

## **Sinclair Pharma PLC**

### **TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) SUPPORTING DOCUMENT FOR 31 DECEMBER 2005 INTERIM STATEMENT**

#### **1. Introduction**

The Group's financial statements for the year ended 30 June 2006 will be the first annual financial statements that comply with International Financial Reporting Standards (IFRS) as adopted by the European Union. The Group's financial statements prior to and including 30 June 2005 had been prepared in accordance with Generally Accepted Accounting Principles in the United Kingdom (UK GAAP).

The purpose of this document is to explain the principal changes in accounting policies arising from the adoption of IFRS and present the restated financial information in section 6 as follows:

- Income statements for six months ended 31 December 2004 and the year ended 30 June 2005.
- Balance sheets as at 30 June 2004, 31 December 2004 and 30 June 2005.

#### **2. Basis of preparation**

The financial information has been prepared on the basis of IFRS as adopted by the European Union, and that the Directors expect to apply as at 30 June 2006. IFRS remains subject to amendment and interpretation by the International Accounting Standards Board (IASB) and there is an ongoing process of review and endorsement by the European Commission. Consequently, the revised accounting policies, which are detailed in section 5 are provisional and subject to change. These policies have been consistently applied to all the periods presented except those relating to the classification and measurement of financial instruments. The Group has made use of the exemption available under IFRS 1, First time adoption of International Accounting Standards, to apply IAS 32, Financial Instruments: Disclosure and Presentation and IAS 39, Financial Instruments: Recognition and Measurement from 1 July 2005 only.

The financial information contained in this document is unaudited and does not constitute full financial information as defined in Section 240 of the Companies Act 1985 (as amended).

The financial information in respect of the year ended 30 June 2005 has been prepared using extracts from the statutory accounts prepared under UK GAAP for this period and amended by adjustments arising from the implementation of IFRS as detailed below. The statutory accounts for this period have been filed with the Register of Companies. The auditors report on these accounts was unqualified and did not contain a statement under section 237 (2) or (3) of the Companies Act 1985 which deal respectively with the maintaining of proper accounting books and records and the availability of information to the auditors.

#### **3. Transitional provisions**

IFRS 1, First Tme Adoption of IFRS, sets out the procedures to be followed when adopting IFRS for the first time as the basis for preparing the Group's financial statements. The Group is required to establish its IFRS accounting policies for the year ending 30 June 2006, and, apply these retrospectively to determine the IFRS opening balance sheet at the date of transition, 1 July 2004. IFRS 1 provides a number of optional exemptions to this general principle. The Group has taken advantage of two of the exemptions afforded to it under IFRS:

##### **IFRS 3, Business Combinations**

The Group has elected not to restate business combinations occurring before the date of transition.

#### **IFRS 2, Share-based Payment**

The Group has elected to only apply IFRS 2 to all share-based awards and options granted post 7 November 2002 that had not vested by 1 July 2005.

#### **4. Principal differences between IFRS and UK GAAP**

The principal effects of IFRS on the financial statements of the Group are as follows:

##### **Presentation – IAS 1, Presentation of Financial Statements**

The presentation format of IFRS is different from UK GAAP and the illustrative financial information herein is designed to assist the reader to understand these changes.

##### **Employee option and performance share schemes – IFRS 2, Share-based Payments**

The Group makes equity-settled share based payments to its employees and directors. Such payments are measured at fair value at the date of grant and expensed to the profit and loss account over time. All transactions within the scope of IFRS 2 (subject to the transitional exemptions noted above) are valued based on the fair value of the option or award at grant date and expensed to the income statement over the vesting period of the scheme.

##### **Acquisitions – IFRS 3, Business Combinations**

IFRS 3 requires that goodwill arising upon acquisition of businesses is not amortised but is subject to impairment reviews. As noted in section 3, the Group has applied the exemption not to restate business combinations prior to the date of transition, and as a result, amortisation previously charged under U.K. GAAP has been reversed from 1 July 2004 onwards.

