epistem

Controlling lifelong tissue renewal

Progress and growth

Epistem Holdings Plc
Interim Report and Accounts
31 December 2007

epistem

Epistem is a biotechnology company commercialising its expertise in tissue renewal in the areas of oncology, gastrointestinal diseases and dermatology.

Epistem is recognized as a specialist in epithelial tissue and stem cell analyses. Our heritage is based on expert science and know-how in the field of epithelial tissue and adult stem cell biology.

Epistem provides specialised preclinical efficacy testing, biomarker services and develops proprietary novel therapeutics for partnership and co-development with drug development companies.

Located in purpose built office and laboratory facilities adjacent to the University of Manchester, UK, Epistem maintains close links with drug companies, clinicians and academics in the field, ensuring that the company remains at the forefront of stem cell science and technology.

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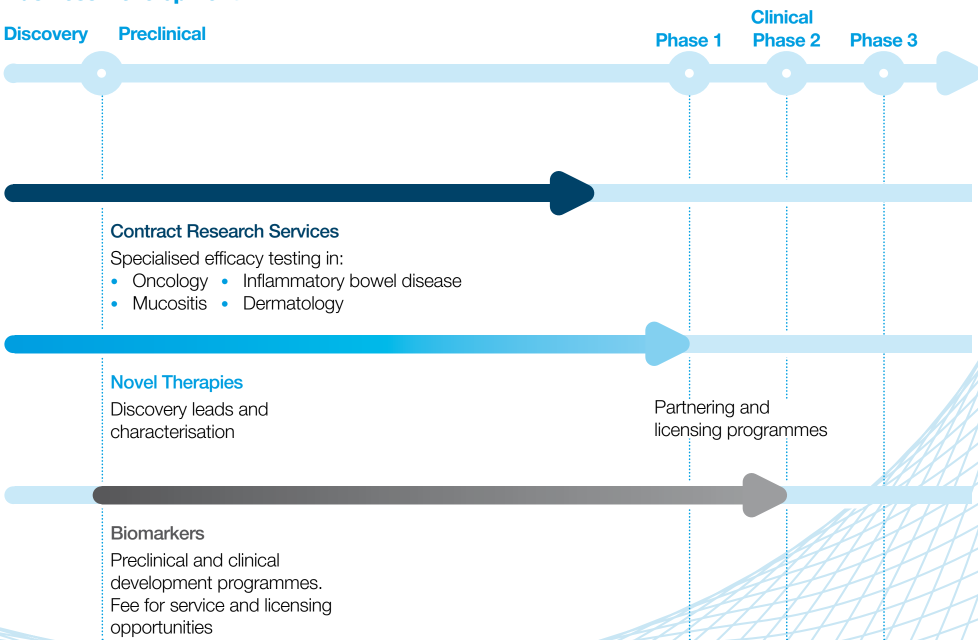
IBC Directors, Secretary and Advisers

Highlights

- 66% growth in Interim year on year sales
- Novel Therapeutics accelerating development of selected therapeutic lead candidates
- £1.1m fundraising in November 2007 for newly emerging biomarker business
- Epistem Biomarker technology wins Bionow 2007 ‘Biomedical Project of The Year’ award
- Strong customer interest in new product developments including cancer stem cells and wound healing
- Healthy balance sheet with £2.6m of cash at period end
- 20% increase in share price post April 2007 admission, set against downturn in financial markets and market segment

Business Development



About Epistem

Controlling lifelong tissue renewal

Epithelial stem cells
Epithelial stem cells are rare cells that provide the 'building blocks' of tissue growth enabling lifelong tissue renewal. Stem cells are essential for repairing damaged tissue and are responsible for new tissue and cell regeneration.

Epistem expertise
Epistem is applying its know-how and expertise to identify genes and proteins that control tissue regeneration to develop drugs to treat cancer and epithelial diseases.

Epistem has 3 core areas of business focus, described below

Novel Therapies

The Novel Therapies division is discovering the key proteins that regulate epithelial stem cells and developing therapeutics to control cell generation, initially in the area of oncology. With over 80% of adult cancers arising from epithelial tissues, the Company believes that its understanding of the behaviour of stem cells will identify new targets and pathways for drug development.

