Vernalis Research Limited
(Registered Number 3070163)
Annual Report
for the year ended 31 December 2003

Vernalis Research Limited

Annual report
for the year ended 31 December 2003

Directors' report for the year ended 31 December 2003

The directors present their report and the audited financial statements of the Company for the year ended 31 December 2003.

Principal activity

The principal trading activity of the Company is the research and development of pharmaceutical products and their subsequent licensing, production, distribution and sale, together with any ancillary operations that enhance directly or indirectly such products and activities.

Review of business and future developments

The profit and loss account for the year is set out on page 4.

The directors are satisfied with the performance of the Company in the period and the balance sheet position and expect the current level of activity to continue for the foreseeable future.

Results and dividends

The loss for the year amounted to £5,650,000 (2002: £7,652,000) and has been deducted from reserves. The directors do not recommend payment of a dividend (2002: £Nil).

Directors

The directors of the Company at 31 December 2003, all of whom have been directors for the whole of the year ended on that date and to the date of signing, are listed below:

Dr C T Dourish	(Resigned 4 September 2003)
Dr J B Hutchison	
Mr R G Mansfield	(Resigned 20 March 2003)
Mr R J Robinski	(Resigned 28 February 2003)
Mr P B Worrall	
Mr A J Weir	(Appointed 4 September 2003)

Directors' interests

None of the directors at 31 December 2003 had any interest in shares of the Company. All the directors at the year end, except for C T Dourish, are directors of Vernalis plc, the ultimate parent company. Their interests in the shares of that company are disclosed in the financial statements of that company.

Research and development

During the period the Company spent £6,558,000 (2002: £9,577,000) on research and development.

Charitable and political donations

The Company made donations to charities amounting to £3,700 (2002: £4,105). No contributions were made to political organisations (2002: £nil).

Statement of directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the company and the group and of the profit or loss of the group for that period. The directors are required to prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the company will continue in business (see note 1).

The directors confirm that suitable accounting policies have been used and applied consistently. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the year ended 31 December 2003 and that applicable accounting standards have been followed.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and the group and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Auditors

A resolution to reappoint PricewaterhouseCoopers LLP as auditors to the Company will be proposed at the Annual General Meeting.

By order of the board

PB Worrall
Company Secretary
17 September 2004

Independent auditors' report to the members of Vernalis Research Limited

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

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities.

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

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

Basis of audit opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs at 31 December 2003 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
17 September 2004

Profit and loss account for the year ended 31 December 2003

	Note	2003 £'000	2002 £'000
Turnover	2	**1,855**	2,553
Gross profit		**1,855**	2,553
Research and development expenditure		**(6,558)**	(9,577)
Administrative expenditure		**(2,083)**	(1,132)
Other operating (expenses)		**-**	(36)
Operating loss	5	**(6,786)**	(8,192)
Interest receivable and similar income		**1**	2
Interest payable and similar charges	6	**(63)**	(461)
Loss on ordinary activities before taxation		**(6,848)**	(8,651)
Tax on loss on ordinary activities	7	**1,198**	999
Loss for the financial year	14	**(5,650)**	(7,652)

The results for the periods above are derived entirely from continuing activities.

The Company has no recognised gains and losses other than the results above and therefore no separate statement of total recognised gains and losses has been presented.

There is no material difference between the loss on ordinary activities before taxation and the loss for the financial year stated above, and their historical cost equivalents.

Balance sheet as at 31 December 2003

	Note	2003 £'000	2002 £'000
Fixed assets			
Tangible assets	8	**1,348**	1,735
		1,348	1,735
Current assets			
Debtors	9	**2,596**	1,491
Cash at bank and in hand		**748**	1
		3,344	1,492
Creditors – Amounts falling due within one year	10	**(28,594)**	(21,977)
Net current liabilities		**(25,250)**	(20,485)
Total assets less current liabilities		**(23,902)**	(18,750)
Creditors – Amounts falling due after more than one year	11	**(11,156)**	(11,261)
Provisions for liabilities and charges	12	**(603)**	-
Net liabilities		**(35,661)**	(30,011)
Capital and reserves			
Called up share capital	14	**1,839**	1,839
Share premium account	15	**24,293**	24,293
Capital contribution	15	**1,600**	1,600
Profit and loss account	15	**(63,393)**	(57,743)
Total equity shareholders' deficit	16	**(35,661)**	(30,011)

The financial statements on pages 4 to 14 were approved by the board of directors on 17 September 2004 and were signed on its behalf by:

P B Worrall
Director

The notes on pages 6 to 14 form part of these financial statements.