As a result of the transition to IFRS, the accounting for the Euroderm acquisition, completed in January 2005, has been reviewed. As a result of the transition and the revaluation using fair value of the intangible assets acquired, the intangible assets recognized under UK GAAP have not now been recognized under IFRS, resulting in an increase in the goodwill arising on this acquisition.

#### **5. Summary of principal accounting policies**

The financial information included in the interim statement for the six months ended 31 December 2005 and the restated comparative information contained in this document have been prepared under the historical cost convention applying the principal accounting policies summarised below. As previously indicated, IFRS is subject to amendment and interpretation by the IASB and to review and endorsement by the European Commission. Consequently these accounting policies may be subject to change.

##### **Basis of consolidation**

The consolidated financial statements of Sinclair Pharma PLC incorporate the financial statements of the Company and its subsidiaries. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. Control is achieved where the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. They are de-consolidated from the date on which control ceases.

The acquisition method of accounting is applied to all business combinations made by the Group. The cost of an acquisition is measured, as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed, in a business combination are measured initially at their fair values on the date of acquisition, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of identifiable net assets, including intangible assets acquired, is recorded as goodwill. If the cost of acquisition is less than the fair value of the Group's share of net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring accounting policies used into line with those used by the Group. On consolidation, all intra-group transactions, balances, income and expenditure are eliminated.

##### **Foreign currency translation**

Items included in the financial statements of each of the Group's entities are measured using the functional currency of the primary economic environment in which the entity operates (the "functional currency"). The

consolidated financial statements are presented in Sterling, which is the Company's functional and presentational currency. Transactions in foreign currencies are recorded at the rate of exchange ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the rates of exchange prevailing at that date. Gains and losses arising on translation are included in the income statement. The results of operations that have a functional currency different from the presentational currency are translated at the average rate of exchange during the period and their balance sheets at the rates ruling at the date of the balance sheet. Exchange differences arising on translation from 1 July 2004 are taken directly to a separate component of equity, the cumulative translation reserve.

#### **Revenue recognition**

Revenue from product sales is recognised upon shipment to customers. Provisions for rebates, product returns and discounts to customers are provided for as reductions to revenue in the same period as the related sales occurred. Royalties receivable under licensing agreements are recognised as they are earned and are recorded within revenue. The recognition of other payments received and receivable, such as licence fees, upfront payments and milestones, is dependent on the terms of the related arrangement, having regard to the ongoing risks and rewards of the arrangement, and the existence of any performance or repayment obligations, if any, with the third party. Amounts received are recognised immediately as revenue where there are no substantial remaining risks, no ongoing performance obligations and amounts received are not refundable. Amounts are deferred over an appropriate period where these conditions are not met.

#### **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, including intangible assets, of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries 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 arising on acquisitions before the date of transition to IFRS has been retained at the previous UK GAAP amounts.

#### **Intangible assets**

##### **a) Licences and trademarks**

Licences and trademarks including product distribution rights and technical dossiers are recognized at cost. They have a definite useful life and are carried at cost less accumulated amortization. Amortisation is calculated using the straight-line method to allocate the cost over their estimated useful lives (10 to 18 years).

##### **b) Research and development**

Research expenditure is recognised as an expense as incurred. Costs incurred on development activities are recognised as intangible assets when it is probable that the project will be a success, considering its commercial and technological feasibility, status of regulatory approval, and costs can be measured reliably. Other development expenditure is recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Development costs that have a finite useful life and that have been capitalised are amortised from the date of regulatory approval of the product on a straight-line basis over the period of its expected benefit.

#### **Property, plant and equipment**

All property, plant and equipment is shown at cost less accumulated depreciation and impairment. Cost includes expenditure that is directly attributable to the acquisition of the items.

