concept studies, followed by revenue generation through out-licensing and co-development deals with commercial partners. Phynova's drugs will be produced from sustainable resources.

Highlights and milestones

March 2008

Successful £1.2 million placement.

April 2008

Joins the International OTCQX trading platform giving direct access to the US securities market.

May 2008

PYN6 MRSA data presented at American Society of Microbiology annual conference.

July 2008

PYN17 (chronic hep C) US patent granted.

Product pipeline with high upside

| Disease | Phynova Candidate | Key Opportunities |
|-----------------------------------|-------------------|---|
| Chronic HCV | PYN17 | Phynova believes PYN17 is only drug in development for symptomatic relief - >50% of patients. |
| Fatty Liver (NAFLD/NASH) | PYN22 | No specific treatment available. |
| Post Operative Ileus | PYN9-BCCL | Complication of abdominal surgery. Limited indication on only current marketed therapy. |
| Antibacterial (MRSA, Acne) | PYN6 | New drugs needed for MRSA, few novel acne therapies. |
| Anti viral (HCV, Dengue) | PYN18 | Novel HCV treatments being sought, no therapy for Dengue. |
| Cancer | PYN7 | Cancer drugs now achieving \$1b + sales, novel approaches sought. |

October 2008

PYN6 demonstrates potential advantages for successfully combating MRSA in pre-clinical work.

November 2008

Announced collaboration with Norgine to conduct research on two of Phynova's pipeline candidates.

December 2008

Patent granted for PYN22- a potential treatment for non-alcoholic fatty liver disease (NAFLD).

January 2009

PYN17, PYN6, PYN22- commercial discussions ongoing with potential out-licensing partners.

Despite the challenging environment, Phynova has made real progress in the development of its business in the past year.

Chairman's Statement

Despite the challenging environment, Phynova has made real progress in the development of its business in the past year. We have grown the Groups' presence in China with important new commercial collaborations, made significant strides in the advancement of our pipeline of drug candidates through the development process, and are now generating strong commercial interest in our pipeline.

As previously reported, we have re-organised our Board and appointed two non-executive directors with strong pharmaceuticals backgrounds. We have also taken the opportunity to streamline our management and focus on the two core elements of our business: the development of our interests in China to generate a pipeline of novel new therapeutic candidates and the development and commercialisation of the pipeline in the West.

Development Programme

The further development and commercialisation of Phynova's pipeline of drug candidates is key to the success of the Group. During the last several months Phynova has been in discussions with a number of potential licensing and development partners. In November the Company announced a commercial agreement with Norgine, a leading specialty pharmaceutical company. Under the terms of the collaboration, Norgine will assess certain of Phynova's drug candidates in proprietary assays in order to measure their effectiveness in the treatment of liver disease. We are very pleased to be working with Norgine and we believe that this collaboration is the first of several we anticipate announcing in the near future.

Regarding the pipeline, I can report the following:

PYN17 - Financial constraints have prevented us from commencing the Phase IIb study planned to begin in 2008. The IND granted for the trial is still open and if sufficient funding becomes available or a partner is found for PYN17 we would carry on with the trial. We are also in talks with a regional pharmaceutical company to license PYN17 in an area of the world that has a very high rate of hepatitis C infections.

PYN 6 - Phynova's anti-MRSA drug candidate has continued to show excellent efficacy in further pre-clinical studies carried out in the past year. Working with collaborators at Queen Mary, University of London, Phynova demonstrated that MRSA cultured in the presence of PYN6 does not become resistant to PYN6. These studies have also demonstrated that PYN6 appears to have a dual action on MRSA, inhibiting the growth of the bacterium, as well as a strong bactericidal action. As a consequence of these results, PYN6 will become Phynova's next clinical candidate and first human studies are targeted to start within 12-15 months. In June 2007, a presentation on PYN6 was given at the American Society of Microbiology's Annual General Meeting. PYN6 is an excellent candidate for rapid development and because of this, commercial discussions with interested parties are well underway.



PYN22 - is a candidate for the treatment of non-alcoholic fatty liver disease (NAFLD), considered to be the most common liver disorder in the Western world. NAFLD is closely associated with the metabolic syndrome and obesity. There is no evidenced-based treatment for NAFLD, and most pharmacological agents are primarily approved for other aspects of the metabolic syndrome, i.e. anti-obesity drugs and diabetic drugs. With the recent withdrawal of the marketing authorisation for one of the leading obesity drugs (rimonabant) that was being trialled for use in NAFLD, there is renewed interest from pharmaceutical companies to find novel treatments for this potential block-buster market. We are in commercial discussions with various specialty pharmaceutical companies about co-developing and/or out-licensing PYN22. Again, financial constraints have delayed the clinical development of PYN22. However, further funding or co-development/out-licensing deals could see PYN22 in the clinic within 12 months of financing.

PYN9 - as has been well documented in the press over the last year, China's drug regulatory agency, the SFDA, is going through a major restructuring that has caused extensive delays in the normal course of its business. Unfortunately our JV partner, Botanic Century has been one of many Chinese drug development companies who have suffered as a result. Very recently there have been signs that the SFDA is beginning to function again and Botanic Century have had communication with the agency that suggests they will be able to begin the registration trial for PYN9 in the second quarter of 2009 and hopefully have Phase II data by the end of 2009. If this timeline is achieved, Phynova will be in a strong position to license out PYN9 in 2010.

PYN18 - is an antiviral candidate that has shown good activity against two flaviviruses; hepatitis C virus (HCV) and dengue virus. During the past year, the preclinical in vitro screening was furthered with confirmatory studies being carried out at the world-renowned virology labs of Prof Eric de Clercq at the Katholieke Universiteit Leuven in Belgium. Laboratory studies have confirmed that PYN18 has a potentially wide therapeutic index with very low toxicity in cell culture. Studies investigating the activity of PYN18 against dengue confirmed the data from initial screenings in Thailand and showed that it had significant antiviral activity against the dengue virus (MIC $1.2\mu\text{g/mL}$) and appeared to have a novel mechanism of action, affecting late-stage viral processes. We are in advanced discussions with several Chinese organisations interested in the collaborative development of PYN18 for treating HCV, and are seeking charitable and/or government/military funding for the further development of the dengue programme.

PYN7 - Investigations of compounds obtained from the Hong Kong Jockey Club Institute of Chinese Medicine continued through 2008. The studies identified three compounds with activity to warrant further investigation and these compounds were screened against various cancer cell lines as well as non-cancerous cells with the compounds showing greater selectivity towards cancerous cells. The compounds were screened to investigate their combination with standard chemotherapy agents and showed good additive activity. Due to the early stage of this project and the current financial climate, this project has been temporarily put on hold so that greater resources can be injected into the projects closer to realising commercial/out-licensing revenues.

Phynova China

China has been the source of Phynova's product pipeline for several years now and the Group has continued to benefit from its presence there during the last year. Our subsidiary Phynova China has made steady progress in developing its commercial relationships with our existing partners such as Botanic Century as well as establishing new ones with major companies in China such as Fosun Pharma and Tasly Pharmaceuticals.

Botanic Century, of which the Group owns 45% and which, as a result of the agreements controlling its operations and activities, is accounted for as joint venture, has made good progress in a number of areas. As detailed above, the registration trial for PYN9 is scheduled to begin next year. Botanic Century already has a marketing and distribution agreement in place for PYN9 that will facilitate its rapid entry into the Chinese pharmaceutical market as soon as regulatory approval is granted. In addition to developing its drug pipeline, Botanic Century has over the last year begun to develop products for the nutraceuticals and cosmetics industries. An extract originally developed for the treatment of diabetes has shown good in vitro activity as an 'anti-aging' substance for the skin and discussions are underway to out-license it as a new cosmetic ingredient. Botanic Century has also developed a new supplement for people suffering from acne that has been introduced to the US market where sales of it have recently begun. One advantage of developing products for the non-pharmaceutical markets is that they can generate early revenues.

PYN17

Symptomatic relief of chronic hepatitis C (CHC)

China has been the source of Phynova's product pipeline for several years now and the Group has continued to benefit from its presence there during the last year.

Chairman's Statement continued

In July Phynova signed a Memorandum of Understanding with Fosun Pharma, one of China's largest pharmaceutical groups to establish a strategic collaboration for the development of botanical drugs for the Chinese and global markets. Discussions are currently underway with other pharmaceutical companies with a view to creating co-development and commercial partnerships for several of Phynova's pipeline candidates in China, which by 2010 is expected to be the world's fifth largest pharmaceutical market.

China is fast gaining a reputation one of the most innovative R & D centres for drug research in the world and over the last year Phynova has continued to expand its research network amongst scientists and institutions involved in 'cutting edge' research relating to plant-derived drugs. Phynova has recently entered into a Collaboration Agreement with the School of Pharmacy at Suzhou University to co-develop novel botanical drugs. Phynova China's research network has attracted the attention of Western pharmaceutical, cosmetic and nutraceutical companies who have expressed interest in collaborating with Phynova in order to discover and develop new plant-derived active compounds for their respective areas of interest and the Company anticipates signing research agreements with such companies next year.

Phynova's management team has spent several years creating a significant 'footprint' in China. Given the confluence of favourable conditions in the Chinese pharmaceutical market together with Phynova's well established presence and extensive research and commercial network in China, the upcoming year is an opportune moment to further expand Phynova's business interests in China.

Financials

The results for the year ended 30 September 2008 are in the financial statements starting on page 10.

The Company's cash position, as at 30 September 2008, was £375,811 and its cash position immediately prior to the date of these financial statements was £69,000. In April 2008, Phynova raised £1.2 million before expenses by means of a placing of shares. These funds were raised through a placing of new ordinary shares at 40 pence per share with existing investors and other private investors.

Phynova's American Depositary Receipts ("ADRs") were listed for trading on the OTCQX platform in New York in April 2008. This was undertaken in order to improve our liquidity and to increase our access to US based investors. However in order to make full use of the facility we need to visit and make presentations to US investors, which we have not done in view of the current financial environment. When investment activity picks up, we will do this.



The management continues to exercise prudent cash management demonstrated by relatively low administrative and operational costs.

Following our announcement in September 2008 that we need to raise additional cash resources, we have been holding discussions with our Nominated Advisor and certain investors. We have been encouraged by these discussions and hope to be able to announce the terms of a fund raising early in the New Year. These funds are necessary for the Company to continue to trade through to the medium term.

