

Press Release

ProStrakan Group plc Interim Results for the Six Months Ended 30 June 2006

13th September 2006: ProStrakan Group plc, the European specialty pharmaceutical company, today announces its interim results for the six months ended 30 June 2006. Together with progress made since the period end date, significant achievements have been recorded:

Operating Highlights

- **Sancuso** (transdermal granisetron patch for prevention of chemotherapy-induced nausea and vomiting)
 - Recruitment into Phase III trial completed on schedule in September 2006
 - On track to announce headline results in early 2007
 - Dossier expected for submission to US and EU during 2007 for launch by end 2008
- **Rapinyl** (muco-adhesive sub-lingual fentanyl tablet for breakthrough pain in cancer patients)
 - EU filing for marketing approval completed on schedule in July 2006. Approval being sought in EU under decentralised procedure – “Day 0” allocated as 1st September 2006
 - Distribution agreement for certain Central and Eastern Europe countries entered into with Gedeon Richter, announced in July
- **Tostran** (testosterone gel for hypogonadal males) (branded Tostrex in Sweden)
 - Following launch in Sweden, has now achieved 29% market share of testosterone gels
 - EU Mutual Recognition Procedure (MRP) was successfully concluded in April to allow pan-EU launches in 2007
 - Product rights extended to include Russia and CIS
 - Post-marketing, Phase IIIb/IV study progressing to plan
 - Product to be branded as Tostran for most EU markets
- **Rectogesic** (for pain associated with chronic anal fissures)
 - Strong UK sales in first half 2006 of £0.8 million (£0.1 million)
 - EU MRP successfully concluded in March to allow pan-EU launches in 2007
 - Product rights extended to include Russia and CIS
- **Droperidol/ Xomolix** (post-operative nausea and vomiting)
 - Filing made under EU decentralised procedure to allow wider marketing – “Day 0” allocated as 4th September 2006
- **Adcal D3** (osteoporosis)
 - Sales up 32% to £6.0 million (£4.5 million)
 - Achieved market leader status in the UK by volume and value
 - New pack sizes launched (56 and 112 tablets)
- **Research collaboration** with Amgen for development and commercialisation of certain preclinical compounds for renal disease, announced in July
 - Upfront of \$7 million, potentially in excess of \$150 million in milestones and royalties on sales

Financial Highlights

- **Sales** from products that continue to be sold up by 28% to £16.1 million (£12.6 million). Reported total sales at £16.3 million compare to first half 2005 (£16.5 million) as prior period included Sandoglobulin (reverted to its licensor in June 2005)
- **Organic product sales growth** of 24%
- **Gross profit** increased 14% to £9.9 million (£8.6 million)
- **Retained loss** of £14.9 million (£14.0 million); IFRS basic loss per share of 8.0p
- **Net cash** at period end of £20.0 million (31 December 2005: £38.7 million)
- **Share placing** in July raised additional £11.3 million before expenses

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

“The first half of the year and the period since have been a time of great achievement at ProStrakan and the benefits of our business model are now becoming evident. We have fast-growing revenues from our existing marketed products, high potential, value-driving products awaiting regulatory approval and launch throughout Europe over the coming 12-18 months and, behind that, a valuable development pipeline for which we are putting an effective distribution infrastructure in place. We are very well positioned to deliver growth on the back of the launch of a number of strategic products through 2007 and 2008 and look forward to a busy period of activity through the second half of the year.”

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ProStrakan

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Financial Dynamics

David Yates / Sarah Macleod

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A presentation and conference call for analysts will be held today at 10.15 for 10.30am 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 for the six months to 30th June 2006 September 2006

Note: all figures are rounded to 1 decimal place and those in brackets refer to the comparative figure for the six months to 30th June 2005 unless otherwise stated

Introduction

ProStrakan's goal is to build a sustainably profitable specialty pharmaceutical business with a broad range of novel products and a healthy pipeline. We have a strong specialist sales force now able to cover most major European markets and have a broad range of products either on the market, in or immediately post-registration or in development, leading us to believe that the key elements are in place to fulfil our objectives.