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

Depreciation on assets is calculated to write off the cost of each asset to its residual value over its estimated useful life as follows:

Leasehold improvements expensed over period of lease – straight-line basis

Computer equipment and software depreciated at 25% per year – reducing balance basis  
Fixtures and fittings depreciated at 15% to 25% per year – reducing balance basis

The assets residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or where shorter, over the term of the relevant lease.

#### **Impairment of intangible assets**

Annually, the Group reviews the carrying amounts of its intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted. If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately. Impairment losses in respect of goodwill may not be reversed.

#### **Inventories**

Inventories are valued at the lower of cost and net realisable value. Cost is determined using the first in first out (FIFO) method. Provision is made for obsolete, slow-moving or defective items where appropriate. Net realisable value is determined at the balance sheet date on commercially saleable products based on estimated selling price less all further costs to completion and all relevant marketing, selling and distribution costs.

#### **Taxation**

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the period. Taxable profit differs from net profit as reported in the income statement because it excludes items of income and expenses that are taxable and deductible in other periods and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or the initial recognition (other than a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising from investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets are reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

**Leases**

Leases are classifieded as a finance lease whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Assets held under finance leases and HP contracts are capitalised and included in tangible fixed assets at fair value. Each asset is depreciated over the shorter of the lease term or its useful life. The obligations related to finance leases, net of finance charges in respect of future periods, are included, as appropriate, under creditors due within, or creditors due after more than, one year. The interest element of a rental obligation is allocated to accounting periods during the lease term to reflect a constant rate of interest on the remaining balance of the obligation for each accounting period.

Rentals under operating leases are charged to income on a straight-line basis over the term of the relevant lease.

**Pensions**

The Group operates a defined contribution pension scheme for its employees. The assets of the scheme are held in independently administered funds. Contributions are charged to the profit and loss account as they become payable in accordance with the rules of the schemes.

**Other employee benefits**

The expected cost of compensated short-term absence (i.e. holidays) is recognised when employees render services that increase their entitlement. An accrual is made for holidays earned but not taken.

**Share-based payments**

The Group grants share options to directors and employees. Equity-settled share-based payments are measured at fair value at the date of grant and expensed on a straight-line basis over the expected life of the option, based on the estimated number of options that will eventually vest.

The share options granted have varying performance criteria required for the option to vest and these are considered in the method of measuring the fair value. Where it is considered appropriate, the fair value is measured using the Black-Scholes model. Where complex market performance criteria exist, a Montecarlo model has been used to establish the fair value on grant.

**Trade receivables**

Trade receivables do not carry any interest and are stated at their face value as reduced by appropriate allowances for estimated irrecoverable amounts.

**Trade payables**

Trade payables are not interest bearing and are stated at their face value.

**Cash and cash equivalents**

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

## 6. Restated IFRS financial information

### Reconciliation of the UK GAAP profit and loss account to the IFRS income statement for the six months ended 31 December 2004 (unaudited)

	Notes	UK GAAP in IFRS format £'000	Effect of transition to IFRS £'000	IFRS £'000
<b>Revenue</b>		<b>796</b>	-	<b>796</b>
Cost of Sales		(408)	-	(408)
<b>Gross Profit</b>		<b>388</b>		<b>388</b>
Administrative expenses				
Selling, marketing and distribution costs		(711)	-	(711)
General and administrative expenses	(i)	(1,942)	85	(1,857)
Total administrative expenses		(2,653)	85	(2,568)
<b>Operating loss</b>		<b>(2,265)</b>	<b>85</b>	<b>(2,180)</b>
Interest receivable		149	-	149
Interest payable and similar charges		(1)	-	(1)
<b>Loss before tax</b>		<b>(2,117)</b>	<b>85</b>	<b>(2,032)</b>
Taxation		10	-	10
<b>Loss for the period</b>		<b>(2,127)</b>	<b>85</b>	<b>(2,042)</b>

### Reconciliation of the UK GAAP profit and loss account to the IFRS income statement for the year ended 30 June 2005 (unaudited)