Future trading and liquidity risk

As noted above, the Group is in the development phase of its activities and has not yet completed the commercial licensing of any of its products. Therefore the group has generated significant losses in recent years (£7.7 million at 30 September 2008 and £2.0 million after tax credits for research and development expenditure for the year ended 30 September 2008). However the directors remain confident of the commercial viability of the product pipeline and consider that revenue from product licensing will be generated in 2009 and through subsequent years.

The directors have prepared profit and cash flow forecasts ("the forecasts") for the short term period to end February 2009 and for the year to 31 December 2009 based on current expectations of activity levels which latter forecasts include cash flow from licensing and product sales amounting to £1.6 million.

These forecasts also show that the Group requires additional funding from February 2009 in order to continue trading. The directors are seeking to arrange a placing of new shares which is planned to raise up to an additional £1.5 million and which is expected to be completed in early February 2009. Based on initial discussions with our Nominated Adviser and current and potential investors the directors consider that this fund raising should be achievable. This additional funding provides the level of funds shown in the forecasts to enable the Group to continue trading for at least the next 12 months, providing the revenue shown in the forecasts is achieved. In the event that there are delays in the generation of revenue from product licensing arrangements there may be a need to seek further funding from shareholders before the end of the next 12 month period. The directors intend to manage the cash flows of the Group carefully during January and February 2009 through a range of measures and consider that this close management of the payments profile should enable the Group to continue in a cash positive position through to the planned fund raising.

The Group has no available bank or other funding facilities other than cash at bank.

Based on our current expectations of the support of our key investors on the continuing progress of product development and out-licensing discussions, and our ability to manage the short term payments of the Group through to the planned fund raising the directors consider that the Group will have adequate funding resources to continue in operational existence for the foreseeable future. Accordingly, we continue to adopt the going concern basis in preparing the annual report and accounts.

People

I would like to thank those board members who stepped down in September for their valuable contributions to the Group. As we enter a new phase in our development, having experienced pharmaceutical industry veterans on the Board is important and we are very pleased that Steve Harris and Dr Jin Li joined the board in September. We know that their experience and expertise will be of great assistance to the management team.

The Future

I believe that the Group is at an exciting stage in its development, with the potential for generating revenues in the coming year, with discussions on some new out-licensing and collaboration deals well underway. Botanically derived drugs are now recognised by the FDA as having significant therapeutic value. China continues to expand, albeit more slowly in the current economic climate, and is becoming of greater significance in our field as a major global player and market. We are now well placed to take advantage of these opportunities.

John Pool

Chairman

The directors present their report together with the audited financial statements for the year ended 30 September 2008.

Directors' Report

Results and dividends

The consolidated income statement is set out on page 10 and shows the loss for the year.

The directors do not recommend the payment of a dividend (2007: nil).

Principal activities, review of business and future developments

The Group's principal activity is that of a developer of pharmaceuticals derived from medicinal plants that have a history of use as medicines in countries like China. In the United States these types of pharmaceutical and over the counter drugs are referred to as Botanical Drug Products and have a regulatory standing equal to conventional single molecule and biological drugs. The Group's drug candidates target areas of significant unmet therapeutic need including bacterial, viral and metabolic diseases. The Group is also developing products from its pipeline that can be marketed as ingredients for the nutraceutical and cosmetic industries (a summary of the principal activities of subsidiary companies is included within note 13). These activities remain unchanged from last year.

The group now has a well developed portfolio of products derived from medicinal plants that address major unmet needs in large sections of the world's population.

Commercialisation will be through licensing and co-development deals with pharmaceutical companies which will then take the products through final trials and to market. Commercialisation of the Group's non-pharma products will be through licensing deals with manufacturers of nutraceuticals and cosmetics. The group is actively engaged in a number of discussions regarding the co-development and out-licensing of its products.

Developments in 2008, particularly the collaboration agreement with Norgine continue to reinforce the Directors' opinion that the market for pharmaceuticals derived from medicinal plants for the treatment of unmet therapeutic needs has great potential. The pharmaceutical market and rapidly expanding R & D infrastructure of China are particularly attractive in the current financial climate. It is the intention of the directors to take full advantage of Phynova's strengths in the emerging Chinese market in the coming year.

International Financial Reporting Standards

This is the first annual report for the Group presented under International Financial Reporting Standards as adopted by the European Union ("IFRS"). The comparative figures have been restated to reflect this. There has been no significant impact on the Group in either the current year's results or the restated historic figures. An explanation, including the impact of transition to IFRS, is included in the notes to the Group financial statements. The financial statements of the Company continue to be prepared in accordance with United Kingdom Generally Accepted Accounting Principles ("UK GAAP") and are set out on pages 28 to 32.

PYN9

Complication of abdominal surgery

Phynova is able to reduce the risk associated with pharmaceutical drug development by virtue of its diversified portfolio of drug candidates, which address a number of different therapeutic areas.

Principal risks and uncertainties

Phynova is able to reduce the risk associated with pharmaceutical drug development by virtue of its diversified portfolio of drug candidates, which address a number of different therapeutic areas and are derived from plants with a history of therapeutic efficacy. Plants provide the active ingredients for many well known drugs in use today. The directors consider that the key risks to the Group are:

Funding risk

Funding for life science companies in general and for Phynova in particular is currently difficult to obtain due to the financial climate. In order for the Group to continue to trade and to fulfil its current development programme over the next twelve months in addition to completing the out-licensing deals referred to below in Commercial risk, further fund raising will be necessary. There is no certainty that Phynova will successfully raise further funding. Further discussion on this matter is included within the Chairman's statement.

Commercial risk

As set out in the Chairman's report, the Directors are greatly encouraged by the commercial discussions underway to license the Company's products under development to pharmaceutical and other partners. However there is no certainty that these discussions will have a successful outcome.

R&D risk

However much the use of medicinal plants as a source of new drug candidates mitigates the chance of failure, drug development is a highly risky business and there is a high probability some of the Group's drug candidates may fail to be successfully developed.

Regulatory risk

There is a risk that delays in the development of the Group's drug candidates may be caused by the regulatory authorities requiring further pre-clinical and clinical development than is currently envisaged by management.

Policy and practice on the payment of creditors

The Group does not subscribe to a particular code but follows a policy whereby it agrees appropriate terms and conditions for its business transactions with suppliers. Payments are then made on these terms, subject to the terms and conditions being met by suppliers. At the balance sheet date the trade creditors value was £160,699 (2007: £278,689) representing 37 creditor days (2007: 44 creditor days).

Charitable and political donations

During the year the group made charitable donations of £nil (2007: £400) to charities serving the community in which the Group operates. No political donations were made.

Research and development

Research and development amounted to £682,760 (2007: £1,027,581) all of which was written off during the year. Details of the research and development being completed by the company can be found within the Chairman's report.

Director's indemnity insurance

Certain directors benefit from qualifying third party indemnity provisions in place during the financial year and at the date of this report.

Financial Instruments

Details of the financial instruments held by the company and its subsidiary undertaking are contained in note 15 of the financial statements.

Financial Key Performance Indicators (KPIs)

The directors consider progress in developing and licencing the products in its pipeline to be the Group's key non-financial performance indicators. These are the key measures of the Group achieving its strategy. The directors are satisfied with the performance of the Group in this respect as noted in the Chairman's Statement.

The directors consider cash flow management to be the Group's key financial stability indicator. Cash is monitored closely and funding requirements are met through generation of funds through the AIM financial market, enabling the Group to plan resource for future development projects. As noted in the Chairman's Statement the Group requires additional funds by February 2009 to be able to continue trading.

Further discussion of the key performance indicators used by the company are discussed within the Chairman's report.

Directors

The directors who held office at the end of the year had the following interests in the shares of the company recorded in the register of directors' shares and share options:

| | Ordinary shares of 1p each | | Share Options | |
|----------|----------------------------|--------------------|--------------------------|--------------------|
| | Number 30/09/08 | Number 30/09/07 | Number 30/09/08 | Number 30/09/07 |
| R Miller | 745,853 | 745,853 | - | - |
| M Martin | 1,053,830 | 1,053,830 | (1) 50,000 (2) 30,417 | 50,000 30,417 |
| T Mills | 23,280 | 23,280 | | |

On the 19th of September 2008, K Watkin, W Doyle, A Brown and S Marshall resigned as directors and T Mills, S Harris and J Li were appointed to the board of directors. On the 19th of September 2008 K Watkin resigned as Chairman and J Pool was appointed executive Chairman.

The share options are exercisable between the following dates and at the following rates:

- (1) 24 January 2006 and 24 January 2009 at 50p
- (2) 27 February 2006 and 27 February 2009 at 60p

PYN7**Cancer drugs now achieving
\$1b + sales**

The Directors are greatly encouraged by the commercial discussions underway to license the Company's products under development to pharmaceutical and other partners.

Directors' Report continued

Directors' responsibilities

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the group, for safeguarding the assets of the company, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a Directors' Report which complies with the requirements of the Companies Act 1985.

The directors are responsible for preparing the annual report and the financial statements in accordance with the Companies Act 1985. The directors are also required to prepare financial statements for the group in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs) and the rules of the London Stock Exchange for companies trading securities on the Alternative Investment Market. The directors have chosen to prepare financial statements for the company in accordance with UK Generally Accepted Accounting Practice.

Group financial statements

International Accounting Standard 1 requires that financial statements present fairly for each financial year the group's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the preparation and presentation of financial statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRSs. A fair presentation also requires the Directors to:

- consistently select and apply appropriate accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; and
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

Parent company financial statements

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements.

Financial statements are published on the group's website in accordance with legislation in the United Kingdom governing the preparation and dissemination of financial statements, which may vary from legislation in other jurisdictions. The maintenance and integrity of the group's website is the responsibility of the directors. The directors' responsibility also extends to the ongoing integrity of the financial statements contained therein.

Auditors

All of the current directors have taken all the steps that they ought to have taken to make themselves aware of any information needed by the company's auditors for the purpose of their audit and to establish that the auditors are aware of that information. The directors are not aware of any relevant audit information of which the auditors are unaware.

BDO Stoy Hayward LLP have expressed their willingness to continue in office and a resolution will be proposed at the annual general meeting.

