

Press Release

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ProStrakan Group plc

Interim Results for the Six Months Ended 30 June 2005

15 September 2005: ProStrakan Group plc, the European specialty pharmaceutical company, today announces its interim results for the six months ended 30 June 2005, the Company's first results since completing an IPO on The London Stock Exchange in June 2005.

Operating Highlights

- IPO in June 2005 successfully completed, raising £40m (before expenses)
- Tostrex (testosterone gel for androgen deficient males) approved in Sweden
 - Launch in Sweden due to commence imminently
 - EU Mutual Recognition Procedure (MRP) preparations underway for rest of Europe
- Rectogesic (for chronic anal fissures) launched in UK in June
 - Rapid uptake since launch
 - EU MRP to be filed in second half of 2005
- Positive pre IND meetings with FDA on transdermal anti-emetic patch (nausea following chemotherapy)
 - Phase III trial due to commence by year end
- EU sales force roll out continued, particularly in Germany, Sweden and France
- Agreement with Duramed Pharmaceuticals Inc. (part of Barr Pharmaceuticals) for the development and marketing of Trimegestone patch (contraception) in the USA and Canada announced today

Financial Highlights

- Revenues up 78% to £16.5m
 - Sales of lead product, Adcal D3 (osteoporosis), up 59% to £4.5m (H1 2004: £2.8m)
- Gross profit rises 121% to £8.6m
- Retained loss of £14.5m; IFRS basic loss per share of 11.6p
- Net cash at period end of £56.1m

Commenting on the results, Dr Wilson Totten, Chief Executive of ProStrakan, said:

“This has been an exceptionally busy and successful first half of the year, with the completion of the IPO, the preparation of commercialisation plans for two new products, Tostrex and Rectogesic, as well as an acquisition in Germany which has expanded our sales and marketing infrastructure on the Continent.

“Over the medium term, our objective is to build a sustainably profitable specialty pharmaceutical company, with a broad range of products each fulfilling a therapeutic need. We are well on track with our plans and look forward to updating our new shareholders in due course with news of our progress.”

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ProStrakan

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Financial Dynamics

David Yates / Ben Atwell / Sarah Macleod

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A presentation and conference call for analysts will be held today at 9am at the offices of Financial Dynamics, Holborn Gate, 26 Southampton Buildings, London WC2A 1PB. Please call Mo Noonan for further details on 020 7269 7116.

ProStrakan Interim Results September 2005

Introduction

ProStrakan's goal is to build a sustainably profitable specialty pharmaceutical business with a broad range of novel products and a healthy pipeline. ProStrakan has a differentiated approach: as well as the typical ingredients of other specialty pharmaceutical companies, which include a focus on the secondary care market, a direct sales and marketing infrastructure and a heavy emphasis on product in-licensing, we also believe in the importance of being able to build and maintain our own proprietary pipeline. At ProStrakan, where our current focus is on bone biology and steroid chemistry, we have one of the world's leading drug development capabilities in these sectors and, in addition to this expertise, we also have a strong specialist sales force now able to cover most major European markets. With a broad range of products both on the market and in development, we believe that the key elements are in place to fulfill our objective of building a sustainably profitable pharmaceutical company.

During the first half of 2005, we have made substantial progress towards our goal by raising significant additional finance and making important regulatory and commercial progress with our growing portfolio. In June 2005, we raised £40m in our IPO on The London Stock Exchange which has provided us with the financial resources required to take us to profitability. In the period, we also launched Rectogesic (for chronic anal fissures) in the UK and gained approval for Tostrex (testosterone gel for androgen deficient males) in Sweden. We also substantially strengthened our EU sales force both organically and through the acquisition of APS Pharma in Germany.

Revenues in the first half increased by 78% to £16.5 million (H1 2004: £9.3 million), driven by a 59% increase in sales of our lead product Adcal D3 (for osteoporosis). The operating loss, as expected, increased to £15.6 million (H1 2004: £0.6 million) reflecting increased distribution costs and the planned increased investment in Research & Development driven by the merger with ProSkelia last August. Our cash position at the period end was £56.1 million.

Operational Review

Product sales

Our 78% increase in revenues was driven by an impressive performance from our product portfolio. The increase in sales of our currently-marketed products in the market was 24% (organic growth) with the balance representing growth from products or companies acquired since the beginning of the comparative period. ProStrakan has a strong and growing specialist sales force of 188 sales people marketing an increasing portfolio of specialist products.

Adcal D3 (osteoporosis) – continued its strong growth to become UK market leader by volume for the first time in July. Revenues increased 59% in the period to £4.5 million (H1 2004: £2.8 million). Adcal D3's annual revenue is now greater than the entire calcium/vitamin D3 supplement market of ten years ago.

In terms of ex-factory sales, the volume of products sold in the period for Adcal D3 rose by 66% compared to the same period last year. Adcal D3 addresses a £30 million market which is growing at 18% per annum.

Isotard XL (angina) – increased sales by 2% to £2.0 million (H1 2004: £1.9 million). Isotard XL continued to show strong volume growth with unit sales up 22% in a price-competitive market segment. The new PPRS scheme requires vendors of UK prescription medicines to cut prices across their portfolios of products by 7% as from January 2005. We cut the price of Isotard XL by more than this to compensate for smaller price cuts on other products.

Tebetane (benign prostatic hyperplasia) – reported sales of £1.7 million in the period, an increase of 2% over the corresponding prior period but, as the product was acquired on 30 November 2004 through the acquisition of Elfar SA, no sales were included in the Group's figures for H1 2004. As a phytopharmaceutical product derived from a plant extract, Tebetane was not subject to the price reductions required of many other products in Spain.

Droperidol (post operative nausea and vomiting) – reported sales of £1.6 million in the period. This product was acquired through the acquisition of OTL on 26 January 2004 and is sold in many European countries. In-market sales increased by 16%.

Piprol (urinary tract infections) – reported sales of £0.5 million in the period. Like Tebetane, this product was acquired through the acquisition of Elfar SA and is available in a number of forms (tablet, sachet and suspension) some of which are susceptible to price reductions.

Sandoglobuline (immunodeficiency) – this product has recently been marketed by OTL Pharma under a distribution agreement which expired, as expected, on 30 June 2005 and consequently no further sales will be recorded by the Group in relation to this product. It reported sales of £3.7 million (in-market sales in H1 2004 were £2.8 million of which £2.3 million were after the date of acquisition of OTL and so are recorded in the Group's accounts).