During the first half of 2006, we have made further important regulatory and commercial progress with our growing portfolio. In the period, we successfully completed the MRP process for Tostran and Rectogesic and have now started to receive national licences which in turn will allow us to commence commercialisation of these products from early next year.

Since the end of the half year, we have made further significant progress. We announce today that the recruitment for the Sancuso Phase III trial has been completed within schedule which will allow us to evaluate the results of this trial early next year in preparation for EU and US regulatory submissions. Rapinyl has been submitted into the EU decentralised procedure and accepted for review. The strength of demand for Droperidol (to be branded Xomolix in certain additional countries) in those markets where it is available has allowed us to enter into a wider EU regulatory process so as to gain additional approvals.

We announced in July that we had signed a significant Discovery partnership with Amgen to develop and commercialise compounds from a renal programme at our research unit in Paris. Also in July we announced that we had entered into a distribution agreement with Gedeon Richter for Rapinyl for certain CEE countries. Both of these transactions have brought cash into the company. We also placed 12.4 million shares in July to raise additional capital of £11.3 million (before expenses).

We further decided that launching Siklos (hydroxyurea with an orphan drug designation for sickle cell disease in Europe, currently in registration) was not a priority for the company and consequently sold on the rights with all associated costs. This caused us to write down the carrying value of this product (which arose from an earlier corporate acquisition) with a non-cash charge of £1.3 million (£Nil). We also received notification from Duramed that they did not intend to progress to a proof of concept study with the Trimegestone patch (contraception or HRT) and the rights to this project were returned to us.

Total revenue was £16.3 million (£16.5 million) of which product sales represented £16.1 million (£16.3 million). Excluding Sandoglobulin (an immunodeficiency product marketed in France which reverted to its licensor at the end of June 2005), product sales in the first half increased by 28% to £16.1 million (£12.6 million), driven by a 32% increase in sales of our largest product, Adcal D3 (for osteoporosis).

The loss for the period was £14.8 million (£14.0 million) reflecting strong cost control in keeping overhead down to a 3% increase compared to the same period in 2005. Our cash position at the period end was £20.0 million. Since the period end, we have received additional cash from partnering transactions and the share placing.

Operational Review

Product sales

Our underlying 28% increase in revenues arose from the increase in sales of our currently-marketed products of 24% (organic growth) with the balance representing growth from acquisitions in the comparative period.

Adcal D3 (osteoporosis) – the company's top selling medicine continued to strengthen its position as the UK market leader by value and volume in its segment. Revenues increased 32% in the period to £6.0 million (£4.5 million). In terms of volume, the number of units sold rose by 34% compared to the same period last year.

Isotard XL (angina) – increased sales by 15% to £2.2 million (£2.0 million). Isotard XL continued to show strong volume growth with unit sales up 16% in a price-competitive market segment.

Droperidol (post operative nausea and vomiting) – reported sales of £1.9 million in the period (£1.6 million), an increase of 15%. This product is sold in many European countries on a named patient basis only. To allow for broader promotion of this product, we have filed regulatory submissions to gain EU-wide approval using an additional brand name of Xomolix.

Tebetane (benign prostatic hyperplasia) – reported sales of £1.5 million in the period (£1.7 million), a decrease of 10%. This product, which is a phytopharmaceutical product derived from a plant extract, has been on the market in Spain since 1976 and has seen both mandated price reductions and some switching to more modern products. However, it has maintained its market share of this phytotherapy market segment.

Rectogesic (chronic anal fissures) – reported sales of £0.8m in the period (£0.1 million), following its successful launch in May 2005 in the UK. The product completed the EU MRP in March 2006 and we are now in the process of receiving national licences which in turn will permit the launch of Rectogesic across other EU countries from early next year. During the period the geographical rights to Rectogesic were extended to include Russia and CIS. Rectogesic is the first-to-market of the drugs for which we have in-licensed pan-European rights, offering us the economic benefits of providing our salesforce with an attractive, high value addition to the portfolio.