By order of the board

M Martin

Director

29 December 2008

Independent auditor's report to the shareholders of Phynova Group Plc

We have audited the group and parent company financial statements (the "financial statements") of Phynova Group Public Limited Company for the year ended 30 September 2008 which comprise the consolidated income statement, the consolidated and company balance sheets, the consolidated cash flow statement, the consolidated statement of changes in equity and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and for preparing the parent company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and have been properly prepared in accordance with the Companies Act 1985 and whether the information given in the directors' report is consistent with those financial statements. We also report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the directors' report and consider the implications for our report if we become aware of any apparent misstatements within it.

Our report has been prepared pursuant to the requirements of the Companies Act 1985 and for no other purpose. No person is entitled to rely on this report unless such a person is a person entitled to rely upon this report by virtue of and for the purpose of the Companies Act 1985 or has been expressly authorised to do so by our prior written consent. Save as above, we do not accept responsibility for this report to any other person or for any other purpose and we hereby expressly disclaim any and all such liability.

Basis of audit opinion

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

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order

to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 30 September 2008 and of its loss for the year then ended;
- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the parent company's affairs as at 30 September 2008;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the directors' report is consistent with the financial statements.

Emphasis of matter – Going concern and carrying value of investments:

In forming our opinion, which is not qualified, we have considered the adequacy of the disclosures made in the Chairman's Statement and Note 1 of the financial statements concerning the ability of the Group to continue as a going concern. These disclosures indicate that the Group is only able to continue as a going concern if required funds to be obtained from a share issue planned for January 2009 are received as expected by late January 2009. The disclosures also indicate that the Group is then only able to continue as a going concern for at least the twelve months to 31 December 2009 if the cashflow expected from product licensing is generated or, in the event that such sales are not generated, that additional funding is able to be obtained from a further share issue at an appropriate time during the year. In addition, the disclosures note that the Group is only able to continue as a going concern through January and February 2009 if the payments of the Group are carefully managed by the directors in these months. We consider that these conditions indicate the existence of material uncertainties which may cast significant doubt over the group's ability to continue as a going concern. We also draw your attention to note 1 in the financial statements concerning the carrying values shown in the group accounts in respect of the investment in the joint venture (carrying value £0.56m) and the carrying values shown in the parent company accounts in respect of the investment in subsidiary company (£0.07m) and the amount due from subsidiary company (£1.4m). The realisation of these assets is dependant on the successful commercial licensing of products and the ability of the group to raise sufficient finance as noted above. The financial statements do not include any adjustments relating to these uncertainties.

BDO Stoy Hayward LLP

Chartered Accountants and Registered Auditors, Birmingham
29 December 2008

Consolidated Income Statement

for the year ended 30 September 2008

| | Year ended 30 September 2008 | Year ended 30 September 2007 |
|---|------------------------------------|------------------------------------|
| | £ | £ |
| | Note | |
| Research and development costs | (682,760) | (1,027,581) |
| Other administration costs | (1,685,411) | (1,948,445) |
| Total Administrative expenses | (2,368,171) | (2,976,026) |
| Operating loss | (2,368,171) | (2,976,026) |
| Finance income | 34,746 | 87,240 |
| Finance costs | (4,209) | (3,633) |
| Share of joint venture post tax losses | (36,155) | (42,850) |
| Loss before tax | (2,373,789) | (2,935,269) |
| Taxation | 9 419,716 | 93,144 |
| Loss for the year attributable to equity holders of the parent company | 5 (1,954,073) | (2,842,125) |
| Basic and diluted loss per share (pence) | 5 (9.3p) | (15.1p) |

Consolidated Statement of Changes in Equity

for the year ended 30 September 2008

| | Share capital £ | Share premium reserve £ | Warrant reserve £ | Merger difference reserve £ | Foreign exchange reserve £ | Retained losses £ | Total equity £ |
|--|--------------------|----------------------------|----------------------|--------------------------------|-------------------------------|----------------------|--------------------|
| Balance at 1 October 2006 | 147,998 | 3,497,856 | 369,459 | 642,711 | - | (3,000,658) | 1,657,366 |
| Changes in equity for 2006/2007 | | | | | | | |
| Exchange difference arising on translation of foreign operations | - | - | - | - | (2,673) | - | (2,673) |
| Net income recognised directly in equity | 147,998 | 3,497,856 | 369,459 | 642,711 | (2,673) | (3,000,658) | 1,654,693 |
| Loss for the year | - | - | - | - | - | (2,842,125) | (2,842,125) |
| Total recognised income and expense for the year | 147,998 | 3,497,856 | 369,459 | 642,711 | (2,673) | (5,842,783) | (1,187,432) |
| Issue of share capital | 47,365 | 2,986,080 | - | - | - | - | 3,033,445 |
| Issue costs | - | (212,388) | - | - | - | - | (212,388) |
| Share-based payment | - | - | - | - | - | 47,000 | 47,000 |
| Balance at 30 September 2007 | 195,363 | 6,271,548 | 369,459 | 642,711 | (2,673) | (5,795,783) | 1,680,625 |
| | Share capital £ | Share premium reserve £ | Warrant reserve £ | Merger difference reserve £ | Foreign exchange reserve £ | Retained losses £ | Total equity £ |
| Balance at 1 October 2007 | 195,363 | 6,271,548 | 369,459 | 642,711 | (2,673) | (5,795,783) | 1,680,625 |
| Changes in equity for 2007/2008 | | | | | | | |
| Exchange difference arising on translation of foreign operations | - | - | - | - | 52,589 | - | 52,589 |
| Net income recognised directly in equity | 195,363 | 6,271,548 | 369,459 | 642,711 | 49,916 | (5,795,783) | 1,733,214 |
| Loss for the year | - | - | - | - | - | (1,954,073) | (1,954,073) |
| Total recognised income and expense for the year | 195,363 | 6,271,548 | 369,459 | 642,711 | 49,916 | (7,749,856) | (220,859) |
| Issue of share capital | 30,334 | 1,183,036 | - | - | - | - | 1,213,370 |
| Issue costs | - | (153,373) | - | - | - | 52,571 | (100,802) |
| Warrant reserve transfer | - | 116,886 | (116,886) | - | - | - | - |
| Balance at 30 September 2008 | 225,697 | 7,418,097 | 252,573 | 642,711 | 49,916 | (7,697,285) | 891,709 |

Consolidated Balance Sheet at 30 September 2008

| | Note | As at 30 September 2008 | | As at 30 September 2007 | |
|---|------|-------------------------------|------------------|-------------------------------|-----------|
| | | £ | £ | £ | £ |
| Assets | | | | | |
| Non-current assets | | | | | |
| Plant and equipment | 11 | 12,451 | | 16,367 | |
| Investment in equity accounted joint ventures | 12 | 563,473 | | 547,038 | |
| Total non-current assets | | | 575,924 | | 563,405 |
| Current assets | | | | | |
| Other receivables | 16 | 63,618 | | 325,671 | |
| Corporation tax recoverable | 16 | 188,000 | | 93,144 | |
| Cash and cash equivalents | | 375,811 | | 1,426,681 | |
| Total current assets | | | 627,429 | | 1,845,496 |
| Total assets | | | 1,203,353 | | 2,408,901 |
| Liabilities | | | | | |
| Non-current liabilities | | | | | |
| Provisions | 18 | - | | (343,366) | |
| Current Liabilities | | | | | |
| Trade and other payables | 17 | (311,644) | | (384,910) | |
| Total Liabilities | | | (311,644) | | (728,276) |
| Total net assets | | | 891,709 | | 1,680,625 |
| Capital and reserves attributable to equity holders of the group | | | | | |
| Share capital | 19 | 225,697 | | 195,363 | |
| Share premium reserve | | 7,418,097 | | 6,271,548 | |
| Warrant reserve | | 252,573 | | 369,459 | |
| Merger difference reserve | | 642,711 | | 642,711 | |
| Foreign exchange reserve | | 49,916 | | (2,673) | |
| Retained earnings | | (7,697,285) | | (5,795,783) | |
| Total Equity | | | 891,709 | | 1,680,625 |

These financial statements were approved by the board of directors and authorised for issue on 29 December 2008 and were signed on its behalf by:

M Martin
Director

Consolidated Cash Flow Statement for the year ended 30 September 2008

| | Year Ended 30 September 2008 £ | Year ended 30 September 2007 £ |
|---|---|---|
| Cash flows from operating activities | | |
| Loss before tax | (2,373,789) | (2,935,269) |
| Adjustments for: | | |
| Depreciation | 10,052 | 7,195 |
| Share based payments | - | 47,000 |
| Share of losses of joint venture | 36,155 | 42,850 |
| Finance Income | (34,745) | (87,240) |
| Finance cost | 4,209 | 3,633 |
| Cash flows from operating activities before changes in working capital | (2,358,118) | (2,921,831) |
| Decrease/(Increase) in other receivables | 262,053 | (71,271) |
| (Decrease)/Increase in trade and other payables | (73,270) | 173,502 |
| Decrease in provisions | (343,366) | (27,817) |
| Cash used in operations | (2,512,701) | (2,847,417) |
| Income tax received | 324,860 | - |
| Net cash used in operating activities | (2,187,841) | (2,847,417) |
| Investing activities | | |
| Purchase of plant and equipment | (6,136) | (15,972) |
| Investment in joint ventures | - | (592,561) |
| Interest received | 34,746 | 87,240 |
| Cash used in investing activities | 28,610 | (521,293) |
| Financing activities | | |
| Issue of ordinary shares | 1,213,370 | 3,033,445 |
| Share issue costs | (100,800) | (212,388) |
| Interest paid | (4,209) | (3,633) |
| Cash generated by financing activities | 1,108,361 | 2,817,424 |
| Decrease in cash and cash equivalents | (1,050,870) | (551,286) |
| Cash and cash equivalents at beginning of period | 1,426,681 | 1,977,967 |
| Cash and cash equivalents at end of period | 375,811 | 1,426,681 |

Notes forming part of the financial statements for the year ended 30 September 2008

1 Basis of preparation

The principal accounting policies adopted in the preparation of the financial statements are set out below. The policies have been consistently applied to all years presented, unless otherwise stated.

The financial information has been prepared on the historical cost basis or fair value as appropriate.