Novel Therapies is developing proprietary therapeutics to regulate epithelial cell generation. From an identified 250 protein regulators, the group is advancing four leads in the therapeutic areas of oncology and wound healing. The Company anticipates additional leads emerging in the coming months from its 250 protein asset. These leads will be evaluated in the Company's preclinical efficacy models and further developed in collaboration with pharmaceutical or biotechnology partner companies.

Biomarker

Epistem is developing a minimally invasive biomarker test for pharmaceutical companies to help guide drug development, initially in the area of oncology. The pharmacodynamic biomarker is designed to identify drug induced changes in gene expression resulting from treatment with a new targeted oncology drug. The Company is currently working with several top-tier pharmaceutical and biotechnology companies to validate its platform technology in the treatment of cancer.

This proprietary molecular biomarker technology leverages the Company's knowledge of the behaviour of epithelial tissue and high resolution gene expression to measure drug effects during treatment.

Vision

Epistem's vision is to control stem cells and other epithelial tissues with its emerging novel protein therapeutics to provide a new biological approach to prevent, treat or cure life threatening diseases.

Contract Research Services

Contract Research Services provides specialised preclinical efficacy testing primarily for drug development companies on a 'fee for service' basis. The division is growing strongly and is profitable and cash generative on a stand-alone basis. Our Contract Research Services division has an established seven-year track record of providing testing services to over 80 client companies primarily in Europe and the United States, including many major pharmaceutical companies.

We assist companies with the preclinical development of their drug therapies to treat epithelial proliferative diseases including:

- Cancers
- Mucositis (cancer supportive care)
- Inflammatory bowel disease
- UV-induced skin damage
- Wound healing
- Dermatology

Chairman and Chief Executive Officer Statement

"The Board of Epistem remain convinced that in the medium term there will be substantial uplift in the value of the Company based on its current performance and the value opportunities now beginning to emerge"

Following the April 2007 admission, we are pleased to report to shareholders that the Company continues to make excellent progress across its core business areas. This Interim Report covers the six month period from 1 July 2007 to 31 December 2007.

Overview

Results for the first six months showed a 66% year on year growth in revenues for the Company, primarily from the Company's Contract Research Services division. This growth represents a significant uplift in the first half business performance over last year and further evidence of the growing interest in the Company's stem cell services and expertise.

The Novel Therapies division has selected a small group of proteins from its 250 protein asset for accelerated development. The early characterisation and efficacy results for these lead candidate proteins are very encouraging.

Biomarker developments have also accelerated with the initial feasibility studies undertaken with AstraZeneca Plc proving successful. The Company also completed a £1.1m placement in November 2007 to fund further development of its Biomarker business and received the 2007 North West Regional Development Agency 'Bionow' award for Biomedical Project of The Year.

Against the backdrop of the volatile financial markets, the combination of a revenue-generating and profitable Contract Research Services division coupled with an investment-driven Novel Therapies division continues to provide a balanced risk profile for our ongoing business model. This position has been further recognised by our shareholders with the stock price now 20% above its admission price in April 2007.

Cash reserves in the Company are healthy at £2.6m with the monthly cash burn (~£0.1m/month) primarily related to investment in our Novel Therapies division.

Financial Review

Sales revenue from business operations for the first six months of this financial year was £1.1m, an increase of £0.4m. The revenue growth was driven by increased 'fee for service' business generated by the Contract Research Services division. Interim Operating Profits for The Contract Research Services Division increased by £0.3m over the previous year. Cost increases over the period were primarily in relation to new staff and expertise, with other costs remaining under tight control. The net loss for the period amounted to £0.5m compared with a loss of £0.5m over the same period last year. The corresponding Earnings Per Share figure for the Interim period was (6)p against (10)p for the previous year.

At the time of writing there is a high degree of uncertainty in the financial markets. The directors consider that the Group's cash reserves place the business in a strong position which along with the Company's growth prospects will allow the Company to take advantage of opportunities that may present themselves in such market conditions.

Operational Review

Over the first half, Contract Research Services has responded to an increased demand for its drug efficacy and skin testing models. This included an increase in the number of biodefence candidates tested under the US National Institutes of Health (NIH) contract for radiation sickness. We are also applying our knowledge of the behaviour of normal epithelial stem cells to develop new models for testing drugs in the area of cancer stem cells. With the pharmaceutical industry beginning to focus more closely on cancer stem cells and their microenvironment the Company is well positioned to address this growing area of oncology development.