Rectogesic (chronic anal fissures) - was successfully launched in June in the UK and will be filed under the EU Mutual Recognition Procedure during the second half of this year. It is estimated that up to 800,000 individuals suffer from anal fissures in the EU. Initial sales of Rectogesic have shown very rapid uptake both in terms of initial and repeat prescriptions and adoption onto hospital formularies. This confirms our expectation of a real market need for a new therapy in this disorder for which there were previously no available prescription products.

Tostrex (testosterone gel for androgen deficient males) - received initial Swedish marketing authorisation in January and will be launched imminently in that country, as planned, with further launches envisaged throughout 2006 following an EU Mutual Recognition Procedure.

R&D

ProStrakan has developed a strong pipeline of products through its extensive expertise in bone biology and medicinal and steroid chemistry.

This investment continued in the first half with R&D expenditure of £9.2 million (H1 2004: £1.8 million).

Ostalis - we continue to focus on the expected UK launch of our branded bisphosphonate product. The licence agreement is now effective, but launch of the product is dependent on receipt by our licensor of the final UK product licence, which we target to be achieved before the end of 2005.

Pipeline Highlights

Transdermal anti-emetic patch - significant progress was made in the period with our lead clinical trial project, a transdermal patch formulation of an anti-emetic drug (granisetron) intended for the prevention of chemotherapy-induced nausea and vomiting (CINV) in cancer patients. Positive pre-IND discussions with the FDA in January were followed by meetings with a number of European agencies. In June, results from the Phase II clinical study were received and the decision confirmed that we should proceed to a Phase III study to be commenced by the end of 2005. Preparatory work for the Phase III study has already begun, bringing forward some R&D expenditure from next year into 2005. In addition, a commercial manufacturer has been identified.

Siklos (hydroxyurea) - an application has been made to the EMEA seeking approval to market Siklos for patients with sickle-cell disease. This was the subject of Orphan Drug designation within the EU in 2003. If approved, it will be available for marketing in 2006.

Oestrogen and Testosterone Glucoside - are in Phase II with the Testosterone Glucoside project mid-way through a pivotal pharmacokinetic study which will complete by year end.

Good progress is being made in our discovery pipeline, with new development candidates emerging for nomination from 2006 onwards.

Our strategy remains to manage R&D spend prudently as we progress towards profitability, and the pipeline is regularly reviewed to identify potential for partnering and cost-sharing. In line with this, we announced today the signing of an agreement with Duramed Pharmaceuticals Inc, a subsidiary of Barr Pharmaceuticals Inc for the marketing of Trimegestone patch (contraception) in the USA and Canada. Under the terms of this agreement, Duramed will fund the next stage of clinical development which, if successful, will result in Duramed having the option to take a formal development and commercialisation licence for the USA and Canada.

Outlook

After an exceptionally busy and successful first half of the year, we anticipate continued news flow during the second half. We have been very pleased with the progress of Rectogesic since its launch in June and we are optimistic as to the market potential of this product.

Commercialisation plans are also well underway for our hypogonadism product, Tostrex, to be launched in Sweden imminently. We shall be updating shareholders on progress under the EU Mutual Recognition procedure for both of these products in the coming months.

Meanwhile, we continue to expand our sales and marketing infrastructure in Europe which we estimate is now two-thirds complete. One of our near-term objectives is to build a sales infrastructure in Italy, enabling us to sell Tostrex and Rectogesic into the Italian market.

We continue to focus on commercialising our late stage development pipeline, including completion of the projects in registration and about to be filed throughout Europe. Our most advanced clinical phase project, transdermal granisetron for CINV, is on track to start Phase III under a US IND by year end.

Our objective over the medium term is to build a sustainably profitable specialty pharmaceutical company, with a broad range of products each fulfilling a therapeutic need. We are well on track with our plans and look forward to updating our new shareholders in due course with news of our progress.

Financial Review

The financial results, prepared under the Group's accounting policies based on International Financial Reporting Standards, for the six months ended 30 June 2005 are presented below. The narrative reflects a comparison of our activities in 2005 and 2004 and, unless otherwise stated, the comparative figures in parentheses relate to the equivalent period in 2004.

Trading results

Revenue for H1 was £16.5 million (£9.3 million) of which product sales represented £16.3 million (£9.2 million). The sales of those products which we currently market grew by 24% compared to the prior period with additional sales being recorded as a result of the various acquisitions made since last year.

Cost of sales amounted to £7.9 million (£5.4 million), of which £7.0 million (£3.9 million) related to costs of products sold and £0.6 million (£1.3 million) to amortisation of acquired product rights – a non-cash charge. This gives a cash gross profit margin in H1 on product sales of 57.0% (57.8%) and a total gross margin of 52.2% (41.9%). The increase in total gross margin in H1 2005 arises from the reduction in amortisation of acquired product rights. The charge in H1 2004 included a charge of £1.0 million relating to the acquisition of rights to Isotard XL which was fully amortised by the end of 2004 and so not repeated in H1 2005.

Operating costs were £24.2 million (£7.4 million). Distribution costs were £9.5 million (£3.7 million) with the increase arising from the acquisitions of commercial companies in France, Spain and Germany and preparing for the launch of Rectogesic in the UK. Expenditure on R&D was £9.2 million (£1.8 million) with the increase arising both from the merger with ProSkelia in H2 2004 and from lower than normal expenditure in the UK in H1 2004 which reflected the timing and number of clinical trials undertaken. Administrative costs were £5.7 million (£1.9 million) reflecting the increased scale of the company and £0.5 million of costs arising from the IPO.

Operating loss was £15.6 million (£0.6 million). The prior period figure benefited from a non-cash credit representing the excess of acquirer's interest in the fair value of net assets over cost of £2.9 million. This amount arose as a one-time credit from the acquisition of OTL in France in January 2004.

Cash flow

Cash used in operating activities was £13.1 million (£5.3 million) which arises from the operating loss for the period as adjusted for non-cash charges (including stock option expenses and amortisation of product rights) and working capital movements. Cash used in investing activities was £2.9 million (£1.1 million) which comprised the acquisition of subsidiaries net of cash acquired at £2.1 million (£0.6 million) which related to the acquisition of APS in Germany and capital expenditure on tangible assets was £0.4 million (£0.0 million). Cash generated by financing activities was £38.5 million (£2.5 million). This came substantially from the issuance of new shares at £35.5 million (£0.0 million) which predominantly arose from the net proceeds from the IPO.

As at 30 June 2005, cash on hand was £56.1 million.