These financial statements have been published in accordance with International Financial Reporting Standards (IFRS and IFRIC interpretation) published by the International Accounting Standards Board (IASB) as adopted by the European Union ("EU adopted IFRS") and with those parts of the Companies Act 1985 applicable to companies preparing its financial statements in accordance with IFRS. This is the first time the group has prepared its financial statements in accordance with IFRS, having previously prepared its financial statements in accordance with UK GAAP. Details of how the transition from UK accounting standards to EU adopted IFRS has affected the group's reported financial position, financial performance and cash flows are given in Note 4. The company has elected to prepare its financial statements in accordance with UK GAAP.

Going concern

Further information on future trading and liquidity risk is included in the Chairman's Statement. Based on their current expectations of the intentions and support of key investors in the Company the directors have a reasonable expectation that the Group will be able to raise additional funding in the share issue planned for January 2009. Based on their current expectations of the progress of product development the directors have a reasonable expectation that revenue will be generated in line with the forecasts during this year and will be available to underpin the cash flows of the Group. In the event that this revenue is not generated the directors consider it likely that additional funding can be raised from shareholders at an appropriate time in 2009. Based on their expectations of their ability to manage the payments of the Group and the expected receipt of funds from the Revenue in respect of the research and development tax credits, the directors consider that the cash flows can be managed in a way that maintains the Group in a cash positive position in the period through to the share issue. On these bases the directors consider that the Group will have adequate funding resources to continue in operational existence for the foreseeable future.

Accordingly the directors continue to adopt the going concern basis in preparing the annual report and accounts.

2 Basis of accounting

The preparation of the consolidated financial statements in accordance with IFRS resulted in changes to the accounting policies compared with the most recent Group financial statements prepared under UK GAAP. The accounting policies are set out below, and have been applied to all periods presented in these Group financial statements and are in accordance with IFRS, as adopted by the European Union, and International Financial Interpretations Committee ("IFRIC") interpretations that were applicable for the year ended 30 September 2008.

The Group has elected to make use of the exemptions available in IFRS 1 as follows:

- IFRS 2 'Share-based Payments' has been applied to all grants of equity instruments after 7 November 2002 that were unvested at 1 October 2006.
- IFRS 3 'Business Combinations' has not been applied retrospectively to business combinations that occurred before 1 October 2006.

The following are standards, interpretations and amendments to published statements not yet effective:

- IFRS 8 "Operating segments", effective for periods beginning on or after 1 January 2009;
- IFRS 3 (Revised 2008) "Business combinations" and complementary amendments to IAS 27, "Consolidated and Separate Financial Statements", both effective for periods beginning on or after 1 July 2009*;
- Amendment to IFRS 2 "Share Based Payment" - Vesting Conditions and Cancellations", effective for Annual periods beginning on or after 1 January 2009;
- IFRIC 12, "Service Concession Arrangements" effective for periods beginning on or after 1 January 2008*;
- IFRIC 13, "Customer Loyalty Programmes" effective for periods beginning on or after 1 July 2008*;
- IFRIC 14, IAS 19, "The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction" effective for periods beginning on or after 1 January 2008*;
- IFRIC 15 "Agreements for the Construction of Real Estate" Annual periods beginning on or after 1 January 2009*;
- IFRIC 16 "Hedges of a Net Investment in a Foreign Operation" Annual periods beginning on or after 1 October 2008*;
- IFRIC 17 "Distributions of Non-cash Assets to Owners" Annual periods beginning on or after 1 July 2009*;
- IAS 1 (Revised 2007), "Presentation of Financial Statements – a revised approach", effective for periods beginning on or after 1 January 2009*;
- Improvements to IFRS, effective for annual periods beginning on or after 1 January 2009*;
- Amendment to IAS 23 "Borrowing Costs" Annual periods beginning on or after 1 January 2009*;
- Amendments to IAS 32 "Financial Instruments: Presentation" and IAS 1 "Presentation of Financial Statements" – Puttable Financial Instruments and Obligations Arising on Liquidation" effective for periods beginning on or after 1 January 2009*;
- Amendment to IAS 39 "Financial Instruments: Recognition and Measurement" – Eligible Hedged Items, effective for annual periods beginning on or after 1 July 2009*.

* not yet endorsed for use in the European Union.

Notes forming part of the financial statements for the year ended 30 September 2008

2. Basis of accounting (continued)

IAS 1 (Revised 2007) will require a change to how the Group Income Statement is presented by the inclusion of a Statement of Comprehensive Income which includes items taken directly to equity (with the exception of transactions with the shareholders of the Group). This new presentation will either be in terms of one single Statement of Comprehensive Income, or as two separate statements comprising a Group Income Statement, which is currently presented, and a further Statement of Comprehensive Income which incorporates only those items to be taken directly to equity.

The Directors do not anticipate that the adoption of the other standards and interpretations listed above will have a material impact on the Group's financial statements in the period of initial application on the basis that they do not impact upon the Group's current activities.

2.1 Basis of consolidation

Where the Company has the power, either directly or indirectly, to govern the financial and operating policies of another entity or business so as to obtain benefits from its activities, it is classified as a subsidiary. The consolidated financial information presents the results of the Company and its subsidiaries Phynova Limited and Phynova China Limited as if they formed a single entity ("the Group"). Inter company transactions and balances between the Group companies are therefore eliminated in full.

2.2 Leased assets

Operating lease rentals are charged to the income statement on a straight line basis over the lease term.

2.3 Intangible assets

Research and development

Expenditure on pure and applied research and development is charged to profit and loss in the year which it occurs.

Internally generated intangible assets (research and development costs)

Expenditure on internally developed products is capitalised if it can be demonstrated that:

- it is technically feasible to develop the product for it to be sold;
- adequate resources are available to complete the development;
- there is an intention to complete and sell the product;
- the group is able to sell the product;
- sale of the product will generate future economic benefits; and
- expenditure on the project can be measured reliably.

Capitalised development costs are amortised over the periods the group expects to benefit from selling the products developed. The amortisation expense would be included within the cost of administrative expenses, in the consolidated income statement. At this stage of product development no research and development expenditure has been capitalised.

Development expenditure not satisfying the above criteria and expenditure on the research phase of internal projects are recognised in the consolidated income statement as incurred.

Patents and trademarks

All expenditure is currently expensed in the period in which it is incurred. The Group currently has no qualifying expenditure for capitalisation.

2.4 Plant and equipment

Plant and equipment are stated at cost less accumulated depreciation and any accumulated impairment losses. Cost includes expenditure that is directly attributable to the acquisition of the items. Depreciation is charged to the income statement on all plant and equipment at rates calculated to write off the cost or valuation, less estimated residual value, of each asset on a straight line basis over the estimated useful lives, which is three years for plant and equipment and three years for furniture and fittings.

The assets' residual values and useful lives are determined by the Directors and reviewed and adjusted if appropriate at each balance sheet date in accordance with Group policy for impairment of assets (note 2.5).

Notes forming part of the financial statements for the year ended 30 September 2008

2 Basis of accounting (continued)

2.5 Impairment of assets

Assets that have a finite useful life and are not yet in use and are not subject to amortisation are tested annually for impairment.

Assets that are subject to amortisation are reviewed for impairment annually and when events or circumstances suggest 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.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units).

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised immediately in the income statement, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

When an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior periods. A reversal of an impairment loss is recognised immediately in the income statement, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

2.6 Taxation

Deferred tax assets and liabilities are recognised where the carrying amount of an asset or liability in the balance sheet differs to its base, except for differences arising on:

- The initial recognition of goodwill;
- Goodwill for which amortisation is not tax deductible;
- The initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction affects neither accounting or taxable profit; and
- Investments in subsidiaries and jointly controlled entities where the Group is able to control the timing of the reversal of the difference and it is probable that the difference will not reverse in the foreseeable future.

Recognition of deferred tax assets is restricted to those instances where it is probable that taxable profit will be available against which the difference can be utilised.

The amount of the asset or liability is determined using tax rates that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the deferred tax liabilities / (assets) are settled / (recovered). Deferred tax balances are not discounted.

Deferred tax assets and liabilities are offset when the Group has a legally enforceable right to offset current tax assets and liabilities and the deferred tax assets and liabilities relate to taxes levied by the same tax authority on either:

- The same taxable group company; or
- Different group entities which intend to settle current tax assets and liabilities on a net basis, or to realise the assets and settle the liabilities simultaneously, on each future period in which significant amounts of deferred tax assets or liabilities are expected to be settled or recovered.

Income tax is provided at amounts expected to be recovered or to be paid using the tax rates and tax laws that have been enacted or substantially enacted at the balance sheet date. When research and development tax credits are claimed they are recognised on an accrual basis and are included as a taxation credit.

2.7 Foreign currency translation

The financial statements for 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 information is presented in sterling, which is the Group's functional currency and presentation currency.

Foreign currency transactions are translated into the functional currency using the exchange rate prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

On consolidation, the results of overseas operations are translated into sterling at rates approximating to those ruling when the transactions took place. All assets and liabilities of overseas operations, including goodwill arising on the acquisition of those operations, are translated at the rate ruling at the balance sheet date. Exchange differences arising on translating the opening net assets at opening rate and the results of overseas operations at actual rate are recognised directly in equity (the "foreign exchange reserve").

Notes forming part of the financial statements for the year ended 30 September 2008

2 Basis of accounting (continued)

On disposal of a foreign operation, the cumulative exchange differences recognised in the foreign exchange reserve relating to that operation up to the date of disposal are transferred to the consolidated income statement as part of the profit or loss on disposal.

2.8 Share-based payments

Where share options are awarded to employees, the fair value of the options at the date of grant is charged to the income statement over the vesting period. Non-market vesting conditions are taken into account by adjusting the number of equity instruments expected to vest at each balance sheet date so that, ultimately, the cumulative amount recognised over the vesting period is based on the number of options that eventually vest. Market vesting conditions are factored into the fair value of the options granted. As long as all other vesting conditions are satisfied, a charge is made irrespective of whether the market vesting conditions are satisfied. The cumulative expense is not adjusted for failure to achieve a market vesting condition.

Where the terms and conditions of options are modified before they vest, the increase in fair value of the options, measured immediately before and after the modification, is also charged to the income statement over the remaining vesting period.

Where equity instruments are granted to persons other than employees, the income statement is charged with the fair value of goods and services received.