Notes to the financial statements for the year ended 31 December 2003

1 Accounting policies

Basis of accounting

The financial statements have been prepared on the going concern basis under the historical cost convention and in accordance with applicable Companies Act 1985 and Accounting Standards in the United Kingdom. A summary of the more important accounting policies, which have been applied consistently, is set out below.

Basis of preparation – going concern

These financial statements have been prepared on the going concern basis as the parent company has indicated its willingness to continue to provide financial support to the company for the foreseeable future.

Tangible fixed assets and depreciation

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

Leasehold improvements	20%
Computer equipment	33 1/3%
Fixtures & fittings	20%
Laboratory equipment	20%

Finance and operating leases

Costs in respect of operating leases are charged on a straight line basis over the lease term. Leasing agreements which transfer to the Company substantially all the benefits and risks of ownership of an asset are treated as if the asset had been purchased outright. The assets are included in fixed assets and the capital element of the leasing commitments is shown as obligations under finance leases. The lease rentals are treated as consisting of capital and interest element. The capital element is applied to reduce the outstanding obligations and the interest element is charged against profit in proportion to the reducing capital element outstanding. Assets held under finance leases are depreciated over the shorter of the lease terms and the useful lives of equivalent owned assets.

Foreign currencies

Monetary assets and liabilities in foreign currencies are translated into sterling at rates of exchange ruling at the end of the financial year. Transactions in foreign currencies are translated into sterling at the rate of exchange ruling at the date of the transaction. All foreign exchange differences are taken to the profit and loss account in the period in which they arise.

Turnover

Turnover, which excludes value added tax, represents the value of goods and services supplied. Non-refundable access fees, option fees and milestone payments, received for participation by a third party in commercialisation of a compound, are recognised in the period when they become contractually binding providing there are no related commitments of the company and that recoverability is assured. Where there are related commitments, revenue is recognised on a percentage of completion basis in line with the actual levels of expenditure incurred in fulfilling these commitments. All other licence income and contract research fees are recognised over the accounting period to which the relevant services relate.

Notes to the financial statements for the year ended 31 December 2003 (continued)

1 Accounting policies (continued)

Research and development expenditure

Expenditure arising on these activities is written off as incurred except where assets are acquired or constructed in order to provide facilities for research and development over a number of years. These assets are capitalised and depreciated over their useful lives. Expenditure relating to clinical trials is accrued on a percentage of completion basis with reference to fee estimates agreed with third parties.

Deferred taxation

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

Pensions

The Company operates a defined contribution scheme. The assets of the scheme are held separately from those of the company in independently administered funds. Pension fund contributions are charged to the profit and loss account in the period in which payments are payable to the pension fund.

Cash flow statement and related party disclosures

The Company is a wholly owned subsidiary of Vernalis plc. The cash flows of the Company are included in the cash flow statement of Vernalis plc, whose accounts are publicly available. Consequently, the Company is exempt under the terms of Financial Reporting Standard Number 1 (revised 1996) from publishing a cash flow statement. The Company is also exempt under the terms of Financial Reporting Standard 8 from disclosing related party transactions with entities that are part of Vernalis plc.

2 Segmental analysis

A geographical analysis of turnover by destination according to the location of the country of registration of the fee-paying parties is set out below:

	2003	2002
	£'000	£'000
Rest of Europe	**1,855**	2,553

All revenue in 2003 and 2002 is attributable to licence fees and other similar research related income.

Notes to the financial statements for the year ended 31 December 2003 (continued)

3 Directors' emoluments

	2003 £'000	2002 £'000
Aggregate emoluments	**289**	225
Company pension contributions to money purchase scheme	**33**	25

There are three directors (2002: one) to whom retirement benefits are accruing under money purchase schemes. No directors (2002: none) exercised any share options in the Company during the year.