Consolidated interim balance sheet (unaudited)

	30 June	30 June	31 December
Note	2005	2004	2004
	£'000	£'000	£'000
Assets			
Non-current assets			
Intangible assets	89,716	7,082	92,113
Property, plant and equipment	6,191	156	6,972
Trade and other receivables	-	-	70
Research and development tax credits receivable	6,584	78	6,315
	102,491	7,316	105,470
Current assets			
Inventories	2,970	1,971	3,232
Trade and other receivables	7,563	3,855	8,758
Income tax receivable	126	-	23
Research and development tax credits receivable	378	-	473
Investments available for sale	-	-	95
Cash and cash equivalents	56,113	5,677	34,028
	67,150	11,503	46,609
Liabilities			
Current liabilities			
Trade and other payables	16,969	7,021	16,835
Income tax liabilities	67	-	-
Retirement benefit obligations	24	-	24
Provisions for other liabilities and charges	29	-	26
	17,089	7,021	16,885
Net current assets	50,061	4,482	29,724
Non-current liabilities			
Retirement benefit obligations	351	20	345
Other non-current liabilities	1,809	-	2,891
Provisions for other liabilities and charges	382	-	383
	2,542	20	3,619
Net assets	150,010	11,778	131,575
EQUITY			
Capital and reserves attributable to the Company's equity holders			
Share capital	5	158,867	66,077
Other reserves	77,090	6,817	75,398
Cumulative translation adjustments	(166)	(712)	4,762
Retained earnings	(85,781)	(60,404)	(71,233)
Total equity	150,010	11,778	131,575

The notes on pages 12 to 24 are an integral part of these consolidated interim financial statements.

Consolidated interim income statement (unaudited)

	Note	Six months ended 30 June		Year ended 31
		2005	2004	December
		£'000	£'000	2004
				£'000
Sales		16,535	9,308	21,592
Cost of goods sold		(7,900)	(5,407)	(11,754)
Gross profit		8,635	3,901	9,838
Distribution costs		(9,463)	(3,701)	(8,926)
Research and development		(9,243)	(1,782)	(10,459)
Administrative expenses		(5,569)	(1,924)	(7,255)
Excess of acquirer's interest in the fair value of net assets over cost		-	2,924	3,015
Other gains — net		51	-	200
Operating loss		(15,589)	(582)	(13,587)
Finance costs — net		513	89	378
Loss before income tax		(15,076)	(493)	(13,209)
Taxation		531	(7)	1,881
Loss for the period		(14,545)	(500)	(11,328)

Attributable to equity holders of the company

Loss per share for loss attributable to the equity holders of the Company during the period (expressed in pence per share)

- basic	6	11.6	0.9	15.1
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The notes on pages 12 to 24 are an integral part of these consolidated interim financial statements.

Consolidated interim statement of changes in equity (unaudited)

	Attributable to equity holders of the company					Total equity
	Note	Share capital	Fair value and other reserves	Cumulative translation adjustments	Retained earnings	
		£'000	£'000	£'000	£'000	
Balance at 1 January 2004		64,729	4,517	(530)	(59,904)	8,812
Currency translation differences – being net income recognised directly in equity		-	-	(182)	-	(182)
Loss for the period		-	-	-	(500)	(500)
Total recognised income for the period		-	-	(182)	(500)	(682)
Employee share option scheme:						
- value of services provided		-	123	-	-	123
- proceeds from shares issued		20	-	-	-	20
Other share based payments		36	-	-	-	36
Business combinations:						
- issue of share capital		1,292	2,154	-	-	3,446
- options issued		-	23	-	-	23
		1,348	2,300	-	-	3,648
Balance at 30 June 2004		66,077	6,817	(712)	(60,404)	11,778
Balance at 1 July 2004		66,077	6,817	(712)	(60,404)	11,778
Currency translation differences – being net income recognised directly in equity		-	-	5,474	-	5,474
Loss for the period		-	-	-	(10,829)	(10,829)
Total recognised income for the period		-	-	5,474	(10,829)	(5,355)
Employee share option scheme:						
- value of services provided		-	1,574	-	-	1,574
- proceeds from shares issued		25	-	-	-	25
Other share based payments		46	-	-	-	46
Business combinations:						
- issue of share capital		33,806	56,349	-	-	90,155
- shares to be issued		-	462	-	-	462
- issue of warrants		-	5,894	-	-	5,894
- options assumed		-	4,302	-	-	4,302
Issue of share capital		22,803	-	-	-	22,803
Purchase of own shares by ESOP		(200)	-	-	-	(200)
Sale of own shares by ESOP		91	-	-	-	91
		56,571	68,581	-	-	125,152
Balance at 31 December 2004		122,648	75,398	4,762	(71,233)	131,575
Balance at 1 January 2005		122,648	75,398	4,762	(71,233)	131,575
Currency translation differences – being net income recognised directly in equity		-	-	(4,928)	-	(4,928)
Loss for the period		-	-	-	(14,545)	(14,545)
Total recognised income for the period		-	-	(4,928)	(14,545)	(19,473)
Employee share option scheme:						
- value of services provided		-	1,692	-	-	1,692
- proceeds from shares issued	5	129	-	-	-	129
Other share based payments	5	32	-	-	-	32
Issue of share capital	5	35,625	-	-	-	35,625
Purchase of own shares by ESOP	5	(200)	-	-	-	(200)
Sale of own shares by ESOP	5	633	-	-	(3)	630
		36,219	1,692	-	(3)	37,908
Balance at 30 June 2005		158,867	77,090	(166)	(85,781)	150,010

The notes on pages 12 to 24 are an integral part of these consolidated interim financial statements.

Consolidated interim cash flow statement (unaudited)

	Note	Six months ended 30 June		Year ended
		2005	2004	31 December
		£'000	£'000	2004
				£'000
Cash flows from operating activities				
Cash used in operations	7	(13,561)	(5,427)	(16,466)
Interest received		533	102	331
Interest paid		(20)	(13)	(31)
R&D tax credits received		95	-	500
Income tax paid		(111)	(7)	(56)
Net cash used in operating activities		(13,064)	(5,345)	(15,722)
Cash flows from investing activities				
Acquisition of subsidiaries, net of cash acquired	8	(2,095)	(580)	(9,932)
Sale of investment (acquired in business combination)		93	-	25,741
Purchases of intangible assets		(554)	(502)	(1,834)
Purchases of property, plant and equipment (PPE)		(395)	(30)	(1,057)
Proceeds from sale of PPE	7	2	-	94
Net cash generated by investing activities		(2,949)	(1,112)	(13,012)
Cash flows from financing activities				
Net proceeds of accounts receivable factoring	7	2,390	2,525	3,871
Proceeds from issuance of ordinary shares (net of own shares purchased by ESOP)	5	35,554	20	22,602
Proceeds from sale of own shares by ESOP	5	630	-	91
Net cash generated by financing activities		38,574	2,545	26,564
Net increase/(decrease) in cash and bank overdrafts		22,561	(3,912)	23,854
Cash and bank overdrafts at the beginning of the period		34,028	8,763	8,763
Exchange gains (losses) on cash and bank overdrafts		(476)	826	1,411
Cash and bank overdrafts at the end of the period		56,113	5,677	34,028

The notes on pages 12 to 24 are an integral part of these consolidated interim financial statements.