2.9 National insurance on share options

To the extent that the share price at the balance sheet date is greater than the exercise price on options granted under unapproved schemes, provision for any National Insurance contributions has been made based on the prevailing rate of National Insurance. The provision is accrued over the performance period attaching to the award.

2.10 Joint ventures

An entity is treated as a joint venture where the group holds a long-term interest and shares control under a contractual agreement.

In the group financial statements, interests in joint ventures are accounted for using the equity method of accounting whereby the Consolidated Balance Sheet incorporates the group's share of the net assets of the joint venture. The group income statement incorporates the group's share of the joint ventures profits after tax.

2.11 Financial assets

The group classifies its financial assets in the category of loans and receivables. They are recognised initially at fair value and subsequently at amortised cost using the effective interest rate method.

The Group's loans and receivables comprise trade and other receivables and cash and cash equivalents in the balance sheet.

The group assesses at each balance sheet date whether there is objective evidence that a financial asset is impaired.

2.12 Other receivables

Trade and other receivables are initially recognised at fair value and thereafter at amortised cost using the effective interest rate method. Impairment provisions are recognised when there is objective evidence that the group will be unable to collect all of the amounts due. The Group assesses for impairment at each balance sheet date. If an impairment provision is required, such provisions are recorded in a separate allowance account with the loss being recognised within administrative expenses.

2.13 Cash and cash equivalents

Cash and cash equivalents includes deposits on call with banks and other short term highly liquid investments with original maturities of three months or less.

2.14 Financial liabilities

The group classifies its financial liabilities into one of two categories, depending on the purpose for which the liability was acquired.

Other financial liabilities include the trade payables and other short-term monetary liabilities, which are initially recognised at fair value and subsequently carried at amortised cost using the effective interest method.

2.15 Share capital

Financial instruments issued by the Group are treated as equity only to the extent that they do not meet the definition of a financial liability. The Group's ordinary shares are classified as equity instruments.

2.16 Provisions

Provisions are recognised for liabilities of uncertain timing or amount that have arisen as a result of past transactions and are discounted at a pre-tax rate reflecting current market assessments of the time value of money and the risks specific to the liability.

Notes forming part of the financial statements for the year ended 30 September 2008

2 Basis of accounting (continued)

2.17 Simultaneous Issue of Shares and Warrants

Where shares and warrants are issued simultaneously and the warrants can be transferred, cancelled or redeemed independently of the shares, and the related proceeds are apportioned to the shares and warrants. This apportionment is based upon the fair value of the warrants at the date of issue. The proceeds allocated to the warrants are credited to a warrant reserve. On the exercise of the warrants a transfer is made from the warrant reserve to the share premium account.

2.18 Critical accounting estimates and judgements

The preparation of the Consolidated Financial Statements requires the Group to make estimates and judgements that affect the reported amounts. The Group bases its estimates and judgements on past experience, other assumptions and available information. Actual results may differ from these estimates under different assumptions and conditions.

Impairment

The group regularly reviews the carrying values of assets. Certain assets held by the group require judgement in order to confirm the carrying values do not require impairment. Included within these assets are the value shown in the group accounts in respect of the investment in the joint venture. In assessing the carrying value of this asset the group has considered the potential of the future commercial sale of products in the joint venture. The group considers that these future sales will generate the required net present value of cash flows to support the recorded values for these assets. The group has prepared detailed cash flow forecasts through to 2012 which fully support the carrying value of the asset using an appropriate discount factor providing sales are generated as expected. On this basis the group concluded that no impairment to this asset is required.

Share-based payments

Incentives in the form of shares are provided to employees under share options. The fair value of the shares at the date of grant is charged to the Income Statement. The charge is based on a number of assumptions. The selection of different assumptions could affect the future results of the Group.

3 Segment reporting

The group is organised and operates as one business unit being pharmaceutical drug development. The principal activity of the Group is the research and development of drugs and their commercial out licence. The main area of research and development continues to be the development of prescription pharmaceuticals derived from plants used in Chinese medicines.

The Group operates in and manages any overseas research and development from the UK. The group has operations in China. Segmental information has not been provided in respect of this on the basis that the operations are contained within the Joint Venture, which is clearly evidenced from the consolidated income statement, consolidated balance sheet and disclosures made in note 12 to the financial statements, all other operations are based in the UK. Since there is currently only one primary segment and one geographical segment, no separate segment reporting has been prepared.

4 Explanation of transition to IFRS

This is the first year that the Group has presented its full financial information under IFRS. The transition to IFRS has had no impact on the Group cash flow statement, other than on the layout. The last financial statements under UK GAAP were for the year ended 30 September 2007 and the date of full transition to IFRS was therefore 1 October 2006. The following disclosures are required in the year of transition.

Reconciliation of Group equity at 1 October 2006 (date of transition to IFRS)

| | Note | UK GAAP £'000 | Effect of IFRS Restatement £'000 | IFRS As restated £'000 |
|-----------------------------|------|------------------|--|------------------------------|
| Plant and equipment | | 8 | | 8 |
| Trade and other receivables | | 254 | | 254 |
| Cash and cash equivalents | | 1,978 | | 1,978 |
| Total assets | | 2,240 | | 2,240 |
| Trade and other payables | (i) | (207) | (5) | (212) |
| Provisions | | (371) | (371) | (371) |
| Total net assets | | 1,662 | (5) | 1,657 |
| Share capital | | 148 | | 148 |
| Share premium reserve | | 3,498 | | 3,498 |
| Warrant reserve | | 369 | | 369 |
| Merger difference reserve | | 643 | | 643 |
| Retained earnings | | (2,996) | (5) | (3,001) |
| Total equity | | 1,662 | (5) | 1,657 |

Note (i): Holiday pay provision

IAS 19 'Employee Benefits' requires the creation of an accrued holiday pay provision. This was not required under UK GAAP.

Notes forming part of the financial statements for the year ended 30 September 2008

4 Explanation of transition to IFRS (continued) Reconciliation of Group equity at 30 September 2007

| | Note | UK GAAP £'000 | Effect of IFRS Restatement £'000 | IFRS As restated £'000 |
|------------------------------|-------|------------------|--|------------------------------|
| Plant and equipment | | 16 | | 16 |
| Investment in joint ventures | (ii) | 531 | 16 | 547 |
| Other receivables | | 419 | | 419 |
| Cash and cash equivalents | | 1,427 | | 1,427 |
| Total assets | | 2,393 | | 2,409 |
| Trade and other payables | (i) | (375) | (10) | (385) |
| Provisions | | (343) | | (343) |
| Total net assets | | 1,675 | 6 | 1,681 |
| Share capital | | 195 | | 195 |
| Share premium reserve | | 6,272 | | 6,272 |
| Warrant reserve | | 369 | | 369 |
| Merger difference reserve | | 643 | | 643 |
| Retained earnings | (iii) | (5,804) | 6 | (5,798) |
| Total equity | | 1,675 | | 1,681 |

Note (i): Holiday pay provision

IAS 19 'Employee Benefits' requires the creation of an accrued holiday pay provision. This was not required under UK GAAP.

Note (ii): Goodwill amortisation

Under FRS 9 goodwill arising on associates was subject to amortisation but under IFRS goodwill arising on the associates is not amortised, but instead is subject to annual impairment reviews.

Note (iii): Retained earnings

The impact of (i) is a charge to retained earnings of £10,110 and (ii) is a credit to retained earnings of £15,802 at 30 September 2007. This gives a net credit of £5,692.

Reconciliation of consolidated income statement for year ended 30 September 2007

| | Note | UK GAAP £'000 | Effect of IFRS Restatement £'000 | IFRS As restated £'000 |
|---|------|------------------|--|------------------------------|
| Revenue | | - | - | - |
| Research and development costs | | (1,028) | - | (1,028) |
| Administrative costs | (i) | (1,943) | (5) | (1,948) |
| Group operating loss | | (2,971) | (5) | (2,976) |
| Share of operating loss in Joint ventures | (ii) | (59) | 16 | (43) |
| Finance income | | 84 | - | 84 |
| Loss before tax | | (2,946) | 11 | (2,935) |
| Taxation | | 93 | - | 93 |
| Loss for the period attributable to equity holders of the company | | (2,853) | 11 | (2,842) |

Note (i): Holiday pay provision

IAS 19 'Employee Benefits' requires the creation of an accrued holiday pay provision. This was not required under UK GAAP.

Note (ii): Goodwill amortisation

Under FRS 9 goodwill arising on associates was subject to amortisation but under IFRS goodwill arising on the associates is not amortised, but instead is subject to annual impairment reviews.

Notes forming part of the financial statements for the year ended 30 September 2008

5 Loss per share

The calculation of the basic and diluted loss per share is based on the loss on ordinary activities after tax and on the weighted average number of ordinary shares in issue during the period. The loss and weighted average number of shares used in the calculation are set out below:

| Basic and diluted loss per share | Loss £ | Weighted average number of shares | Loss per share pence |
|--|--------------------|--------------------------------------|-------------------------|
| 12 months ended 30 September 2008 | (1,954,073) | 20,978,516 | (9.3) |
| 12 months ended 30 September 2007 | (2,842,125) | 18,855,303 | (15.1) |

At 30 September 2008, the Company had 3,652,964 share options and warrants outstanding (2007 – 5,690,920). The share options have not been included in the calculation of the diluted loss per share as they would dilute a loss per share and therefore 'antidilutive' under IAS33 "Earnings Per Share".