Highest paid director	2003 £'000	2002 £'000
Aggregate emoluments	**207**	225
Company pension contributions to money purchase scheme	**19**	25

4 Employee information

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

By activity	2003 Number	2002 Number
Management	**1**	1
Technical	**66**	82
Administration	**9**	12
	76	95

Staff costs (for the above persons)	2003 £'000	2002 £'000
Wages and salaries	**3,043**	4,122
Social security costs	**337**	443
Pension costs	**245**	296
	3,625	4,861

Notes to the financial statements for the year ended 31 December 2003 (continued)

5 Operating loss

	2003 £'000	2002 £'000
Operating loss is stated after charging:		
Depreciation of tangible fixed assets: - owned assets	**657**	719
- leased assets	**318**	340
Loss on disposal of fixed assets	**-**	1
Operating lease charges: - plant and machinery	**45**	46
- other (including land and buildings)	**730**	730
Redundancy costs (see below)	**451**	467
Auditors' remuneration: - audit services (borne by parent company in 2003)	**-**	20
- non-audit services	**-**	1

The exceptional redundancy cost in 2002 of £467,000 relates to the cost of a redundancy programme which was undertaken by the company during October and November 2002. In 2003 the charge relates to restructuring following the merger of the Company's parent company with British Biotech plc.

6 Interest payable and similar charges

	2003 £'000	2002 £'000
On finance leases	**63**	72
On unsecured loan stock due to parent company (note 11)	**-**	389
	63	461

7 Tax on loss on ordinary activities

	2003 £'000	2002 £'000
Corporation tax research and development credit:		
Current year	**889**	971
Adjustment in respect of prior year	**309**	28
Total current tax credit	**1,198**	999

The Company is entitled to claim tax credits for certain research and development expenditure.

Notes to the financial statements for the year ended 31 December 2003 (continued)

7 Tax on loss on ordinary activities (continued)

The tax assessed for the current year differs to the standard rate of corporation tax in the UK.

The differences are explained below:

	2003	2002
	£'000	£'000
Loss on ordinary activities	**(6,848)**	(8,650)
Loss on ordinary activities before tax multiplied by the standard rate in the UK of 30% (2002: 30%)	**(2,055)**	(2,595)
Effects of:		
Depreciation for the period in excess of capital allowances	**-**	178
Expenses not deductible for tax purposes	**30**	26
R&D relief 50% mark up on expenses	**-**	(607)
Other timing differences	**-**	(13)
Change in rate in respect of R&D tax credits received	**222**	853
Deferred tax asset not recognised (note 13)	**914**	-
Adjustment in respect of prior year	**(309)**	(28)
Tax losses unutilised and carried forward to future periods	**-**	1,187
Current tax charge for the year	**(1,198)**	(999)

8 Tangible fixed assets

	Leasehold improvements	**Computer equipment**	**Fixtures & fittings**	**Laboratory equipment**	**Total**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Cost					
At 1 January 2003	1,673	1,362	508	3,152	6,695
Additions	528	36	8	19	591
Disposals	(3)	(458)	-	(65)	(526)
At 31 December 2003	**2,198**	**940**	**516**	**3,106**	**6,760**
Accumulated depreciation					
At 1 January 2003	1,309	982	385	2,284	4,960
Charge for year	220	279	57	419	975
Disposals	-	(458)	-	(65)	(523)
At 31 December 2003	**1,529**	**803**	**442**	**2,638**	**5,412**
Net book amount					
At 31 December 2003	669	137	74	468	1,348
At 31 December 2002	364	380	123	868	1,735

The net book amount of tangible fixed assets includes an amount of £256,000 (2002: £574,000) in respect of assets held under finance leases.

Notes to the financial statements for the year ended 31 December 2003 (continued)

9 Debtors

	2003 £'000	2002 £'000
Amounts falling due within one year		
Trade debtors	-	1
Amounts owed by group undertakings	1,316	35
Corporation tax recoverable	889	971
Other debtors	66	77
Prepayments and accrued income	325	407
	2,596	1,491

10 Creditors - Amounts falling due within one year

	2003 £'000	2002 £'000
Trade creditors	253	285
Amount owed to group undertakings	27,827	20,605
Obligations under finance leases	105	271
Taxation and social security	95	142
Accruals and deferred income	314	674
	28,594	21,977

11 Creditors - Amounts falling due after more than one year

	2003 £'000	2002 £'000
Obligations under finance leases	18	123
Amount owed to parent company – unsecured loan stock 2010	7,848	7,848
Other amounts owed to parent company undertaking	3,290	3,290
	11,156	11,261

The other amounts owed to the parent undertaking are interest free and have no fixed repayment date. Although technically repayable on demand, they have been classified as creditors falling due after more than one year because the parent company has indicated that it will not seek repayment within 12 months of the balance sheet date.