Notes on the consolidated financial statements

1. General information

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

On 29 April 2005, the Group completed the corporate acquisition of APS Pharma GmbH, a pharmaceutical marketing company incorporated in Germany. Details can be found in note 8. During 2004 the Group completed four corporate acquisitions: OTL Pharma SA, a pharmaceutical marketing company incorporated in France, was acquired on 26 January 2004 and is included in the comparative interim figures; Proskelia BV, a pharmaceutical research and development company incorporated in the Netherlands, was acquired on 26 August 2004; and two pharmaceutical marketing companies incorporated in Spain, Devon Farmacéutica SLU and Elfar SA, were acquired on 2 September and 30 November 2004 (respectively).

The Company reregistered as a public company on 2 March 2005 and was admitted to the London Stock Exchange on 16 June 2005. The Company is incorporated and domiciled in the United Kingdom, with its registered office at Buckholm Mill, Galashiels, TD1 2HB, Scotland.

2. Summary of significant accounting policies

In 2004 ProStrakan Group plc prepared its consolidated financial statements under UK Generally Accepted Accounting Practice (UK GAAP). Following European Parliament legislation passed in 2002, all listed EU companies are required to prepare consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) with effect from 1 January 2005.

ProStrakan Group plc will therefore prepare its first IFRS compliant Report and Accounts for the year ended 31 December 2005. The Group will present comparative IFRS financial information for the year ended 31 December 2004 and consequently the date of transition to IFRS for the Group is 1 January 2004, being the first day of the comparative period. The first results to be prepared on an IFRS basis are the Group’s interim results for the six months ended 30 June 2005.

The financial information presented in these financial statements has been prepared on the basis of those International Financial Reporting Standards, International Accounting Standards, and International Financial Reporting Interpretations Committee (IFRIC) and Standard Interpretation Committee (SIC) interpretations that are expected to be applicable to 2005 financial reporting. These are subject to ongoing review and endorsement by the European Commission and as a consequence further adjustments to the accounting policies and treatments may need to be made in the Report and Accounts for the year ended 31 December 2005.

IFRS 1 “First time adoption of International Financial Reporting Standards” sets out the requirements for the first time adoption of IFRS. Generally, IFRS 1 requires that accounting policies be adopted that are compliant with IFRS and that these policies be applied retrospectively to all periods presented. IFRS 1 does however contain the option to take advantage of certain exemptions to retrospective application. These are detailed in note 3.1.2.

2.1 Basis of preparation

These interim consolidated financial statements are for the six months ended 30 June 2005. They were approved by the Board of Directors on 14 September 2005 and are unaudited. The Group accounts for the year to 31 December 2004 prepared in accordance with UKGAAP, which carried an unqualified Auditors’ Report, have been filed with the Registrar of Companies.

This interim statement is the first ProStrakan Group plc has prepared under International Financial Reporting Standards and complies with IFRS accounting policies management expects to be in force for the preparation of the 2005 full year financial statements.

The Group has not applied IAS 34 “Interim financial reporting”, which is not mandatory for UK groups, in the preparation of these interim financial statements. For the reasons outlined above, it is possible that the information presented in this report and the accounting policies used, may be subject to change before their inclusion in the Group’s first complete financial statements prepared in accordance with IFRS.

2.2 Segment reporting

The Group’s primary segment for IFRS segment reporting is the business segment: a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. The Group operates in a single business segment, pharmaceuticals. Geographical regions are the secondary reporting segments, where the Group is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of other economic environments.

Notes on the consolidated financial statements, continued

2.3 Intangible assets

(a) Goodwill

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

Goodwill is allocated to cash-generating units (CGU) for the purpose of impairment testing. Research and development is one CGU and so is taken as a whole. Each commercial territory under the control and guidance of a General Manager is a CGU.

(b) In-process Research and development

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

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

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

(c) Product rights

Product rights and other intangible assets are initially recorded at cost. Where these assets have been acquired through a business combination, they are recorded at fair value where they are separately identifiable and their value can be readily ascertained. Product rights are amortised over their useful life on a straight-line basis from the date of the first commercial launch. Estimated useful life is the lower of legal duration and economic useful life, up to a maximum of 15 years. Prior to their first commercial launch they are tested annually for impairment. Provision is made for any impairment.

(d) Computer software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives (not exceeding 3 years).

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

Computer software development costs recognised as assets are amortised over their estimated useful lives (not exceeding 3 years).

(e) Chemical library

Early stage chemical libraries built up for use in research activities and acquired in a business combination have been recognised separately as an intangible asset. This is being amortised over its estimated useful life of 10 years.

2.4 Share capital

Ordinary shares are classified as equity.

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

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

Notes on the consolidated financial statements, continued

2.5 Employee benefits

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

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

3. Transition to IFRS

3.1 Basis of transition to IFRS

3.1.1 Application of IFRS 1

The Group's financial statements for the year ended 31 December 2005 will be the first annual financial statements that comply with IFRS. These interim financial statements have been prepared as described in Note 2.1. The Group has applied IFRS 1 in preparing these consolidated interim financial statements.

ProStrakan's transition date is 1 January 2004. The Group prepared its opening IFRS balance sheet at that date. The reporting date of these interim consolidated financial statements is 30 June 2005. The Group's IFRS adoption date is 1 January 2005.

In preparing these interim consolidated financial statements in accordance with IFRS 1, the Group has applied the mandatory exceptions and certain of the optional exemptions from full retrospective application of IFRS.

3.1.2 Exemptions from full retrospective application elected by the Group

ProStrakan Group has elected to apply the following optional exemptions from full retrospective application.

(a) *Business combinations exemption*

The Group has applied the business combinations exemption in IFRS 1. It has not restated business combinations that took place prior to the 1 January 2004 transition date.