Tostran (testosterone gel for androgen deficient males) – reported sales of £0.1m in the Swedish market in the period (£Nil) following its launch in September 2005 (where it is branded Tostrex) and it is notable that it now has attained a 29% market share of the testosterone gels market. The product completed the EU MRP in April 2006 and we are now in the process of receiving national licences across other EU countries which in turn will permit the launch of Tostran from early next year. During the period the geographical rights to Tostran were extended to include Russia and CIS. We also continue on schedule with a Phase IIIb / IV trial (TIMES 2 trial) into the impact of testosterone replacement therapy in male Type 2 Diabetes patients and those with Metabolic Syndrome.

Tabphyn (benign prostatic hyperplasia) – reported sales in the period of £0.2m in the UK following its launch in April 2006 (£Nil).

Other products sales of £3.4m (£6.4 million of which Sandoglobulin represented £3.7 million) were achieved in the major markets of Europe, being mainly country-specific smaller products which have been added to our portfolio through company acquisitions.

R&D

Our investment continued in the first half with expenditure of £8.8 million (£9.1 million).

Rapinyl (muco-adhesive sub-lingual fentanyl tablet for breakthrough pain in cancer patients) – we licensed the European rights to Rapinyl in December 2005 from Orexo AB. EU approval for this product is being sought via the decentralised procedure. Since the period end, and on schedule, the file has been accepted for review with Day 0 allocated as 1st September 2006. Should this application for approval be successful, we anticipate being able to launch Rapinyl from the end of 2007. On 25th July the company announced a distribution agreement with Gedeon Richter Ltd, Hungary's largest pharmaceutical company, to distribute Rapinyl in seven territories in Central and Eastern Europe. We are confident that Rapinyl, with its user-friendly fast dissolving, fast-acting, muco-adhesive sub-lingual formulation and IP protection, offers an important long-term commercial opportunity for the Group.

Sancuso (transdermal patch for chemotherapy-induced nausea and vomiting) - significant progress was made in the period with our lead clinical development programme, a novel transdermal patch formulation of granisetron. Granisetron is an established 5-HT₃ receptor antagonist, and our novel patch formulation allows the drug to enter into the bloodstream steadily without the need for injection or having to swallow pills. This project is in a Phase III trial in over 600 patients which, if it is successful, will allow the product to be registered. We announce today that recruitment into this trial has completed within the expected schedule, and so we remain on course to be able to launch this important product to the Group's future by the end of 2008.

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 on 13th July the signing of a licence and collaboration agreement with Amgen to research, develop and commercialise certain of ProStrakan's preclinical compounds for renal disease. This significant agreement brings in an initial upfront payment of \$7 million (received after the period end), research collaboration payments, the possibility of additional milestones in excess of \$150 million and sales royalties. We believe that this represents industry-leading validation of our discovery skills and expertise.

Outlook

After an exceptionally busy and successful first half of the year, we have delivered and anticipate continuing to deliver news flow during the second half.

As a result of having met and in many cases exceeded our objectives to progress our late stage development projects and products in registration, we remain on track towards our goal of creating over the medium term a sustainably profitable specialty pharmaceutical company.

Commercialisation plans are well underway for the launch of Tostran and Rectogesic into many European markets which will take place from early 2007. The TIMES 2 study for Tostran continues on schedule and we anticipate that six month data from this planned two year study will be available late in 2007 to support the marketing of this product as it is rolled out across Europe.

Following the filing of both Rapinyl and Droperidol (Xomolix) into the EU decentralised procedure, if these are successful we anticipate launches into the second half of next year. We anticipate EU and US regulatory filings for Sancuso in the first half of 2007, with launches by the end of 2008.

The next 18 – 24 months will be a particularly busy and exciting time for ProStrakan and we look forward with confidence to updating our shareholders in due course with news of our progress.

Financial Review

The financial results for the six months ended 30 June 2006, prepared under the Group's accounting policies based on International Financial Reporting Standards, are presented below. The narrative reflects a comparison of our activities in 2006 and 2005 and, unless otherwise stated, the comparative figures in parentheses relate to the equivalent six-month period in 2005.