From our 250 genes used to identify candidate stem cell regulators, we are now advancing 4 leads in the therapeutic areas of oncology and wound healing. Early characterisation and efficacy results have been very encouraging. Two of our oncology leads have shown inhibition in our cancer stem cell models and we are currently characterising the nature of this inhibition. The Company anticipates additional leads emerging in the coming months from its protein asset. The early commercial contract for an off-patent molecule outlined in the October 2007 Annual Report has been terminated and this molecule will be repositioned as a biodefence therapeutic lead.

Biomarker developments have moved quickly over the first half, with the Company beginning to put in place foundations for further development and commercialisation of its platform technology. The recent Biomarker feasibility work completed with AstraZeneca Plc provided the first independent validation of the technology platform. We are now undertaking other validation work with our pharmaceutical partners.

Strategy

The Board believes that shareholder value can be best enhanced by maintaining and developing its combined business model and by growing, where appropriate by complementary acquisition. The combined business model offers a cornerstone of a growing and profitable Contract Research Services operation. This business model will be further underpinned by developing the newly emerging Biomarker business. The investment based Novel Therapeutics division will continue to de-risk its drug development position with the advancement of its therapeutic leads.

Outlook

On a like for like basis, we anticipate continued growth in our Contract Research Services business in the second half of the year over the comparative period in 2007. Additional growth is also anticipated through our emerging Biomarker business validated by our pharmaceutical partners.

The early characterisation results from our therapeutic leads are positive and we expect to see further development of our therapeutic lead candidates over the second half.

The Board of Epistem remain convinced that in the medium term there will be substantial uplift in the value of the Company based on its current performance and the value opportunities now beginning to emerge.

David Evans
Chairman

Matthew Walls
Chief Executive Officer

27 February 2008

Consolidated Income Account

Six months ended 31 December 2007

	Six months to 31 Dec 2007 (unaudited) £	Restated Six months to 31 Dec 2006 (unaudited) £	Year ended 30 Jun 2007 (audited) £
Revenue	**1,106,467**	666,846	1,357,444
Contract research costs	**(725,506)**	(499,015)	(1,112,093)
Discovery and development costs	**(525,682)**	(484,159)	(1,034,053)
General administrative costs	**(416,601)**	(190,122)	(452,708)
Operating loss	**(561,322)**	(506,450)	(1,241,410)
Interest receivable	**46,923**	12,138	49,793
Interest payable and similar charges	**(6,799)**	(9,404)	(5,276)
Loss on ordinary activities before taxation	**(521,198)**	(503,716)	(1,196,893)
Tax credit on loss on ordinary activities	**(95,000)**	(100,173)	(160,358)
Loss for the financial period	**(426,198)**	**(403,543)**	**(1,036,535)**
Earnings per share (pence)	**(6)p**	(10)p	(22)p

Consolidated Statement of Changes in Equity

Six months ended 31 December 2007

	Share Capital £	Share Premium Account £	Share Options Reserve £	Reverse Acquisitions Reserve £	Profit and Loss Account £	Total £
Balance at 1 July 2006	202	2,531,968	398,812	–	(1,835,964)	1,095,018
Recognition of equity settled share-based payments in the period	–	–	22,187	–	–	22,187
Loss for period	–	–	–	–	(403,543)	(403,543)
At 31 December 2006	**202**	**2,531,968**	**420,999**	**–**	**(2,239,507)**	**713,662**
IFRS 3 reserve acquisition	60,482	2,423,924	–	(2,484,406)	–	–
Allotment of ordinary shares	37,387	3,053,250	–	–	–	3,090,637
Share issue costs	–	(607,542)	–	–	–	(607,542)
Recognition of equity settled share-based payments in the period	–	–	32,933	–	–	32,933
Loss for period	–	–	–	–	(632,992)	(632,992)
At 30 June 2007	**98,071**	**7,401,600**	**453,932**	**(2,484,406)**	**(2,872,499)**	**2,596,698**
Allotment of ordinary shares	9,807	1,055,897	–	–	–	1,065,704
Share issue costs	–	(20,295)	–	–	–	(20,295)
Recognition of equity settled share-based payments in the period	–	–	55,284	–	–	55,284
Loss for period	–	–	–	–	(426,198)	(426,198)
At 31 December 2007	**107,878**	**8,437,202**	**509,216**	**(2,484,406)**	**(3,298,697)**	**3,271,193**