(b) *Exemption from restatement of comparatives for IAS 32 and IAS 39.*

IAS 32 "Financial instruments: Disclosure and presentation" and IAS 39 "Financial instruments: Recognition and measurement" have been applied prospectively from 1 January 2005.

(c) *Share-based payment transaction exemption*

The Group has elected to apply the share-based payment exemption. It applied IFRS 2 from 1 January 2004 to those options that were issued after 7 November 2002 but that have not vested by 1 January 2005.

3.2 Reconciliations between IFRS and GAAP

The following reconciliations provide a quantification of the effect of the transition to IFRS. The first reconciliation provides an overview of the impact on equity of the transition at 1 January 2004, 30 June 2004 and 31 December 2004

The following five reconciliations provide details of the impact of the transition on:

- equity at 1 January 2004 (Note 3.2.2)
- equity at 30 June 2004 (Note 3.2.3)
- equity at 31 December 2004 (Note 3.2.4)
- net income 30 June 2004 (Note 3.2.5)
- net income 31 December 2004 (Note 3.2.6)

Notes on the consolidated financial statements, continued

3.2.1 Summary of equity

	1 January 2004	Note	30 June 2004	Note	31 December 2004	Note
	£'000		£'000		£'000	
Total equity under UK GAAP	8,812		8,964		124,860	
Capitalisation of acquired intangibles	-		2,814	3.2.3.b	2,973	3.2.4.b
Reversal of amortisation of goodwill	-		-		3,843	3.2.4.b
Pension adjustments	-		-		(101)	3.2.4.d
Total equity under IFRS	8,812		11,778		131,575	

3.2.2 Reconciliation of equity at 1 January 2004 (date of transition to IFRS)

	Note	UK GAAP	Effect of transition	IFRS
		£'000	£'000	£'000
Intangible assets	a	1,500	15	1,515
Property, plant and equipment	a	158	(15)	143
Total non-current assets		1,658	-	1,658
Inventories		1,058	-	1,058
Trade and other receivables		1,450	-	1,450
Cash and cash equivalents		8,763	-	8,763
Total current assets		11,271	-	11,271
Trade and other payables:				
- current		3,867	-	3,867
- non-current		250	-	250
Total liabilities		4,117	-	4,117
Net assets		8,812	-	8,812
Share capital		64,729	-	64,729
Other reserves	b	4,480	37	4,517
Cumulative translation adjustments	c	-	(530)	(530)
Retained earnings	b,c	(60,397)	493	(59,904)
Total equity		8,812	-	8,812

Explanation of the effect of the transition to IFRS

- Certain computer software costs, classified as intangible assets under IAS 38, were previously classified as tangible assets under FRS 15. The carrying amount of this software at 1 January 2004 was £15,000. There is no impact on net assets.
- Under IFRS 2 a charge is required for all share-based payments including share options. The charge in the profit and loss account is based on the fair value of the options at grant date. Under UK GAAP, the profit and loss charge, if any, is based on the difference between the exercise price and the market price on the date of issue. As at 1 January 2004 the charge required under IFRS 2 as recognition of share options issued after 7 November 2002 and not vested at 1 January 2005 amounted to £37,000. There is no impact on net assets.
- Under IAS 21 currency translation differences arising on the net investment in foreign operations must be recognised in a separate component of equity (other reserves), tracked separately and only recognised in profit or loss on disposal of the net investment. ProStrakan has not taken the option under IFRS 1 to set all translation differences to zero at the date of transition, and this has resulted in the separate recognition of translation losses of £530,000 as at 1 January 2004.

Notes on the consolidated financial statements, continued

3.2.3 Reconciliation of equity at 30 June 2004

	Note	UK GAAP	Effect of transition	IFRS
		£'000	£'000	£'000
Intangible assets	a,b	4,260	2,822	7,082
Property, plant and equipment	a	164	(8)	156
Total non-current assets		4,424	2,814	7,238
Inventories		1,971	-	1,971
Trade and other receivables		3,933	-	3,933
Cash and cash equivalents		5,677	-	5,677
Total current assets		11,581	-	11,581
Trade and other payables:				
- current		7,021	-	7,021
- non-current		20	-	20
Total liabilities		7,041	-	7,041
Net assets		8,964	2,814	11,778
Share capital		66,077	-	66,077
Other reserves	c	6,657	160	6,817
Cumulative translation adjustments	d	-	(712)	(712)
Retained earnings	b,c,d	(63,770)	3,366	(60,404)
Total equity		8,964	2,814	11,778

Explanation of the effect of the transition to IFRS

The nature of the adjustments from UK GAAP to IFRS at 30 June 2004 is similar to those at 1 January 2004. There is one additional adjustments at 30 June 2004. This relates to Intangible Assets (see b) below). Explanations of all other adjustments are disclosed in Note 3.2.2.

- a) Reclassification of software with a carrying amount at 30 June 2004 was £8,000. There is no impact on net assets.
- b) Under IFRS 3 all acquired intangible assets must be recognised separately in the consolidated financial statements if they meet the definition of an intangible asset in IAS 38 and if their fair value can be measured reliably. UK GAAP is not as stringent as IFRS with regard to identifying intangibles and does not rule out the possibility of many intangible assets being subsumed within goodwill. During 2004 additional intangible assets were identified under IFRS 3 giving rise to an increase in the net book amount at 30 June 2004 of £1,515,000 and an additional charge for amortization in the 6 months ended 30 June 2004 of £28,000.
Where there is an excess of acquirer's interest in the fair value of the net assets IFRS requires it to be taken to profit and loss in the year of acquisition. Under FRS 10 this negative goodwill is recognized in the balance sheet and recognized in the profit and loss over the period likely to benefit. FRS 10 seeks to restrict situations where goodwill is recognized. One restriction is that FRS 10 does not allow both negative goodwill and intangible assets to be recognized at fair value in respect of a single acquisition. It does this by capping the fair value at an amount that does not give rise to negative goodwill to the extent that there is no readily ascertainable market value for the intangible assets. Removing the capping requirement under IFRS for intangible assets has resulted in an increase in the net amount of intangibles at 30 June 2004 of £1,299,000 and further charge to profit and loss for amortisation of £79,000. The resultant release of the excess of acquirer's interest in the fair value of the net assets (negative goodwill) created a gain to profit and loss of £2,924,000.
- c) As at 30 June 2004 the charge for the recognition of share options issued after 7 November 2002 and not vested at 1 January 2005 amounted to £160,000. There is no impact on net assets.
- d) Currency translation differences arising on the net investment in foreign operations resulted in the separate recognition of translation losses of £712,000 as at 30 June 2004.

