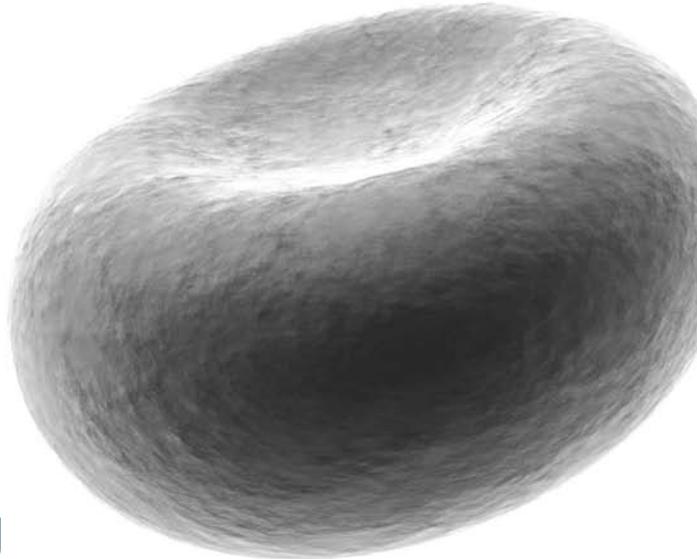
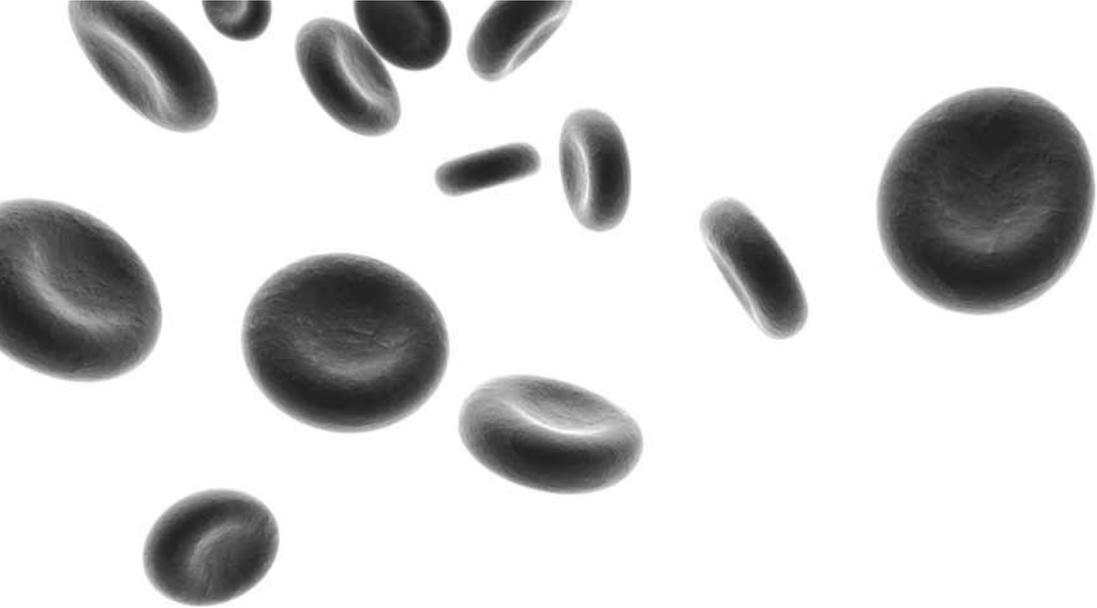




Epistem Holdings Plc
Interim Report 2010

epistem
.....
Controlling life-long tissue renewal



**Advancing
Technologies**

Welcome

Epistem is a biotechnology company commercialising its expertise in epithelial tissue and personalised medicine.

Epistem is focused on understanding how cells function and are controlled so we can identify new drug therapies to address the major diseases of oncology, gastrointestinal disease, dermatology and ageing.

Our proprietary methods and technologies are designed to enable new approaches in cell and molecular biology to advance drug discovery, development and personalised medicine.

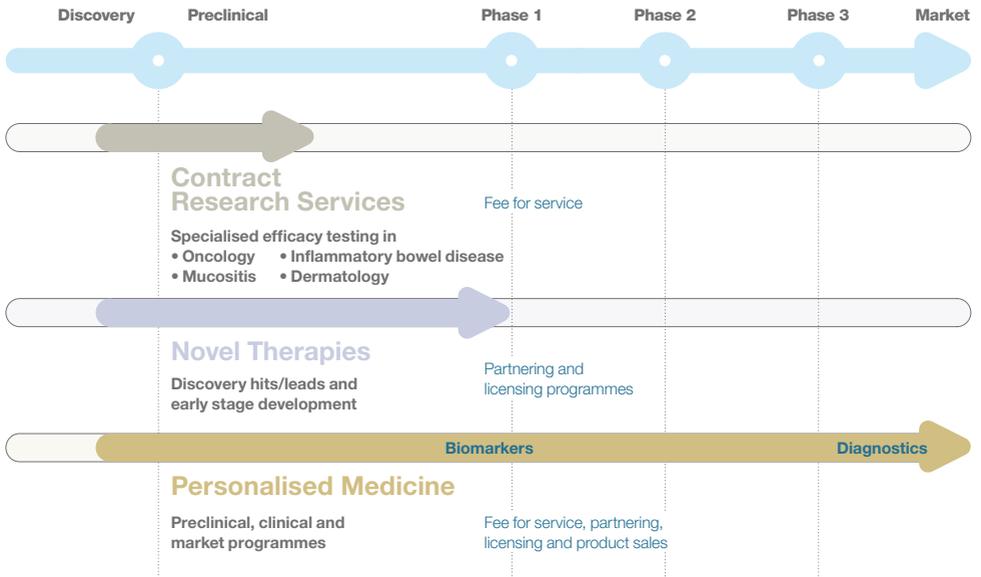
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Highlights