Consolidated Balance Sheet

As at 31 December 2007

	31 Dec 2007 (unaudited) £	Restated 31 Dec 2006 (unaudited) £	30 Jun 2007 (audited) £
Non-current assets			
Intangible assets	**56,894**	60,758	58,826
Plant and equipment	**347,775**	375,977	368,099
	404,669	436,735	426,925
Current assets			
Trade and other receivables	**516,370**	332,853	357,089
Tax receivables	**255,358**	230,700	160,358
Cash and cash equivalents	**2,612,045**	328,414	2,394,456
	3,383,773	891,967	2,911,903
Liabilities			
Current liabilities			
Trade and other payables	**347,305**	356,106	394,994
Obligations under finance leases	**68,812**	94,470	81,317
Bank overdrafts and loans	**–**	–	128,884
	416,117	450,576	605,195
Net current assets	**2,967,656**	441,391	2,306,708
Total assets less current liabilities	**3,372,325**	878,126	2,733,633
Non-current liabilities			
Obligations under finance leases	**(101,132)**	(164,464)	(136,935)
Net assets	**3,271,193**	**713,662**	**2,596,698**
Capital and reserves			
Called-up equity share capital	**107,878**	202	98,071
Share premium account	**8,437,202**	2,531,968	7,401,600
Share options reserve	**509,216**	420,999	453,932
Reverse acquisition reserve	**(2,484,406)**	–	(2,484,406)
Profit and loss account	**(3,298,697)**	(2,239,507)	(2,872,499)
Total shareholders' equity	**3,271,193**	**713,662**	**2,596,698**

Consolidated Statement of Cash Flows

Six months ended 31 December 2007

	Six months to 31 Dec 2007 (unaudited) £	Restated Six months to 31 Dec 2006 (unaudited) £	Year ended 30 Jun 2007 (audited) £
Cash flows from operating activities			
Loss for the period	**(561,322)**	(506,450)	(1,241,410)
Depreciation, amortisation and impairment	**50,022**	53,632	109,264
Share-based payment expense	**55,284**	22,187	55,120
Operating loss before changes in working capital and provisions	**(456,016)**	(430,631)	(1,077,026)
(Increase)/decrease in trade and other receivables	**(159,281)**	(9,490)	(33,726)
(Decrease)/increase in trade and other payables	**(47,689)**	142,068	180,956
Net cash outflow generated from operations	**(662,986)**	(298,053)	(929,796)
Interest paid	**(6,799)**	(9,404)	(5,276)
Interest received	**46,923**	12,138	49,793
Tax received	**–**	–	130,527
Net cash outflow from operating activities	**(622,862)**	(295,319)	(754,752)
Cash flows from investing activities			
Acquisition of property, plant and equipment	**(27,766)**	(17,370)	(63,192)
Net cash outflow from investing activities	**(27,766)**	(17,370)	(63,192)
Cash flows from financing activities			
Proceeds from issue of share capital	**1,065,704**	–	3,090,637
Expenses of share issue	**(20,295)**	–	(607,542)
Repayment of borrowings	**(48,308)**	(34,768)	(75,450)
Net cash inflow from financing activities	**997,101**	(34,768)	2,407,645
Net increase/(decrease) in cash equivalents	**346,473**	**(347,457)**	**1,589,701**
Cash and cash equivalents at beginning of period	**2,265,572**	675,871	675,871
Cash and cash equivalents at end of period	**2,612,045**	**328,414**	**2,265,572**
Analysis of Net Funds			
Cash at bank and in hand	**2,612,045**	328,414	2,394,456
Bank overdrafts	**–**	–	(128,884)
Net Funds	**2,612,045**	**328,414**	**2,265,572**

Notes to the Interim Financial Statements

Six months ended 31 December 2007

1. Significant accounting policies

Basis of accounting

The interim financial statements have been prepared under the historical cost convention, modified to include the revaluation of financial instruments and in accordance with applicable accounting standards in particular International Financial Reporting Standards as adopted by the EU ("Adopted IFRSs").