	Notes	UK GAAP in IFRS format £'000	Effect of transition to IFRS £'000	IFRS £'000
<b>Revenue</b>		<b>6,971</b>	-	<b>6,971</b>
Cost of Sales		(2,616)	-	(2,616)
<b>Gross Profit</b>		<b>4,355</b>		<b>4,355</b>
Administrative expenses				
Selling, marketing and distribution costs		(2,489)	-	(2,489)
General and administrative expenses	(i)	(4,720)	168	(4,552)
Total administrative expenses		(7,209)	168	(7,041)
<b>Operating loss</b>		<b>(2,854)</b>	<b>168</b>	<b>(2,686)</b>
Interest receivable		248	-	248
Interest payable and similar charges		(18)	-	(18)
<b>Loss before tax</b>		<b>(2,624)</b>	<b>168</b>	<b>(2,456)</b>
Taxation		45	-	45
<b>Loss for the year</b>		<b>(2,669)</b>	<b>168</b>	<b>(2,501)</b>

**Reconciliation of UK GAAP balance sheet to the IFRS balance sheet at 30 June 2004 – date of transition to IFRS (unaudited)**

	UK GAAP in IFRS format £'000	Effect of transition to IFRS £'000	IFRS £'000
<b>Non-current assets</b>			
Goodwill	15,662	-	15,662
Other intangible assets	1,266	-	1,266
Property, plant and equipment	124	-	124
	<u>17,052</u>	<u>-</u>	<u>17,052</u>
<b>Current assets</b>			
Inventories	109	-	109
Trade and other receivables	2,061	-	2,061
Cash and cash equivalents	7,753	-	7,753
	<u>9,923</u>	<u>-</u>	<u>9,923</u>
<b>Total assets</b>	<b>26,975</b>	<b>-</b>	<b>26,975</b>
<b>Current liabilities</b>			
Trade and other payables	1,406	-	1,406
Current tax liabilities	384	-	384
Financial liabilities			
Bank overdraft, loans and other borrowings	70	-	70
	<u>1,860</u>	<u>-</u>	<u>1,860</u>
<b>Non-current liabilities</b>			
Minority equity interest	(4)	4	-
	<u>(4)</u>	<u>4</u>	<u>-</u>
<b>Total liabilities</b>	<b>1,856</b>	<b>4</b>	<b>1,860</b>
<b>Net assets</b>	<b>25,119</b>	<b>(4)</b>	<b>25,115</b>
<b>Equity</b>			
Share capital	539	-	539
Share premium account	16,030	-	16,030
Shares to be issued	4,367	-	4,367
Merger reserve	10,062	-	10,062
Other reserve	698	-	698
Retained earnings	(6,577)	-	(6,577)
	<u>25,119</u>	<u>-</u>	<u>25,119</u>
Minority equity interests	-	(4)	(4)
<b>Total equity</b>	<b>25,119</b>	<b>(4)</b>	<b>25,115</b>

**Reconciliation of UK GAAP balance sheet to the IFRS balance sheet at 31 December 2004  
– (unaudited)**

	UK GAAP in IFRS format £'000	Effect of transition to IFRS £'000	IFRS £'000
<b>Non-current assets</b>			
Goodwill	14,373	457	14,830
Other intangible assets	1,224	-	1,224
Property, plant and equipment	169	-	169
	<u>15,766</u>	<u>457</u>	<u>16,223</u>
<b>Current assets</b>			
Inventories	82	-	82
Trade and other receivables	1,607	-	1,607
Cash and cash equivalents	6,680	-	6,680
	<u>8,369</u>	<u>-</u>	<u>8,369</u>
<b>Total assets</b>	<b>24,135</b>	<b>457</b>	<b>24,592</b>
<b>Current liabilities</b>			
Trade and other payables	1,882	-	1,882
Current tax liabilities	111	-	111
	<u>1,993</u>	<u>-</u>	<u>1,993</u>
<b>Non-current liabilities</b>			
Minority equity interest	(4)	4	-
	<u>(4)</u>	<u>4</u>	<u>-</u>
<b>Total liabilities</b>	<b>1,989</b>	<b>4</b>	<b>1,993</b>
<b>Net assets</b>	<b>22,146</b>	<b>453</b>	<b>22,599</b>
<b>Equity</b>			
Share capital	552	-	552
Share premium account	17,303	-	17,303
Shares to be issued	2,251	-	2,251
Merger reserve	10,062	-	10,062
Cumulative translation reserve	-	(50)	(50)
Other reserve	695	-	695
Retained earnings	(8,717)	507	(8,210)
	<u>22,146</u>	<u>457</u>	<u>22,603</u>
Minority equity interests	-	(4)	(4)
<b>Total equity</b>	<b>22,146</b>	<b>453</b>	<b>22,599</b>