Trading results

Product sales from continuing products were £16.1 million (£12.6 million), an increase of 28% driven by growth in our largest selling product, Adcal D3. In the prior period, there were also sales of Sandoglobulin (£3.7 million) which reverted to its licensor in accordance with the license terms in June 2005.

Sales for the period in total were £16.3 million (£16.5 million) of which product sales represented the significant majority. Other income from royalties and licensing income amounted to £0.2 million (£0.2 million).

Cost of sales amounted to £6.5 million (£7.9 million), of which £5.7 million (£7.3 million) related to costs of products sold and royalty or license payments and £0.8 million (£0.6 million) to amortisation of acquired product rights - a non-cash charge. This gives a cash gross profit margin in H1 on product sales of 65.3% (55.8%) and a total gross margin of 60.3% (52.2%). The increase in gross margin percentage compared to the prior period arises from the cessation of sales of Sandoglobulin, which were at a low margin, and a change in product sales mix.

Operating costs before amortisation of intangibles were £24.5 million (£23.8 million), an increase of 3%. Distribution costs were £10.9 million (£9.4 million) with the increase arising from the inclusion of the acquisition of APS in Germany for the full current period (2 months only in prior period) and from increased sales and marketing activity in preparation for next year's launches. Expenditure on R&D was £8.8 million (£9.1 million) with the reduction arising as a result of restructuring of the Discovery unit in Romainville, Paris at the end of 2005 being offset somewhat by the cost of the Sancuso Phase III trial and other regulatory support or clinical trials undertaken. Administrative costs were £4.8 million (£5.3 million) reflecting lower charges from employee option costs at £1.1 million (£1.2 million) and the absence of certain costs broadly related to the IPO in 2005. In addition, there was a charge for impairment of an intangible asset of £1.3 million (£Nil) which is a non-cash charge and arose on the disposition by the company of its interest in Siklos, a product for sickle cell disease.

Operating loss from the above was £15.9 million (£15.1 million). As a result of higher net cash balances, interest income increased to £0.8 million (£0.5 million). Net tax credits were little changed at £0.2 million (£0.5 million) and the loss for the period was consequently £14.9 million (£14.0 million).

Cash flow

Cash used in operating activities was £14.4 million (£13.1 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 £3.4 million (£2.9 million) which comprised the acquisition of product rights - primarily Rapinyl - of £3.3 million (£0.5 million) and capital expenditure on tangible assets of £0.1 million (£0.4 million). No cash was generated by financing activities in the period (£38.6 million).

As at 30 June 2006, cash on hand was £20.0 million (£56.1 million). Since the period end, there have been further receipts from the share placing and partnering and licensing transactions.

Consolidated interim balance sheet (unaudited)

		Restated		
	Note	30 June 2006	30 June 2005	31 December 2005
		£'000	£'000	£'000
Assets				
Non-current assets				
Intangible assets	4	40,713	24,092	38,642
Property, plant and equipment		5,541	6,191	6,381
Research and development tax credits receivable		6,072	6,584	6,252
		52,326	36,867	51,275
Current assets				
Inventories		4,000	2,970	3,463
Trade and other receivables		6,487	7,563	6,412
Income tax receivable		250	126	233
Research and development tax credits receivable		1,417	378	1,435
Cash and cash equivalents		19,979	56,113	38,730
		32,133	67,150	50,273
Liabilities				
Current liabilities				
Trade and other payables		14,050	16,969	19,147
Income tax liabilities		-	67	-
Retirement benefit obligations		-	24	-
Provisions for other liabilities and charges		1,114	29	2,143
		15,164	17,089	21,290
Net current assets		16,969	50,061	28,983
Non-current liabilities				
Retirement benefit obligations		342	351	323
Other non-current liabilities		11,635	1,809	8,517
Provisions for other liabilities and charges		2,130	382	2,103
		14,107	2,542	10,943
Net assets		55,188	84,386	69,315
Equity				
Capital and reserves attributable to the Company's equity holders				
Share capital	5	158,791	158,867	158,786
Other reserves		78,657	73,151	77,911
Retained earnings		(182,260)	(147,632)	(167,382)
Total equity		55,188	84,386	69,315

The notes on pages 9 to 17 are an integral part of these consolidated interim financial statements.