Epistem Holdings Plc is a company incorporated in the UK.

These interim financial statements have not been audited and do not constitute statutory accounts within the meaning of section 240 of the Companies Act 1985.

The comparative figures for the financial year ended 30 June 2007 are not the statutory accounts for the financial year but are abridged from those accounts which have been reported on by the Group's auditors and delivered to the Registrar of Companies. The report of the auditors was unqualified.

These interim financial statements were approved by the Board of Directors on 27 February 2008.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods represented in these consolidated financial statements.

Basis of consolidation

The consolidated financial statements consolidate those of the Company and its subsidiary (together referred to as the "Group").

Subsidiaries are entities controlled by the Group. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Transactions between Group companies are eliminated on consolidation.

On 16 March 2007 Epistem Holdings Plc merged with Epistem Limited, when the shareholders of Epistem Limited exchanged their shares for equivalent shares in Epistem Holdings Plc. As Epistem Holdings Plc was newly incorporated at the time of the transaction under the terms of IFRS 3 'Business Combinations' this transaction has been accounted for as a reverse acquisition, on the basis that the shareholders of Epistem Limited gained a controlling interest in the Group. The financial statements therefore represent a continuation of the financial statements of Epistem Limited.

Revenue recognition

The company generally invoices and reports as sales, 50% of the value of a new contract on signature. This policy is designed to recognise that, in negotiating contracts for new studies, the company performs specific pre-contract work to establish the parameters of the study work. When the final report is issued to the client the remainder of the contract is invoiced and recognised as income, at that date. In other cases where the contract does not provide for income recognition on signature revenue is recognised as the work is invoiced.

Segment reporting

A segment is a group of assets, liabilities and operations engaged in providing products or services that are subject to risks and returns that are different from those of other parts of the business. The group's primary format for segment reporting is based on business segments.

Research and development

Research and development expenditure is written off in the year in which it is incurred.

Share-based payments

The group issues equity-settled and cash-settled share-based payments to certain employees (including directors). Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, together with a corresponding increase in equity, based upon the group's estimate of the shares that will eventually vest.

Fair value is measured using the Black-Scholes pricing model. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

Where the terms of an equity-settled transaction are modified, as a minimum an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any increase in the value of the transaction as a result of the modification, as measured at the date of modification.

Where an equity-settled transaction is cancelled, it is treated as if it had vested on the date of the cancellation, and any expense not yet recognised for the transaction is recognised immediately. However, if a new transaction is substituted for the cancelled transaction, and designated as a replacement transaction on the date that it is granted, the cancelled and new transactions are treated as if they were a modification of the original transaction, as described in the previous paragraph.

Notes to the Interim Financial Statements (continued)

Six months ended 31 December 2007

2. Segment information

	Contract Research Services £	Novel Therapies £	Unallocated Expenses £	Total £
Six months ended 31 December, 2007				
Revenue	1,106,467	–	–	1,106,467
Segment result	394,999	(506,238)	(394,799)	(506,038)
Less equity settled share-based payments (IFRS 2)	(14,038)	(19,444)	(21,802)	(55,284)
Operating Profit/Loss	380,961	(525,682)	(416,601)	(561,322)
Six months ended 31 December, 2006				
Revenue	666,846	–	–	666,846
Segment result	167,831	(461,972)	(190,122)	(484,263)
Less equity settled share-based payments (IFRS 2)	–	(22,187)	–	(22,187)
Operating Profit/Loss	167,831	(484,159)	(190,122)	(506,450)
Twelve months ended 30 June, 2007				
Revenue	1,357,444	–	–	1,357,444
Segment result	245,351	(989,678)	(441,963)	(1,186,290)
Less equity settled share-based payments (IFRS 2)	–	(44,375)	(10,745)	(55,120)
Operating Profit/Loss	245,351	(1,034,053)	(452,708)	(1,241,410)

Directors, Secretary and Advisers

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Matthew Walls
Christopher Potten
Catherine Booth
Gerard Brady
Roger Lloyd
Jeffrey Moore
Robert Nolan
John Rylands

Company Secretary
John Rylands

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