**Reconciliation of UK GAAP balance sheet to the IFRS balance sheet at 30 June 2005-  
(unaudited)**

	UK GAAP in IFRS format £'000	Effect of transition to IFRS £'000	IFRS £'000
<b>Non-current assets</b>			
Goodwill	15,949	2,156	18,105
Other intangible assets	2,392	(1,209)	1,183
Property, plant and equipment	393	-	393
	<u>18,734</u>	<u>947</u>	<u>19,681</u>
<b>Current assets</b>			
Inventories	601	-	601
Trade and other receivables	4,901	-	4,901
Cash and cash equivalents	4,908	-	4,908
	<u>10,410</u>		<u>10,410</u>
<b>Total assets</b>	<b>29,144</b>	<b>947</b>	<b>30,091</b>
<b>Current liabilities</b>			
Trade and other payables	4,343	-	4,343
Current tax liabilities	17	-	17
Financial liabilities			
- Obligations under finance leases	16	-	16
- Bank overdrafts	464	-	464
	<u>4,840</u>	<u>-</u>	<u>4,840</u>
<b>Non-current liabilities</b>			
Financial liabilities			
- Bank loan	135	-	135
- Obligations under finance leases	40	-	40
Minority equity interest	(4)	4	-
	<u>171</u>	<u>4</u>	<u>175</u>
<b>Total liabilities</b>	<b>5,011</b>	<b>4</b>	<b>5,015</b>
<b>Net assets</b>	<b>24,133</b>	<b>943</b>	<b>25,076</b>
<b>Equity</b>			
Share capital	592	-	592
Share premium account	16,171	-	16,171
Merger reserve	15,684	-	15,684
Cumulative translation reserve	-	48	48
Other reserve	686	-	686
Retained earnings	(9,000)	899	(8,101)
	<u>24,133</u>	<u>947</u>	<u>25,080</u>
Minority equity interests	-	(4)	(4)
<b>Total equity</b>	<b>24,133</b>	<b>943</b>	<b>25,076</b>

## Notes to the reconciliations

### (i) Reconciliation of net loss (unaudited)

	Year ended 30 June 2005 £'000	6 months ended 31 December 2004 £'000
Loss for the period reported under UK GAAP	(2,669)	(2,127)
Effects of transition		
Goodwill amortisation	958	457
Share based payments	(779)	(372)
Business combinations – intangible assets	(11)	-
	<u>168</u>	<u>85</u>
<b>Loss of the year/period under IFRS</b>	<b><u>(2,501)</u></b>	<b><u>(2,042)</u></b>

### (ii) Reconciliation of equity (unaudited)

	30 June 2005 £'000	31 December 2004 £'000	30 June 2004 £'000
Equity reported under UK GAAP	24,133	22,146	25,119
Effects of transition			
Goodwill amortisation	958	457	-
Business combinations – intangible assets	(11)	-	-
Minority interest	(4)	(4)	(4)
	<u>943</u>	<u>453</u>	<u>(4)</u>
<b>Equity under IFRS</b>	<b><u>25,076</u></b>	<b><u>22,599</u></b>	<b><u>25,115</u></b>