6 Operating loss

| | Year ended 30 September 2008 £ | Year ended 30 September 2007 £ |
|--|---|---|
| Operating loss is stated after charging: | | |
| Research and development – current period's expenditure | 682,760 | 1,027,506 |
| Depreciation of plant and equipment | 10,052 | 7,195 |
| Hire of other assets – operating leases - land and buildings | 37,973 | 36,165 |
| Realised exchange losses | - | (14,965) |
| Audit of the company's annual accounts pursuant to legislation | 22,000 | 19,300 |
| Other services relating to tax | | |
| Other services | | |
| Audit of company's subsidiary undertakings pursuant to legislation | 5,000 | 5,000 |
| Other services relating to tax | 3,900 | 3,750 |
| Other services relating to Corporate finance | 45,000 | 10,500 |

7 Staff numbers and costs

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

| | 2008 £ | 2007 £ |
|----------------|-----------|-----------|
| Directors | 5 | 3 |
| Scientists | 4 | 4 |
| Administration | 2 | 1 |
| | 11 | 8 |

The aggregate payroll costs of these persons were as follows:

| | 2008 £ | 2007 £ |
|--------------------------------------|----------------|----------------|
| Wages and salaries | 886,910 | 813,891 |
| Social security costs | 104,134 | 98,359 |
| Total cash settled emoluments | 991,044 | 912,140 |
| Share based payment | - | 47,000 |
| | 991,044 | 949,140 |

Notes forming part of the financial statements for the year ended 30 September 2008

8 Directors' remuneration

| | 2008 £ | 2007 £ |
|-----------------------|----------------|-----------|
| Directors' emoluments | 501,627 | 611,435 |

The highest paid director received emoluments of £170,000 (2007: £167,400) excluding pension contributions of £nil (2007: £nil).

Details of consultancy services provided by entities in which any director holds an interest are disclosed in note 22. Included in the above amount is £30,627 (2007: £26,000), which has been paid to third party companies, which the directors control, for the services of those directors. Non consultancy payments of £16,972 (2007: £43,815) were also made.

A further amount of £117,500 (2007: £164,250) has been paid to third parties in respect of directors' qualifying services.

During the year Directors exercised share options realising gains of £nil (2007: £1,184).

A share based payment charge in respect of key management personnel of £nil (2007 : £47,000) was charged to the accounts.

9 Taxation

| | Year ended 30 September 2008 £ | Year ended 30 September 2007 £ |
|--|---|---|
| Research and development tax credit – Current year | (188,000) | |
| Research and development tax credit – Prior year | (231,716) | (93,144) |
| Total income tax expense | (419,716) | (93,144) |

In previous years the research and development credit was recognised on a received basis but for 2008 has been recognised on an accrued basis and is also recorded within debtors.

The tax assessed for the year is different than the standard rate of corporation tax in the UK. The differences are explained below:

| | 2008 £ | 2007 £ |
|--|--------------------|-------------|
| Loss on ordinary activities before tax | (2,373,789) | (2,909,280) |
| Loss on ordinary activities at the standard rate of corporation tax in the UK of 29% (2007: 30%) | (688,399) | (872,784) |
| Expenses not deductible for tax purposes | 55,113 | 2,217 |
| Prior year adjustment | (231,716) | (93,144) |
| Additional deduction for research and development expenditure | (123,076) | (181,737) |
| Research and development tax credit receivable | (188,000) | - |
| Unrelieved tax losses | 395,584 | 1,052,304 |
| Losses surrendered for tax credit | 350,293 | - |
| Loss in joint venture | 10,485 | - |
| Total Taxation | (419,716) | (93,144) |

There is no deferred tax in either the current or prior period.

The directors are not aware of any factors which may affect future tax charges.

The group has tax losses of approximately £5,925,000 (2007: £4,557,847) to carry forward against profits of the same trade. The related deferred tax asset of £1.7m has not been recognised on the basis that its future economic benefit is not certain.

Notes forming part of the financial statements for the year ended 30 September 2008

10 Finance income and costs

| | 2008 £ | 2007 £ |
|--------------------------------------|-----------|-----------|
| Bank borrowings | (4,209) | (3,633) |
| Interest receivable on bank deposits | 34,746 | 87,240 |
| Net Finance Income | 30,537 | 83,607 |

11 Plant and equipment

| Group | Fixtures and fittings £ | Office equipment £ | Scientific equipment £ | Total £ |
|--|-------------------------------|--------------------------|------------------------------|---------------|
| Cost | | | | |
| At 30 September 2007 | 12,587 | 16,829 | 695 | 30,111 |
| Additions | 2,875 | 3,261 | - | 6,136 |
| At 30 September 2008 | 15,462 | 20,090 | 695 | 36,247 |
| Depreciation | | | | |
| At 30 September 2007 | 3,851 | 9,198 | 695 | 13,744 |
| Charge for the year | 4,734 | 5,318 | - | 10,052 |
| At 30 September 2008 | 8,585 | 14,516 | 695 | 23,796 |
| Net book value At 30 September 2008 | 6,877 | 5,574 | - | 12,451 |
| At 30 September 2007 | 8,736 | 7,631 | - | 16,367 |
| Cost | | | | |
| At 30 September 2006 | 2,568 | 10,876 | 695 | 14,139 |
| Additions | 10,019 | 6,378 | - | 16,397 |
| Disposals | - | (425) | - | (425) |
| At 30 September 2007 | 12,587 | 16,829 | 695 | 30,111 |
| Depreciation | | | | |
| At 30 September 2006 | 1,118 | 4,871 | 560 | 6,549 |
| Charge for the year | 2,733 | 4,327 | 135 | 7,195 |
| At 30 September 2007 | 3,851 | 9,198 | 695 | 13,744 |
| Net book value At 30 September 2007 | 8,736 | 7,631 | - | 16,367 |
| At 30 September 2006 | 1,450 | 6,005 | 135 | 7,590 |

Notes forming part of the financial statements for the year ended 30 September 2008

12 Investments in joint venture

| | Joint Venture £ |
|-------------------------------------|--------------------|
| Balance at 1 October 2006 | - |
| Additions | 592,561 |
| Share of loss of Joint venture | (42,850) |
| Exchange translation differences | (2,673) |
| Balance at 30 September 2007 | 547,038 |
| Share of loss of Joint venture | (36,154) |
| Exchange translation differences | 52,589 |
| Balance at 30 September 2008 | 563,473 |

The following entity meets the definition of a joint venture and have been equity accounted in the consolidated financial statements:

| Name | Country of Incorporation | Proportion of voting rights held at 30 September | |
|---------------------------------|-----------------------------|---|------|
| | | 2008 | 2007 |
| Botanic Century Beijing. Co Ltd | China | 45% | 45% |

Aggregated amounts relating to the joint venture are as follows:

| | 2008 £ | 2007 £ |
|------------------------------|-----------|-----------|
| Total assets | 491,225 | 517,141 |
| Total liabilities | 50,750 | 81,660 |
| Revenues | 21,955 | 5,846 |
| Profit/(Loss) | (36,154) | (42,850) |
| Unrecognised share of losses | | |
| - arising during the year | (44,189) | (52,370) |
| - in aggregate | (96,559) | (52,370) |

13 Subsidiaries

The principal subsidiaries of Phynova Group PLC, all of which have been included in these consolidated financial statements, are as follows:

| Name | Country of Incorporation | Proportion of ownership interest | Nature of business |
|-----------------------|-----------------------------|--|-----------------------|
| Phynova Limited | England | 100% | Drug development |
| Phynova China Limited | Hong Kong | 100% | Holding Company |

14 Operating lease commitments

The Group's total commitments under non-cancellable operating leases are as follows:

| | 2008 £ | 2007 £ |
|---|---------------|---------------|
| Expiring: | | |
| Within one year | 37,973 | 37,973 |
| Later than one year and not later than five years | - | 37,973 |
| | 37,973 | 75,946 |

Notes forming part of the financial statements for the year ended 30 September 2008

15 Financial instruments by category

The accounting policies for financial instruments have been applied to the line items below:

| | 2008 £ | 2007 £ |
|---|----------------|------------------|
| Assets as per balance sheet Receivables and cash under amortised cost | | |
| Other receivables | 1,307 | 22,353 |
| Cash and cash equivalents | 375,811 | 1,426,681 |
| Total Receivables and cash | 550,792 | 1,622,562 |
| Liabilities under amortised cost as per balance sheet Total trade and other payables | 261,667 | 346,720 |

Cash and cash equivalents are held at a financial institution with a suitable credit rating. The carrying value of cash is equal to the fair value.

16 Other receivables

| | 2008 £ | 2007 £ |
|-------------------------------|----------------|----------------|
| Corporation tax debtor | 188,000 | 93,144 |
| Other debtors and prepayments | 63,618 | 325,671 |
| | 251,618 | 418,815 |

17 Trade and other payables

| | 2008 £ | 2007 £ |
|---------------------------------|----------------|----------------|
| Trade payables | 160,699 | 278,689 |
| Social security and other taxes | 49,977 | 38,190 |
| Accruals and deferred income | 100,968 | 68,031 |
| | 311,644 | 384,910 |

Trade payables fall due for payment in line with contractual obligations agreed, which would normally be a maximum of 3 months.

18 Provision

| | Taxation and social security provisions £ | National Insurance on share options £ | Total £ |
|-------------------------------------|--|--|------------|
| Balance at 1 October 2007 | 343,175 | 191 | 343,366 |
| Released to the income statement | (343,175) | (191) | (343,366) |
| Balance at 30 September 2008 | - | - | - |

In prior years the Group made provision for certain employment matters. The Directors believe that this provision is no longer required and has been released to the income statement.

Notes forming part of the financial statements for the year ended 30 September 2008

19 Share capital

Authorised share capital

| | £ | | Number | |
|----------------------------|----------------------|----------------------|----------------------|----------------------|
| | 30 September 2008 | 30 September 2007 | 30 September 2008 | 30 September 2007 |
| Ordinary shares of 1p each | 1,000,000 | 500,000 | 100,000,000 | 50,000,000 |

On the 30 April 2008 the authorised share capital was increased by 50,000,000 ordinary shares of 1p each, ranking equally with the existing share capital of the company.