Consolidated interim income statement (unaudited)

	Note	Six months ended 30 June 2006 £'000	Restated Six months ended 30 June 2005 £'000	Year ended 31 December 2005 £'000
Sales	3	16,348	16,535	31,637
Cost of goods sold		(6,480)	(7,900)	(14,949)
Gross profit		9,868	8,635	16,688
Distribution costs		(10,891)	(9,357)	(19,970)
Research and development		(8,817)	(9,080)	(22,429)
Administrative expenses		(4,798)	(5,321)	(11,307)
Impairment of Intangibles		(1,274)	-	-
Other gains — net		42	51	206
Operating loss		(15,870)	(15,072)	(36,812)
Finance income — net		793	513	1,432
Loss before income tax		(15,077)	(14,559)	(35,380)
Taxation		204	531	1,615
Loss for the period		(14,873)	(14,028)	(33,765)

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	(8.0)	(11.0)	(21.5)
- diluted	6	(7.7)	(10.5)	(20.7)

The notes on pages 9 to 17 are an integral part of these consolidated interim financial statements.

Consolidated interim statement of changes in equity (unaudited)

	Share capital	Fair value and other reserves	Retained earnings	Total equity
	£'000	£'000	£'000	£'000
Balance at 1 January 2005	122,648	76,905	(133,602)	65,951
Currency translation differences – being net loss recognised directly in equity	-	(4,929)	-	(4,929)
Loss for the period	-	-	(14,028)	(14,028)
Total recognised income for the period	-	(4,929)	(14,028)	(18,957)
Employee share option scheme:				
- value of services provided	-	1,175	-	1,175
- proceeds from shares issued	129	-	-	129
Other share based payments	32	-	-	32
Issue of share capital	35,625	-	-	35,625
Purchase of own shares by ESOP	(200)	-	-	(200)
Sale of own shares by ESOP	633	-	(2)	631
	36,219	1,175	(2)	37,392
Balance at 30 June 2005	158,867	73,151	(147,632)	84,386
Balance at 1 July 2005	158,867	73,151	(147,632)	84,386
Currency translation differences – being net income recognised directly in equity	-	3,802	-	3,802
Loss for the period	-	-	(19,737)	(19,737)
Total recognised income for the period	-	3,802	(19,737)	(15,935)
Employee share option scheme:				
- value of services provided	-	958	-	958
- proceeds from shares issued	1	-	-	1
Issue of share capital	(92)	-	-	(92)
Sale of own shares by ESOP	(3)	-	-	(3)
Revaluation of owned shares held by ESOP	13	-	(13)	-
	(81)	958	(13)	864
Balance at 31 December 2005	158,786	77,911	(167,382)	69,315
Balance at 1 January 2006	158,786	77,911	(167,382)	69,315
Currency translation differences – being net loss recognised directly in equity	-	(382)	-	(382)
Loss for the period	-	-	(14,873)	(14,873)
Total recognised income for the period	-	(382)	(14,873)	(15,255)
Employee share option scheme:				
- value of services provided	-	1,128	-	1,128
Revaluation of owned shares held by ESOP	5	-	(5)	-
	5	1,128	(5)	1,128
Balance at 30 June 2006	158,791	78,657	(182,260)	55,188

The notes on pages 9 to 17 are an integral part of these consolidated interim financial statements.