Notes on the consolidated financial statements, continued

3.2.4 Reconciliation of equity at 31 December 2004

	Note	UK GAAP £'000	Effect of transition £'000	IFRS £'000
Intangible assets	a,b	85,035	7,078	92,113
Property, plant and equipment	a	7,234	(262)	6,972
Trade and other receivables	c	-	70	70
Research and development tax credits receivable	c	-	6,315	6,315
Total non-current assets		92,269	13,201	105,470
Inventories		3,232	-	3,232
Trade and other receivables	c	8,828	(70)	8,758
Income tax receivable		23	-	23
Research and development tax credits receivable	c	6,788	(6,315)	473
Other financial assets at fair value through profit or loss		95	-	95
Cash and cash equivalents		34,028	-	34,028
Total current assets		52,994	(6,385)	46,609
Trade and other payables		16,835	-	16,835
Retirement benefit obligations	e	-	24	24
Provisions for other liabilities and charges	e	-	26	26
Total current liabilities		16,835	50	16,885
Net current assets		36,159	(6,435)	29,724
Retirement benefit obligations	d,e	268	77	345
Other non-current liabilities		2,891	-	2,891
Provisions for other liabilities and charges	e	409	(26)	383
Total non-current liabilities		3,568	51	3,619
Net assets		124,860	6,715	131,575
Share capital		122,648	-	122,648
Other reserves	f	73,664	1,734	75,398
Cumulative translation adjustments	g	-	4,762	4,762
Retained earnings	h	(71,452)	219	(71,233)
Total equity		124,860	6,715	131,575

Explanation of the effect of the transition to IFRS

The nature of the adjustments from UK GAAP to IFRS at 31 December 2004 is similar to those at 30 June 2004. There are two additional adjustments at 31 December 2004. These relate to Intangible Assets (see b) below) and pensions (see d) below). Explanations of all other adjustments are disclosed above.

- a) Reclassification of software with a carrying amount at 31 December 2004 was £262,000. There is no impact on net assets.
- b) Additional intangible assets identified, net of those separated from goodwill £1,695,000.
Removal of the capping requirement relating to negative goodwill £1,278,000.
Under both IFRS and UK GAAP, goodwill arising on an acquisition is treated as an asset. IFRS 3 prohibits the amortisation of goodwill and, instead, subjects it to an annual impairment review. Under FRS 10, goodwill is amortised over its useful life (presumed to be 20 years or less). The charge for amortisation of goodwill under UK GAAP of £3,843,000 has been removed.
- c) Certain current assets, receivables from related parties and research and development tax credits receivable have been reclassified as non-current under IAS 1.
- d) Accounting for pensions in accordance with IAS 19 is different from FRS 17. The main differences are:
 - under FRS 17 actuarial losses (£18,000) were recognised in the statement of recognised gains and losses. There is no requirement to recognise these losses under IAS 19 as they are less than 10% of the present value of the obligation at the end of the previous year.
 - interest on pension liabilities is recorded within interest and similar charges under UK GAAP, but within operating expenses under IFRS. This also affects interest on the long service employee benefits liability.
 - under FRS 17, pension balances are presented net of deferred tax on the face of the balance sheet. Under IFRS these balances are grossed up. The adjustment required amounts to £119,000.

Notes on the consolidated financial statements, continued

- e) Parts of the retirement benefit obligation and the long service employee benefit (included within Provisions for other liabilities and charges) have been reclassified as current under IAS 1.
- f) As at 31 December 2004 the charge for the recognition of share options issued after 7 November 2002 and not vested at 1 January 2005 amounted to £1,734,000. There is no impact on net assets.
- g) Currency translation differences arising on the net investment in foreign operations resulted in the separate recognition of translation gains of £4,762,000 as at 31 December 2004.

h)

Impact on retained earnings:	£'000
Additional amortisation charge arising from additional intangible assets identified see b) above	(100)
Additional amortisation charge arising from removal of capping requirement see b) above	(176)
Removal of amortisation of goodwill see b) above	3,843
Release of the excess of acquirer's interest in the fair value of the net assets	3,015
Pensions adjustment	15
Charge for the recognition of share options	(1,721)
Currency translation adjustment	(4,657)
Total impact	219

3.2.5 Reconciliation of net income for six months ended 30 June 2004

	Note	UK GAAP £'000	Effect of transition £'000	IFRS £'000
Revenue		9,308	-	9,308
Cost of sales	a	(5,328)	(79)	(5,407)
Gross profit		3,980	(79)	3,901
Distribution costs	b	(3,649)	(52)	(3,701)
Research and development costs	c	(1,760)	(22)	(1,782)
Administrative costs	d	(1,847)	(77)	(1,924)
Excess of acquirer's interest in the fair value of net assets over cost	e	-	2,924	2,924
Operating loss		(3,276)	2,694	(582)
Finance costs - net		89	-	89
Taxation		(7)	-	(7)
Loss for the year		(3,194)	2,694	(500)

Explanation of the effect of the transition to IFRS

- a) Additional amortisation charge arising from removal of capping requirement.
Total impact – increase in cost of sales £79,000.
- b) Additional amortisation charge arising from additional intangible assets identified £28,000.
Charge for the recognition of share options £24,000.
Total impact – increase in distribution costs £52,000.
- c) Charge for the recognition of share options £22,000.
Total impact – increase in research and development costs £22,000.
- d) Charge for the recognition of share options £77,000.
Total impact – increase in administrative costs £77,000
- e) Release of the excess of acquirer's interest in the fair value of the net assets £2,924,000.

Notes on the consolidated financial statements, continued

3.2.6 Reconciliation of net income for the year ended 31 December 2004

	Note	UK GAAP	Effect of transition	IFRS
		£'000	£'000	£'000
Revenue		21,592	-	21,592
Cost of sales	a	(11,539)	(215)	(11,754)
Gross profit		10,053	(215)	9,838
Distribution costs	b	(8,615)	(311)	(8,926)
Research and development costs	c	(9,885)	(574)	(10,459)
Administrative costs	d	(6,303)	(952)	(7,255)
Amortisation of goodwill	e	(3,754)	3,754	-
Excess of acquirer's interest in the fair value of net assets over cost	f	-	3,015	3,015
Other gains - net		200	-	200
Operating loss		(18,304)	4,717	(13,587)
Finance costs - net	g	289	89	378
Taxation		1,881	-	1,881
Loss for the year		(16,134)	4,806	(11,328)

Explanation of the effect of the transition to IFRS

- a) Additional amortisation charge arising from removal of capping requirement £176,000.
Reclassification of foreign exchange losses results in additional charge of £39,000.
Total impact – increase in cost of sales £215,000.
- b) Additional amortisation charge arising from additional intangible assets identified £81,000.
Charge for the recognition of share options £228,000.
Pension adjustments £2,000
Total impact – increase in distribution costs £311,000
- c) Additional amortisation charge arising from additional intangible assets identified £21,000.
Charge for the recognition of share options £540,000.
Pension adjustments £13,000.
Total impact – increase in research and development costs £574,000.
- d) Charge for the recognition of share options £915,000.
Reclassification of foreign exchange losses results in additional charges of £37,000.
Total impact – increase in administrative costs £952,000.
- e) Removal of amortisation of goodwill £3,754,000
- f) Release of the excess of acquirer's interest in the fair value of the net assets £3,015,000.
- g) Pension reclassification resulting in a reduction of the finance costs £11,000
Reclassification of foreign exchange losses £78,000.
Total impact – increase in costs £89,000.