Allotted, called up and fully paid share capital

| | £ | | Number | |
|----------------------------|----------------------|----------------------|----------------------|----------------------|
| | 30 September 2008 | 30 September 2007 | 30 September 2008 | 30 September 2007 |
| Ordinary shares of 1p each | 225,697 | 195,363 | 22,569,684 | 19,536,258 |

During the year ended 30 September 2007 the company issued shares of £0.01 each as follows:

| | Number | Issue price £ | Ordinary shares of 1p each £ |
|--------------------------------------|-------------------|------------------|---------------------------------------|
| In issue at 30 September 2006 | 14,799,570 | | 147,998 |
| Shares issued on 5 October 2006 | 3,385,999 | 0.75 | 33,859 |
| Shares issued on 19 February 2007 | 652,080 | 0.3657 | 6,520 |
| Shares issued on 17 April 2007 | 698,609 | 0.3657 | 6,986 |
| In issue at 30 September 2007 | 19,536,258 | | 195,363 |

During the year ended 30 September 2008 the company issued shares of £0.01 each as follows:

| | Number | Issue price £ | Ordinary shares of 1p each £ |
|--------------------------------------|-------------------|------------------|---------------------------------------|
| In issue at 30 September 2007 | 19,536,258 | | 195,363 |
| Shares issued on 3 April 2008 | 335,926 | 0.40 | 3,359 |
| Shares issued on 10 April 2008 | 2,520,000 | 0.40 | 25,200 |
| Shares issued on 14 April 2008 | 177,500 | 0.40 | 1,775 |
| In issue at 30 September 2008 | 22,569,684 | | 225,697 |

Notes forming part of the financial statements for the year ended 30 September 2008

20 At 30 September 2008, the following share options were outstanding in respect of the ordinary shares

| Date of grant | Number of warrants | Number of options | Period of option | Price per share |
|-------------------|--------------------|-------------------|---------------------------------|-----------------|
| 31 March 2005 | - | 70,000 | March 2005 – March 2010 | 50p |
| 22 September 2005 | 20,926 | - | September 2005 – September 2010 | 50p |
| 30 September 2005 | - | 60,000 | September 2005 – September 2010 | 50p |
| 9 December 2005 | 1,200,000 | - | December 2005 – December 2008 | 50p |
| 24 January 2006 | 983,000 | 136,750 | January 2006 – January 2009 | 50p |
| 13 February 2006 | - | 50,000 | February 2006 – February 2009 | 50p |
| 27 February 2006 | - | 877,163 | February 2006 – February 2009 | 60p |
| 27 March 2008 | - | 3,125 | March 2008 – March 2011 | 40p |
| 27 March 2008 | - | 252,000 | March 2008 – March 2013 | 40p |
| | 2,203,926 | 1,449,038 | | |

Of the 5,690,920 options and warrants outstanding at 30 September 2007, 2,293,081 lapsed during the year. Following the grant of a further 255,125 options during the year there were 3,652,964 options and warrants outstanding at 30 September 2008.

On the 27th March 2008, 255,125, unapproved share options were granted to equity fundraisers. The options vested immediately and lapse after 3 years (3,125) and 5 years (252,000). A charge of £52,573 has been made against the share premium account in respect of these options, for which the fair value of the services could not be obtained.

The following information is relevant in the determination of the fair value of the options granted during the year.

| Option pricing model used | Black - Scholes 2008 | Black - Scholes 2007 |
|---|-------------------------|-------------------------|
| Weighted average share price at grant date (pence) | 50 | 73 |
| Exercise price (pence) | 40 | 100 and 150 |
| Risk free rate – Bank of England Base rate | 4.5% per annum | 4.5% per annum |
| Volatility | 25% per annum | 25% per annum |
| Contractual Life (months) | 36 & 60 | 36 |
| Value of the options calculated through Black Scholes | £52,573 | £47,000 |

The exercise price of the options for the purpose of the Black Scholes calculation was 40p. The Black Scholes model calculated the options to have an individual value of 17.1p and 20.6p respectively.

21 Reserves

Group

Share issue expenses amounting to £153,373 have been deducted from the share premium account.

The following describes the nature and purpose of each reserve within owners' equity:

| Reserve | Description and purpose |
|---------------------------|---|
| Share Capital | Amount subscribed for share capital at nominal value |
| Share Premium | Amount subscribed for share capital in excess of nominal value |
| Warrant reserve | Warrants shown at fair value of warrant at issue |
| Merger difference reserve | The merger difference represents the difference between the nominal value of the shares issued to effect the merger over the nominal value of the shares acquired in accordance with the requirements in terms of merger accounting |
| Foreign exchange reserve | Gains/losses arising on retranslating the net assets of overseas operations into sterling |
| Retained earnings | Cumulative net gains and losses recognised in the consolidated income statement |

Notes forming part of the financial statements for the year ended 30 September 2008

22 Related party disclosures

Related party transactions and balances in which certain directors have an interest.

| | Purchases from related party 2008 £ | Purchases from related party 2007 £ | Amounts owed to related party 2008 £ | Amounts owed to related party 2007 £ |
|-------------------------|---|---|--|--|
| Anvil Partners LLP | 122,978 | 110,444 | 20,940 | - |
| Wellbeach Associates | 29,548 | 27,730 | 3,533 | 2,819 |
| Green Atlantic Partners | - | 56,250 | - | - |

- M Martin, a director of both Phynova Group Public Limited Company and Phynova Limited, is a member of Anvil Partners LLP, a limited liability partnership that provides consultancy services to Phynova Group Public Limited Company.
- J Pool, a director of both Phynova Group Public Limited Company and Phynova Limited, has a material interest in Wellbeach Associates, an entity that provides consultancy services to Phynova Group Public Limited Company.
- K. Watkin, a director of Phynova Group Public Limited Company (resigning on the 19th of September 2008), is a member of Green Atlantic Partners, an entity that provides consultancy services to Phynova Group Public Limited Company.

Key management compensation

The Directors' represent the key management personnel. Details of their compensation are given in note 8.

23 Financial risk management

The Group's activities expose it to a variety of financial risks: liquidity risk; credit risk and exchange rate risk.

It is group policy not to enter into speculative positions using complex financial instruments. The Group's principal financial instrument comprises cash, which is used to settle the liabilities from operating activities. Cash is retained in current accounts which earn interest at variable rates. In addition, the Group has other financial instruments that arise from its operations such as trade payables.

Funding and liquidity risk

Liquidity risk arises from the group's management of working capital, it is the risk the group will encounter difficulty in meeting its financial obligations as they fall due. Funding for life science companies in general and for Phynova in particular is currently difficult to obtain due to its financial climate. In order for the Group to continue trading and to fulfil its current development programme over the next twelve months in addition to completing the out-licensing deals referred to below in Commercial risk, further fund raising will be necessary. There is no certainty that Phynova will successfully raise further funding. Further discussion on this matter is included within the Chairman's statement. Regular cash flow forecasts are prepared to help manage the companies liquidity requirements. Forecasts are normally prepared on a quarterly basis or more regular if required. As set out in the Chairman's report, the Directors are greatly encouraged by the commercial discussions underway to license the Company's products under development to pharmaceutical and other partners. However there is no certainty that these discussions will have a successful outcome.

Capital

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern, support the growth of the business and to maintain an optimal capital structure to reduce the cost of capital. Capital is defined as the capital and reserves as shown in the balance sheet as well as cash held by the company.

Exchange risk

The group primarily enters into supplier contracts which are to be settled in sterling. However, some contracts involve other major currencies including US Dollar, the Euro and RMB. The risk from these transactions is not considered material to the group. The group's investment in joint ventures is located in China, therefore exchange rate risk on the value of this investment exists due to changes in the exchange rate. Had the exchange rate appreciated a further 10% the impact would have been to increase the investment by £56k (2007 : £54k) with a corresponding increase to equity.

Credit risk

Credit risk is the risk of financial loss to the group if a counterparty to a financial instrument fails to meet its contractual obligations. As of 30 September 2008, there are no receivables either past due or impaired (2007 - £nil). The Group does not hold any collateral as security and the maximum exposure at the reporting date is the fair value of each class of receivable. Maximum exposure of the group to credit risk is the balance disclosed in note 16 for other receivables.

Phynova Public Limited Company

Individual financial statements

Company Balance Sheet at 30 September 2008

| | Note | Year ended 30 September 2008 | | Year ended 30 September 2007 | |
|---|------|------------------------------------|-------------|------------------------------------|-------------|
| | | £ | £ | £ | £ |
| Fixed assets | | | | | |
| Tangible assets | 5 | | 11,251 | | 12,309 |
| Fixed asset investments | 6 | | 659,866 | | 659,866 |
| | | | 671,117 | | 672,175 |
| Current assets | | | | | |
| Debtors | 7 | 1,676,321 | | 1,604,966 | |
| Cash at bank and in hand | | 352,252 | | 1,403,833 | |
| | | 2,028,573 | | 3,008,799 | |
| Creditors: amounts falling due within one year | 8 | 311,644 | | 356,486 | |
| Net current assets | | | 1,716,929 | | 2,652,313 |
| Total assets less current liabilities | | | 2,192,507 | | 3,324,488 |
| Provisions for liabilities | 9 | | - | | 191 |
| | | | 2,388,046 | | 3,324,297 |
| Capital and reserves | | | | | |
| Called up share capital | 10 | | 225,697 | | 195,363 |
| Share premium account | 11 | | 7,418,097 | | 6,271,548 |
| Warrant Reserve | 11 | | 252,573 | | 369,459 |
| Profit and loss account | 11 | | (5,508,321) | | (3,512,073) |
| Shareholders' funds | 12 | | 2,388,046 | | 3,324,297 |

These financial statements were approved by the board of directors and authorised for issue on 29 December 2008 and were signed on its behalf by:

M Martin
Director

Notes forming part of the financial statements for the year ended 30 September 2008

1 Accounting policies

Basis of preparation

The financial statements have been prepared on the going concern basis (as explained further below), under the historical cost convention and are in accordance with applicable accounting standards

Going concern

Further information on future trading and liquidity risk is included in the Chairman's Statement. Based on their current expectations of the intentions and support of key investors in the Company the directors have a reasonable expectation that the Company will be able to raise additional funding in the share issue planned for January 2009. Based on their current expectations of the progress of product development the directors have a reasonable expectation that revenue will be generated in line with the forecasts during this year and will be available to underpin the cash flows of the Group and Company. In the event that this revenue is not generated the directors consider it likely that additional funding can be raised from shareholders at an appropriate time in 2009. Based on their expectations of their ability to manage the payments of the Group and the expected receipt of funds from the Revenue in respect of the research and development tax credits, the directors consider that the cash flows can be managed in a way that maintains the Group and Company in a cash positive position in the period through to the share issue. On these bases the directors consider that the Group will have adequate funding resources to continue in operational existence for the foreseeable future.

Accordingly the directors continue to adopt the going concern basis in preparing the annual report and accounts.

Research and development

Expenditure on pure and applied research and development is charged to profit and loss in the year which it occurs.

Deferred taxation

Deferred tax balances are recognised in respect of all timing differences that have originated but not reversed by the balance sheet date except that the recognition of deferred tax assets is limited to the extent that the Group anticipates making sufficient taxable profits in the future to absorb the reversal of the underlying timing differences.