Consolidated interim cash flow statement (unaudited)

	Note	Six months ended 30 June 2006 £'000	Six months ended 30 June 2005 £'000	Year ended 31 December 2005 £'000
Cash flows from operating activities				
Cash used in operations	7	(15,656)	(13,561)	(29,612)
Interest received		809	533	1,474
Interest paid		(16)	(20)	(42)
R&D tax credits received		468	95	473
Income tax paid		(42)	(111)	(62)
Net cash used in operating activities		(14,437)	(13,064)	(27,769)
Cash flows from investing activities				
Acquisition of subsidiaries, net of cash acquired		-	(2,095)	(2,133)
Sale of investment (acquired in business combination)		-	93	93
Purchases of intangible assets		(3,344)	(554)	(2,602)
Purchases of property, plant and equipment (PPE)		(112)	(395)	(1,447)
Proceeds from sale of PPE	7	1	2	13
Net cash generated by investing activities		(3,455)	(2,949)	(6,076)
Cash flows from financing activities				
Net proceeds of accounts receivable factoring	7	-	2,390	2,899
Proceeds from issuance of ordinary shares (net of own shares purchased by ESOP)		-	35,554	35,462
Proceeds from sale of own shares by ESOP		-	630	630
Net cash generated by financing activities		-	38,574	38,991
Exchange losses on cash and bank overdrafts		(859)	(476)	(444)
Net (decrease)/increase in cash and bank overdrafts		(18,751)	22,085	4,702
Cash and bank overdrafts at the beginning of the period		38,730	34,028	34,028
Cash and bank overdrafts at the end of the period		19,979	56,113	38,730

The notes on pages 9 to 17 are an integral part of these consolidated interim 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.

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

2. Summary of significant accounting policies

The financial information presented in these financial statements has been prepared on the basis of those International Financial Reporting Standards (IFRS), International Accounting Standards (IAS), and International Financial Reporting Interpretations Committee (IFRIC) and Standard Interpretation Committee (SIC) interpretations that are expected to be applicable to 2006 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 2006.

2.1 Basis of preparation

These interim consolidated financial statements are for the six months ended 30 June 2006. They were approved by the Board of Directors on 12 September 2006 and are unaudited. The Group accounts for the year to 31 December 2005 prepared in accordance with IFRS, which carried an unqualified Auditors' Report, have been filed with the Registrar of Companies.

Where necessary, the results for the half year to June 2005 have been restated to reflect the accounting policies and treatments adopted in the Report and Accounts for the year ended 31 December 2005.

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.

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.

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 are viewed as separate CGUs. 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 are 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.

Notes to the consolidated financial statements

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.

2.5 **Impairment of assets**

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

2.6 **Employee benefits**

(a) *Pension obligations*

The Group operates both defined benefit pension schemes based on final salary and defined contribution schemes.

Group companies operate two defined benefit pension schemes. The schemes are unfunded, and the obligations are determined by annual actuarial calculations. The schemes are mandatory under the French Chemical and Pharmaceutical Industries Collective Agreements and require the companies to pay retirement lump-sum amounts depending on the employees' seniority as and

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when they retire from the company with full pension as defined by the French Social Security system.

The liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date, together with adjustments for unrecognised actuarial gains or losses and past service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related pension liability.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to profit or loss over the employees' expected average remaining working lives, only to the extent that their net cumulative amount exceeds 10% of the greater of the present value of the obligation or of the fair value of the plan assets at the end of the previous year. The plan is unfunded, so there are no plan assets. Unrecognised actuarial gains and losses are reflected on the balance sheet.

Past-service costs are recognised immediately in profit or loss, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

For defined contribution schemes, the assets are held separately from those of the Group in independently administered funds. Payments to defined contribution schemes are charged to the income statement as they fall due.

(b) Long service employee benefits

One of the Group's French subsidiaries operates a long service employment benefit scheme, whereby employees are paid seniority bonuses upon reaching certain anniversaries within the Company. The liabilities are measured on an actuarial basis using the projected unit credit method and are discounted at a rate equivalent to the current rate of return on a high quality corporate bond in France of equivalent term to the scheme liabilities. The actuarial valuations are obtained annually. Service costs are included in staff costs and charged to profit or loss in the period in which they become payable. The liability is presented within provisions for liabilities and charges.

(c) Share-based compensation

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

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

(d) Termination benefits

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

(e) Bonus plans

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

2.7 Revenue Recognition

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

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

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

(a) Sales of product

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

(b) Sales of services

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

(c) Licensing, development and milestone income

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

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

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

In circumstances where the initial licence is not for a defined period and there is no royalty arrangement related to the licence product included in the agreement, revenue is deferred and recognised over the period to the expiry of the relevant patent to which the licence relates.