4. Segment information

Primary reporting format - business segments

Based on the risks and returns the directors consider that the primary reporting format is by business segment. The directors consider that there is only one business segment, being pharmaceuticals. The Group develops, registers, internationally markets or outlicenses a range of pharmaceutical products. The Group also generates limited revenues from other sources, mainly the sale of development resources. Therefore the disclosures for the primary segment have already been given in the financial statements.

Secondary reporting format – geographical segments

The Group is organized on a worldwide basis. The operations are based in three main geographical areas. The United Kingdom is the home of the parent company. There are no material inter-segment transfers.

	Six months ended 30 June 2005 £'000	Six months ended 30 June 2004 £'000	Year ended 31 December 2004 £'000
Sales			
United Kingdom	6,878	5,025	11,741
European Union (excluding the UK)	9,511	4,139	9,512
Other countries	146	144	339
	<u>16,535</u>	<u>9,308</u>	<u>21,592</u>

Sales are allocated based on the country in which the customer is located.

	At 30 June 2005	At 30 June 2004	At 31 December 2004
Total assets			
United Kingdom	56,568	7,816	27,600
European Union (excluding the UK)	108,824	10,724	120,525
Other countries	4,249	279	3,954
	<u>169,641</u>	<u>18,819</u>	<u>152,079</u>

Total assets are allocated based on where the assets are located.

	Six months ended 30 June 2005	Six months ended 30 June 2004	Year ended 31 December 2004
Capital expenditure			
United Kingdom	207	30	52
European Union (excluding the UK)	2,504	7,186	92,732
Other countries	-	-	3,961
	<u>2,711</u>	<u>7,216</u>	<u>96,745</u>

Capital expenditure is allocated based on where the assets are located.

	Six months ended 30 June 2005	Six months ended 30 June 2004	Year ended 31 December 2004
Analysis of sales by category			
Sales of goods	16,326	9,186	21,288
Revenue from services	134	5	138
Licensing Income	44	87	101
Royalty income	31	30	65
	<u>16,535</u>	<u>9,308</u>	<u>21,592</u>

5. Share capital

	Total				
	'000				
Authorised – shares of £0.05 each					
30 June 2005	400,000				
Issued and fully paid – shares of £0.05 each					
In issue at 30 June 2005	186,792				
Own shares held by ESOP	(20)				
	<u>186,772</u>				
	Number of shares	Ordinary shares	Share premium	Own shares held	Total
	'000	£'000	£'000	£'000	£'000
At 1 January 2005	303,642	76,085	47,029	(466)	122,648
Employee share option scheme					
- proceeds from shares issued	250	63	34	-	97
Other share based payments	48	12	20	-	32
Issue of shares, purchased by ESOP	-	75	125	(200)	-
Own shares sold by ESOP	949	-	-	633	633
Capitalisation issue	61,191	15,298	(15,298)	-	-
At 15 June 2005	366,080	91,533	31,910	(33)	123,410
Capital reorganisation	146,432	7,322	116,121	(33)	123,410
Conversion of warrants	300	15	(15)	-	-
Issue of shares	40,000	2,000	33,425	-	35,425
Employee share option scheme					
- proceeds from shares issued	40	2	30	-	32
At 30 June 2005	186,772	9,339	149,561	(33)	158,867

Capital reorganisation and consolidation

On 6 May 2005, a resolution of the Company was passed, taking effect immediately prior to Admission on 16 June 2005:

- a) each "A" ordinary share of £0.25 and each "B" ordinary share of £0.25 were reclassified into an ordinary share of £0.25 in the share capital of the Company;
- b) immediately following that reclassification, the ordinary shares of £0.25 each were consolidated, divided and reclassified into Ordinary Shares of £0.05 each and unclassified shares of £0.575 each on the basis of one Ordinary Share of £0.05 each and one unclassified share of £0.575 each for every two and a half ordinary shares of £0.25 each in the capital of the Company held;
- c) the unclassified shares of £0.575 and any fractional entitlements to Ordinary Shares and/or to unclassified shares of £0.575 were consolidated into a single deferred share in the share capital of the Company, which was purchased and cancelled by the Company immediately following Admission. The consideration for the purchase by the Company of the single deferred share was £0.01, which was financed from part of the proceeds of the Offer;
- d) the unissued ordinary shares of £0.25 each were cancelled; and
- e) the authorised share capital of the Company was increased such that it now comprises 400,000,000 Ordinary Shares of £0.05 in the capital of the Company.

Capitalisation issue

The "A" ordinary shares and the "B" ordinary shares held certain anti-dilution rights, such that in the event that the Company issued shares at a price per share less than that paid up (or deemed to have been paid up) by the holders of the "A" ordinary shares or the holders of the "B" ordinary shares on those shares (a Dilutive Issue), then the conversion ratio of the relevant "A" ordinary shares and "B" ordinary shares into ordinary shares should be adjusted in accordance with a formula set out in the Existing Articles. The issue of shares at Admission was a Dilutive Issue and the conversion ratio resulted in a capitalisation issue as follows from the share premium account:

Notes on the consolidated financial statements, continued

The holders of "A" ordinary shares received an additional 47,627,313 ordinary shares of £0.25 each and the holders of "B" ordinary shares received an additional 13,563,930 ordinary shares of £0.25 each immediately prior to Admission.

Conversion of warrants

At completion of the acquisition by the Company of OTL Pharma SA on 26 January 2004, the Company granted certain warrants to various former shareholders in OTL Pharma SA as part of the consideration for the acquisition. The instrument creating those warrants contained certain provisions that allow for the adjustment of the warrants in the event of a reorganisation of the share capital of the Company. Consequently, immediately following the capital reorganisation but before Admission those warrants converted into 299,990 ordinary shares of £0.05 each.