Deferred tax balances are not discounted.

Merger accounting

The cost of investment in subsidiary undertakings is stated at cost less provision for impairment.

Where merger relief is taken under s131 Companies Act 1985, the investment is recorded in the Company's balance sheet at the nominal value of the shares issued.

Fixed assets and depreciation

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

| | | |
|-----------------------|---|--------------------------------|
| Fixtures and fittings | - | Over three years straight line |
| Office furniture | - | Over three years straight line |
| Scientific equipment | - | Over three years straight line |

Foreign currencies

Foreign currency transactions of individual companies are translated at the rates ruling when they occurred. Foreign currency monetary assets and liabilities are translated at the rates ruling at the balance sheet dates. Any differences are taken to the profit and loss account.

Financial Instruments

Financial instruments are measured initially and subsequently at cost.

Operating leases

Rental charges for operating leases are charged to the profit and loss account on a straight line basis over the life of the lease.

Turnover

The Company has not yet received or accrued any turnover.

Simultaneous Issue of Shares and Warrants

Where shares and warrants are issued simultaneously and the warrants can be transferred, cancelled or redeemed independently of the shares, then the related proceeds are apportioned to the shares and warrants in accordance with Financial Reporting Standard 4 "Capital Instruments". This apportionment is based upon the fair value of the warrants at the date of issue. The proceeds allocated to the warrants are credited to a warrant reserve. On the exercise of the warrants a transfer is made from the warrant reserve to the share premium account.

Notes forming part of the financial statements for the year ended 30 September 2008

Share based payments

The Company has adopted FRS 20 'Share-based payment' which requires recognition of share-based payments at fair value at the date of grant.

Where share options are awarded to employees, the fair value of the options at the date of grant is charged to the income statement over the vesting period. Non-market vesting conditions are taken into account by adjusting the number of equity instruments expected to vest at each balance sheet date so that, ultimately, the cumulative amount recognised over the vesting period is based on the number of options that eventually vest. Market vesting conditions are factored into the fair value of the options granted. As long as all other vesting conditions are satisfied, a charge is made irrespective of whether the market vesting conditions are satisfied. The cumulative expense is not adjusted for failure to achieve a market vesting condition.

Where the terms and conditions of options are modified before they vest, the increase in the fair value of the options, measured immediately before and after the modification, is also charged to the income statement over the remaining vesting period.

Where equity instruments are granted to persons other than employees, the income statement is charged with the fair value of goods and services received.

National Insurance on Share Options

To the extent that the share price at the balance sheet date is greater than the exercise price on options granted under unapproved schemes, provision for any National Insurance contributions has been made based on the prevailing rate of National Insurance. The provision is accrued over the performance period attaching to the award.

2 Loss for the financial year

The company has taken advantage of the exemption allowed under section 230 of the Companies Act 1985 and has not presented its own profit and loss account in these financial statements. The group loss for the period includes a result after tax and before dividends of £2,048,819 (2007 - £2,714,346) which is dealt with in the financial statements of the parent company. The auditor's remuneration in respect of the company is disclosed in note 6 to the group's financial statements.

3 Staff numbers and costs

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

| | 2008 £ | 2007 £ |
|----------------|-----------|-----------|
| Directors | 5 | 3 |
| Scientists | 4 | 4 |
| Administration | 2 | 1 |
| | 11 | 8 |

The aggregate payroll costs of these persons were as follows:

| | 2008 £ | 2007 £ |
|--------------------------------------|----------------|----------------|
| Wages and salaries | 886,910 | 813,891 |
| Social security costs | 104,134 | 98,359 |
| Total cash settled emoluments | 991,044 | 912,140 |
| Share based payment | - | 47,000 |
| | 991,044 | 959,140 |

4 Directors' remuneration

| | 2008 £ | 2007 £ |
|-----------------------|-----------|-----------|
| Directors' emoluments | 501,627 | 611,435 |

The highest paid director received emoluments of £170,000 (2007: £167,400) excluding pension contributions of £nil (2007: £nil).

Details of consultancy services provided by entities in which any director holds an interest are disclosed in note 22 to the Group financial statements. Included in the above amount is £30,627 (2007: £26,000), which has been paid to third party companies, which the directors control, for the services of those directors. Non consultancy payments of £16,972 (2007: £43,815) were also made.

A further amount of £117,500 (2007: £164,250) has been paid to third parties in respect of directors' qualifying services.

During the year Directors exercised share options realising gains of £nil (2007: £1,184).

Notes forming part of the financial statements for the year ended 30 September 2008

5 Tangible fixed assets

| | Fixtures and fittings £ | Office equipment £ | Total £ |
|-----------------------|-------------------------------|--------------------------|---------------|
| Cost | | | |
| At 30 September 2007 | 10,019 | 6,378 | 16,397 |
| Additions | 2,875 | 3,261 | 6,136 |
| At 30 September 2008 | 12,894 | 9,639 | 22,533 |
| Depreciation | | | |
| At 30 September 2007 | 2,232 | 1,856 | 4,088 |
| Charged for the year | 4,233 | 2,961 | 7,194 |
| At 30 September 2008 | 6,465 | 4,817 | 11,282 |
| Net book value | | | |
| At 30 September 2008 | 6,429 | 4,822 | 11,251 |
| At 30 September 2007 | 7,787 | 4,522 | 12,309 |

6 Investments in subsidiaries

| | Investment in subsidiary undertaking at cost £ | Loans to subsidiary undertakings £ | Total £ |
|---|--|---|------------|
| Cost at 30 September 2007 & 30 September 2008 | 67,305 | 592,561 | 659,866 |

Details of the company's principal undertakings are included in note 13 to the group financial statements. Details of the company's interest in a jointly controlled company (which is held indirectly) is shown in note 12 to the group financial statements.

7 Debtors

| | 2008 £ | 2007 £ |
|-------------------------------------|------------------|------------------|
| Amounts owed by group undertakings | 1,427,164 | 1,359,678 |
| Research and development tax credit | 188,000 | 93,144 |
| Other debtors and prepayments | 61,157 | 152,144 |
| | 1,676,321 | 1,604,966 |

8 Creditors : amounts falling due within one year

| | 2008 £ | 2007 £ |
|---------------------------------|----------------|----------------|
| Trade creditors | 160,699 | 258,960 |
| Social security and other taxes | 49,977 | 38,189 |
| Accruals and deferred income | 100,968 | 59,337 |
| | 311,644 | 356,486 |

9 Provision for liabilities

| | National Insurance on share options £ |
|---|---|
| Balance at 1 October 2007 | 191 |
| Released to profit and loss in the year | (191) |
| Balance at 30 September 2008 | - |

Notes forming part of the financial statements for the year ended 30 September 2008

10 Share capital

Authorised share capital

| | £ | | Number | |
|----------------------------|----------------------|----------------------|----------------------|----------------------|
| | 30 September 2008 | 30 September 2007 | 30 September 2008 | 30 September 2007 |
| Ordinary shares of 1p each | 1,000,000 | 500,000 | 100,000,000 | 50,000,000 |

On the 30 April 2008 the authorised share capital was increased by 50,000,000 ordinary shares of 1p each, ranking equally with the existing share capital of the company.

Allotted, called up and fully paid share capital

| | £ | | Number | |
|----------------------------|----------------------|----------------------|----------------------|----------------------|
| | 30 September 2008 | 30 September 2007 | 30 September 2008 | 30 September 2007 |
| Ordinary shares of 1p each | 225,697 | 195,363 | 22,569,684 | 19,536,258 |

11 Reserves

| | Share premium account £ | Warrant reserve £ | Retained losses £ | Total £ |
|--|----------------------------------|-------------------------|-------------------------|-------------|
| At 30 September 2007 | 6,271,548 | 369,459 | (3,512,073) | 3,128,934 |
| Premium on shares issued during the period (less expenses) | 1,183,036 | - | - | 1,183,036 |
| Issue costs | (153,373) | - | 52,571 | (100,802) |
| Warrant reserve transfer | 116,886 | (116,886) | - | - |
| Loss for year | - | - | (2,048,819) | (2,048,819) |
| At 30 September 2008 | 7,418,097 | 252,573 | (5,508,321) | 2,162,349 |

12 Reconciliation of movements in shareholders' funds

| | 2008 £ | 2007 £ |
|---|-------------|-------------|
| Loss for the period | (2,048,819) | (2,761,346) |
| Issue of Shares | 30,334 | 47,367 |
| Premium on shares issued during the period (net of issue costs) | 1,082,234 | 2,773,692 |
| Share based payments charge | - | 47,000 |
| Net (deductions from) / additions to shareholders' funds | (936,251) | 106,713 |
| Opening shareholders' funds | 3,324,297 | 3,217,586 |
| Closing shareholders' funds | 2,388,046 | 3,324,297 |

13 Share options

Details are given in note 20 to the consolidated financial statements.

14 Related party transactions

Details are given in note 22 to the consolidated financial statements.

Company information

Directors

The directors who held office during the year were as follows:

| | |
|------------|---|
| J Pool | (appointed as Executive Chairman on the 19th September 2008, Non Executive Director from 24th February 2005) |
| R Miller | |
| M Martin | (appointed as executive Chief Finance Officer on the 19th September 2008, Non Executive Director from 11th August 2004) |
| T Mills | (appointed 19th September 2008) |
| S Harris | (Non Executive, appointed 19th September 2008) |
| J Li | (Non Executive, appointed 19th September 2008) |
| S Marshall | (resigned from the board on the 19th September 2008) |
| E Blair | (resigned from the board on the 19th September 2008) |
| A Brown | (resigned from the board on the 19th September 2008) |
| W Doyle | (Non Executive, resigned from the board on the 19th September 2008) |
| K Watkin | (Non Executive, resigned from the board on the 19th September 2008) |

Secretary and registered office

Michael Martin, 16 Fenlock Court,
Blenheim Office Park, Long Hanborough,
Oxfordshire, OX29 8LN

Company Number

5202283

Independent Auditors

BDO Stoy Hayward LLP,
125 Colmore Row,
Birmingham, B3 3SD

Principal trading address

Phynova House, 16 Fenlock Court,
Blenheim Office Park, Long Hanborough,
Oxfordshire, OX29 8LN