Revenue from R&D collaboration agreements is recognised as the services are performed.

Included in the terms of certain licensing and R&D agreements, the Group expects to receive non-refundable milestone income as certain technical or other performance related targets are achieved. In these circumstances revenue is recognised on achieving such milestones. Where the milestone income relates to clinical milestones, such as first patient entered into a clinical trial then revenue is recognised when the income is receivable.

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

(d) Royalty income

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

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

(e) Interest income

Interest income is recognised on a time-proportion basis using the effective interest method. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at original effective interest rate of the instrument, and

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continues unwinding the discount as interest income. Interest income on impaired loans is recognised either as cash is collected or on a cost-recovery basis as conditions warrant.

(f) Grants

Grants from the Government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

Government grants relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs that they are intended to compensate.

3. 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 organised 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 2006 £'000	Six months ended 30 June 2005 £'000	Year ended 31 December 2005 £'000
Sales			
United Kingdom	9,441	6,878	15,518
European Union (excluding the UK)	6,779	9,511	15,777
Other countries	128	146	342
	<u>16,348</u>	<u>16,535</u>	<u>31,637</u>

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

	30 June 2006	30 June 2005	31 December 2005
Total assets			
United Kingdom	24,449	56,568	42,097
European Union (excluding the UK)	38,976	43,200	42,501
Other countries	21,034	4,249	16,950
	<u>84,459</u>	<u>104,017</u>	<u>101,548</u>

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

	Six months ended 30 June 2006	Six months ended 30 June 2005	Year ended 31 December 2005
Capital expenditure			
United Kingdom	68	207	1,138
European Union (excluding the UK)	31	2,504	2,765
Other countries	5,504	-	11,905
	<u>5,603</u>	<u>2,711</u>	<u>15,808</u>

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

	Six months ended 30 June 2006	Six months ended 30 June 2005	Year ended 31 December 2005
Analysis of sales by category			
Sales of goods	16,136	16,326	31,106
Revenue from services	1	134	134
Licensing Income	140	44	330
Royalty income	71	31	67
	<u>16,348</u>	<u>16,535</u>	<u>31,637</u>

4. Intangible Assets

Impairment of Intangible assets

Impairment of Intangibles in the period relates to the excess of carrying value over sales proceeds of product rights in France sold after the balance sheet date, (note 8).

Impairment tests for goodwill & other intangibles

Goodwill arising from previous acquisitions is tested annually for carrying value under IAS 36.

The goodwill arising on the acquisition of Proskelia BV in 2004 was tested for impairment and fully impaired as at 2004 year end and represents the appropriate IFRS treatment of goodwill that arose on this acquisition and reflects the Directors view that no significant value has been attributed to the Research Cash Generating Unit.

5. Share capital

	Total
	'000
Authorised – shares of £0.05 each	
30 June 2006	400,000
Issued and fully paid – shares of £0.05 each	
In issue at 30 June 2006	186,792
Own shares held by ESOP	(20)
30 June 2006	186,772

	Number of shares	Ordinary shares	Share premium	Own shares held	Total
	'000	£'000	£'000	£'000	£'000
At 1 January 2006	186,772	9,340	149,469	(23)	158,786
Revaluation of owned shares held by ESOP				5	5
At 30 June 2006	186,772	9,340	149,469	(18)	158,791

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 was set up so as to enable future employees of the group to acquire shares in the company, which could not then be readily purchased externally.

Share options

The company maintains a number of historical share schemes from which there are no further grants in addition to the following Share Plans:

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 has obtained 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 are 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.

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

Share Option Schemes	Average exercise price per share	Options ('000)
At 1 January 2006	£1.4200	14,796
Granted	£0.8413	2,740
Exercised	-	-
Lapsed/expired/surrendered	£1.4170	(536)
At 30 June 2006	£1.3242	17,000

Out of the 17,000,370 outstanding options, 7,336,187 options were exercisable. No options were exercised in the six months ended 30 June 2006.