All issued shares are fully paid.

Shares in the Company are held by the Group's employee share ownership plan (ESOP) trust. The ESOP Trust enables future employees of the group to acquire shares in the company, which cannot be purchased externally. The Trust acquires shares and offers them for sale in due course to the employees who are entitled to participate in the scheme. All transactions are at the directors' estimate of fair value.

On 6 May 2005, with effect immediately prior to Admission, the Company adopted the New ProStrakan Group Employee Benefit Trust. It is intended that the new trust will be used in conjunction with the new share plans below, for the benefit of the employees and former employees of the Group and certain classes of their dependants. The trustee of the new trust will have the power to subscribe for ordinary shares in the Company or to acquire ordinary shares in the Company in the market or from treasury, but will not be permitted to hold more than 5% of the Company's issued share capital.

Share options

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

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

ProStrakan Group Performance Share Plan 2005 (PSP)

Awards vest on the third anniversary of the date of grant.

ProStrakan Group Executive Share Option Plan 2005 (Executive Plan)

The Executive Plan is divided into two parts; Part A, is intended to be approved by HM Revenue and Customs and Part B, unapproved. Options vest on the third anniversary of the date of grant and are exercisable up to the tenth anniversary of the date of grant.

ProStrakan Group Sharesave Plan 2005 (Sharesave Plan)

The Company intends to obtain HM Revenue and Customs approval of the Sharesave Plan under the Income Tax (Earnings and Pensions) Act 2003. All employees and full-time directors of the Group, who are resident and ordinarily resident in the UK for tax purposes will be eligible to participate.

ProStrakan Group International Sharesave Plan 2005 (International Sharesave Plan)

This plan will not benefit from HM Customs and Revenue approval and will be open to all employees and directors of the Group in any part of the world.

ProStrakan Group Share Incentive Plan (SIP)

The Company intends to obtain HM Revenue and Customs approval of the SIP and the associated trust deed under the Income Tax (Earnings and Pensions) Act 2003.

The New Share Plans operate over new Ordinary Shares issued, Ordinary Shares in treasury or Ordinary Shares purchased by the Group in the market. No awards or options may be granted more than 10 years after approval of the plan i.e. no later than 5 May 2015. In any 10-year period the Company may not issue more than 10% of the issued ordinary share capital under the New Share Plans and any other employee share plan adopted by the Company. Any Ordinary Shares issued, or which may be issued in the future, under awards or options granted before the Company was listed on the London Stock Exchange will not count towards this limit. As at 30 June 2005 no awards or options had been granted under the New Share Plans.

Notes on the consolidated financial statements, continued

Movements in the number of share options outstanding and their related weighted average exercise prices are as follows:

	Average exercise price per share	Options ('000)
At 1 January 2005	£0.5245	34,876
Granted	£0.6667	2,425
Exercised	£0.3894	(250)
Lapsed/expired/surrendered	£0.6667	(1,116)
At 15 June 2005	£0.5235	35,935
Capital reorganisation	£1.3088	14,374
Exercised	£0.8000	(40)
Lapsed/expired/surrendered	£1,5469	(48)
At 30 June 2005	£1.3105	14,286

Out of the 14,286,000 outstanding options, 9,312,000 options were exercisable. Options exercised in the six months ended 30 June 2005 resulted in the issue of 120,000 shares at £0.80 each and 20,000 shares at £1.66675.

6. Earnings per share

As required by IAS 33 the earnings per share figures reflect the shares outstanding at 30 June 2004 and 31 December 2004 restated following the capital reorganisation on admission, described in Note 5.

Basic

Basic earnings per share is calculated by dividing the loss attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year, excluding those held in the ESOP (Note 5), which are treated as cancelled.

	As at 30 June 2005	As at 30 June 2004	As at 31 December 2004
Loss attributable to equity holders of the Company (£'000)	(14,545)	(500)	(11,328)
Weighted average number of ordinary shares in issue ('000)	124,876	53,424	74,709
Basic loss per share (pence per share)	11.	0.9	15.1

Diluted

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares. The Company has just one category of dilutive potential ordinary shares: shares to be issued in respect of a business combination. For a loss making company with outstanding share options and warrants, net loss per share would only be increased by the exercise of out-of-the-money options and warrants (where the exercise price is above the average share price during the year). Using this approach there is negligible difference between basic and diluted earnings per share.

7. Cash generated from operations

	Six months ended 30 June		Year ended 31 December
	2005	2004	2004
	£'000	£'000	£'000
Loss for the period	(14,545)	(500)	(11,328)
Adjustments for:			
- Tax	(531)	7	(1,881)
- Depreciation	882	66	665
- Amortisation	906	1,352	2,482
- Excess of acquirer's interest in the fair value of acquiree's identifiable net assets over cost	-	(2,924)	(3,015)
- (Profit)/loss on sale of property, plant and equipment (see below)	3	-	2
- Net movement for provisions for liabilities and charges	20	-	33
- Net movement in pension liability	24	-	21
- Charges for share based employee benefits	1,733	159	1,766
- Fair value gains (including profit on disposal) on other financial assets at fair value through profit or loss	(1)	-	(130)
- Net proceeds from accounts receivable factoring	(2,390)	(2,525)	(3,871)
- Interest income	(533)	(102)	(331)
- Interest expense	20	13	31
- Changes in working capital (excluding the effects of acquisition and exchange difference on consolidation):			
- Inventories	325	276	50
- Trade and other receivables	1,427	(270)	(235)
- Trade and other payables	(901)	(979)	(725)
Cash generated from operations	(13,561)	(5,427)	(16,466)

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

Net book amount	5	-	96
Profit/(loss) on sale of property, plant and equipment	(3)	-	(2)
Proceeds from sale of property, plant and equipment	2	-	94

Non-cash transactions

The principal non-cash transaction was the issue of equity instruments to employees and directors.

8. Business combinations

APS Pharma GmbH

On 29 April 2005, the group acquired 100% of the share capital of APS Pharma GmbH, a pharmaceutical marketing company operating in Germany.

The consideration for the acquisition, including costs that were directly related, was approximately €3 million (£2 million) in cash. At the date of the acquisition, the fair value of the net assets of APS were estimated to be €2.2 million (£1.5 million), resulting in goodwill of approximately £0.5 million.

The acquired business contributed revenues of £0.3 million and net loss of £0.02 million to the group for the period from 29 April to 30 June 2005.