The unsecured loan stock is interest bearing at a rate of 1% above LIBOR and is repayable on 31 December 2010. The stockholders may give notice to the company to redeem the whole or part of the stock at that date.

Notes to the financial statements for the year ended 31 December 2003 (continued)

11 Creditors - Amounts falling due after more than one year (continued)

The net finance lease obligations to which the company is committed are:

	2003	2002
	£'000	£'000
In one year or less	**105**	271
In more than one year but not more than five years	**18**	123
	123	394

12 Provisions for liabilities and charges

	Restructuring Provision	**Dilapidations Provision**	**Total**
	£'000	**£'000**	**£'000**
Charge for the year	451	500	603
Utilised during the period	(348)	-	-
At 31 December 2003	**103**	**500**	**603**

The restructuring provision relates to redundancy costs incurred as part of the ongoing restructuring following the merger of the Company's parent company with British Biotech plc during the year and is expected to be utilised in 2004.

The dilapidation provision relates principally to the company's obligation to reinstate a leased building to its original state. It is expected to be utilised on vacation of the property by 2014.

13 Deferred taxation

The amount not recognised of the total potential deferred tax asset is as follows;

	2003	2002
	£'000	£'000
Tax effect of timing differences:		
Excess of tax allowances over depreciation	**(2,195)**	(2,194)
Short term timing differences	**21**	(15)
Losses	**(12,589)**	(12,343)
	(14,763)	(14,552)

The unrecognised potential deferred tax asset will be recognised only once it is more likely then not that the timing differences will reverse.

Notes to the financial statements for the year ended 31 December 2003 (continued)

14 Share capital

	2003 £'000	2002 £'000
Authorised		
8,157,079 'A' ordinary shares of £0.10 each	**816**	816
17,979,921 'B' ordinary shares of £0.10 each	**1,798**	1,798
Issued, called up and fully paid		
4,327,911 'A' ordinary shares of £0.10 each	**433**	433
14,063,040 'B' ordinary shares of £0.10 each	**1,406**	1,406
	1,839	1,839

The holders of the 'B' ordinary shares have a preferential right to assets in the event of a winding up of the company.

15 Reserves

	Share premium account £'000	Capital contribution £'000	Profit and loss account (deficit) £'000
Opening balance at 1 January 2003	24,293	1,600	(57,743)
Loss for the year	-	-	(5,650)
Closing balance at 31 December 2003	**24,293**	**1,600**	**(63,393)**

16 Reconciliation of movements in shareholders' deficit

	2003 £'000	2002 £'000
Loss for the financial year	**(5,650)**	(7,652)
Net reduction in shareholders' funds	**(5,650)**	(7,652)
Opening shareholders' deficit	**(30,011)**	(22,359)
Closing shareholders' deficit	**(35,661)**	(30,011)

Notes to the financial statements for the year ended 31 December 2003 (continued)

17 Financial commitments

At 31 December 2003 the company had annual commitments under non-cancellable operating leases as follows:

	2003		2002	
	Land and buildings £'000	Other £'000	Land and buildings £'000	Other £'000
Expiring within one year	-	9	-	6
Expiring between one and two years	-	20	-	8
Expiring between two and five years	-	-	-	20
Expiring in over five years	730	-	730	-
	730	**29**	**730**	**34**

The company has given a fixed and floating charge over its assets to secure the future rentals payable under the lease of its premises at Oakdene Court, Winnersh.

18 Ultimate parent company and controlling party

The directors regard Vernalis plc as the immediate and ultimate parent company and controlling party. Copies of the ultimate parent's consolidated financial statements may be obtained from the Secretary of Vernalis plc, Oakdene Court, 613 Reading Road, Winnersh, Berkshire, RG41 5UA.

19 Post balance sheet events

On 24 June 2004, the Company announced that it had signed a collaboration agreement with Biogen Idec to advance V2006 and supporting A_{2A} receptor antagonist programme which targets Parkinson's disease and other central nervous system disorders for payments that could exceed $100 million. Biogen Idec made an initial payment of $10 million and an equity investment of $6 million in Vernalis plc.

On 31 July 2004, the trade assets and liability of Vernalis Research Limited were sold to Vernalis (R&D) Limited (a fellow subsidiary undertaking of Vernalis plc) for a consideration of £12 million.