SAYE	Average exercise price per share	Options ('000)
At 1 January 2006	-	-
Granted	£1.0000	214
Exercised	-	-
Lapsed/expired/surrendered	-	-
At 30 June 2006	£1.0000	214

6. Earnings per share

Basic

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

	30 June 2006	30 June 2005	31 December 2005
Loss attributable to equity holders of the Company (£'000)	(14,873)	(14,028)	(33,765)
Weighted average number of ordinary shares in issue ('000)	186,772	126,993	157,001
Basic loss per share (pence per share)	(8.0)	(11.0)	(21.5)

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 dilutive potential Ordinary Shares includes only in-the-money options and PSP awards. 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). Since it seems inappropriate to assume that option and warrant holders would exercise out-of-the-money share options and warrants, no adjustment has been made for these potential Ordinary Shares.

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	30 June 2006	30 June 2005	31 December 2005
Loss attributable to equity holders of the Company (£'000)	(14,873)	(14,028)	(33,765)
Weighted average number of ordinary shares in issue ('000)	186,772	126,993	157,001
Adjustment for – shares to be issued ('000)	6,702	6,381	6,378
Weighted average number of ordinary shares for diluted earning per share ('000)	193,474	133,374	163,379
Diluted loss per share (pence per share)	(7.7)	(10.5)	(20.7)

7. Cash generated from operations

	Six months ended 30 June 2006	Six months ended 30 June 2005	Year ended 31 December 2005
	£'000	£'000	£'000
Loss for the period	(14,873)	(14,028)	(33,765)
Adjustments for:			
- Tax	(204)	(531)	(1,615)
- Depreciation	1,135	882	1,827
- Amortisation	813	906	2,700
- Impairment of Intangibles	1,274	-	-
- Loss on sale of property, plant and equipment (see below)	11	3	5
- Net movement for provisions for liabilities and charges	(1,000)	20	(16)
- Net movement in pension liability	(15)	24	(12)
- Charges for share based employee benefits	1,128	1,216	2,162
- Loss in short term investments	-	(1)	(1)
- Net proceeds from accounts receivable factoring	-	(2,390)	(2,899)
- Interest income	(809)	(533)	(1,474)
- Interest expense	16	20	42
- Changes in working capital (excluding the effects of acquisition and exchange difference on consolidation):			
- Inventories	(357)	325	(141)
- Trade and other receivables	(72)	1,427	2,675
- Trade and other payables	(2,703)	(901)	900
Cash used in operations	(15,656)	(13,561)	(29,612)
In the cash flow statement, proceeds from sale of property, plant and equipment comprise:			
Net book amount	12	5	18
Loss on sale of property, plant and equipment	(11)	(3)	(5)
Proceeds from sale of property, plant and equipment	1	2	13

8. Post balance sheet events

On 13 July the company announced a Placing of 12,434,943 shares with institutional investors at a price of 91 pence per share, raising £11.3m before expenses. The Placing Shares represent approximately 6.7 per cent. of the Company's existing share capital.

On 13 July the company also announced the signing of a license and collaboration agreement with Amgen Inc. to research, develop and commercialise certain of ProStrakan's preclinical compounds for renal disease. Under the terms of this agreement, ProStrakan has granted Amgen an exclusive worldwide licence for the development and commercialisation of its compounds in exchange for an initial upfront payment of \$7 million, research collaboration funding and the possibility of additional milestone income in excess of \$150 million and royalty income based on sales.

On 25 July 2006 the company announced the signing of a distribution agreement with Gedeon Richter Ltd, Hungary's largest pharmaceutical company, to distribute Rapinyl, a muco-adhesive sub-lingual fentanyl tablet for breakthrough pain in cancer patients, in seven territories in Central and Eastern Europe. ProStrakan originally licensed the European rights to Rapinyl from Orexo AB in December 2005.

On 27 July the company agreed the sale of intellectual property and related assets in respect of Siklos, a hydroxyurea product with orphan drug status for sickle-cell disease.