- Year-on-year revenue growth to £3.0m (£2.8m: 2009/10)
- Recent announcement of US\$4.0m collaboration with Sanofi-Aventis for biomarker discovery and clinical support
- Development of our Novel Therapies drug discovery programme with Novartis
- Extension of our 5 year contract to support the US Government biodefence programme
- Commencement of Genedrive™ molecular diagnostic testing
- Strengthening demand for Contract Research Services
- First half profitable growth
- Strong cash position, with Net Funds of £4.3m

Future Strategy



What We Do

Scientific research services, personalised medicine and innovative therapeutics.

Life-long Tissue Renewal Explained

Epithelial stem cells

Epithelial stem cells are rare cells which represent the 'building blocks' of tissue growth and renewal. Stem cells are essential for tissue repair, since they are responsible for replacement of all cells.

Expertise

Epistem is applying its know-how and expertise to identify genes and proteins responsible for controlling cell production to develop drugs to treat cancer and other epithelial diseases.

Vision

Epistem's vision is to exploit its leading stem cell technology to identify Novel Therapeutics and advance a new generation of developments in personalised medicine.



▶ Contract Research Services

Contract Research Services provide specialised preclinical efficacy services primarily for drug development companies on a 'fee for service' basis. The division is growing strongly, is cash generative and profitable. Our Contract Research Services division has a well established record of providing a specialist range of testing services to major pharmaceutical and biotechnology companies globally.

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

- Cancer
- Cancer supportive care (Mucositis)
- Inflammatory bowel disease
- UV-induced skin damage
- Wound healing
- Skin and hair disorders



▶ Personalised Medicine

1 Biomarkers

Epistem has developed a range of innovative technologies allowing highly sensitive analysis of small numbers of cells. These technologies are used by pharmaceutical companies to measure drug-induced gene expression changes, primarily in the area of oncology. Our biomarker libraries assist in identifying changes in gene expression that result from treatment with an oncology drug. We work closely with top-tier pharmaceutical groups to better understand drug-induced gene expression changes in a subject during treatment.

2 Diagnostics

We have expanded our technology offering into diagnostics with the development of Genedrive™, a 'point of care' molecular diagnostic device. Genedrive™ is targeted at providing a 'near patient' diagnosis in less than 30 minutes. Rapid, sensitive and accurate testing offers to revolutionise the field of medical diagnosis by enabling viral, pathogen and gene mutation diagnosis to be made readily available at minimal cost.



▶ Novel Therapies

Epistem is discovering key regulators (proteins and peptides) of epithelial cells and developing therapeutics to control cell production, initially targeting the areas of oncology and inflammatory bowel disease. With over 80% of adult cancers arising from epithelial tissue, we believe applying our understanding of epithelial stem cells and cell production will identify new targets and pathways for drug development.

Our Novel Therapies division continues to develop our regenerative medicine collaboration with Novartis and is identifying the key regulators of stem cells and epithelial cell production. Our research is yielding initial hits/leads. The division's primary focus is to discover new drug leads across major epithelial diseases and expand its technology and intellectual property portfolio alongside other collaborative opportunities.

Chairman and Chief Executive Officer Statement

Solid growth over the first half.



David Evans

Non-executive Chairman



Matthew Walls

Chief Executive Officer

Despite the challenging economic climate, we have seen solid growth over the first half, both in year-on-year revenues as well as earnings.

The recent announcement of our industry leading biomarker collaboration with Sanofi-Aventis, alongside a 5 year extension of our US government biodefence contract, continues to build strength in our core business, enabling us to advance our leading drug discovery and diagnostic programmes.

This Interim report covers the six-month period from 1 July 2010 to 31 December 2010.

Overview

Results for the first six months showed a year-on-year revenue increase to £3.0m (£2.8m: 2009/10), largely driven by an improvement in Contract Research and Personalised Medicine revenues (including our Biomarker activities), which gave rise to a profit for the first half of £0.1m (£0.0: 2009/10).

Contract Research Services saw a 19% increase in year-on-year revenues to £1.4m (£1.2m: 2009/10). The announcement of a 5 year extension to the US NIH biodefence contract, coupled with strengthening performance in Europe, helped buoy the first half divisional results.

Personalised Medicine

Biomarkers – The recent announcement of the Sanofi-Aventis biomarker collaboration sets out a new business model for biomarker discovery across the industry and this will greatly enhance the outlook of our Biomarker division. We anticipate that the collaboration with Sanofi-Aventis will generate Biomarker divisional revenues of ~\$4.0m over the next three years; with the prospect of the model being reproducible across our other pharmaceutical partners. Biomarker revenues also improved over the first half to £0.4m (£0.3m: 2009/10).

Diagnostics – The division has commenced diagnostic testing in selected genitourinary medicine clinics in the UK for sexually transmitted diseases. Commercial discussions have also commenced with major industry groups capable of internationally unfolding our first disease diagnostics products into the market with initial (evaluation) revenues expected in the second half of the current financial year.

Novel Therapies discovery and development programme continues to advance around identifying novel regulators of epithelial tissue. The research phase of the Novartis collaboration was completed at the end of February 2011 and we anticipate discussions continuing over the coming months about how best to develop the novel hits/leads that have emerged. Collaborative discussions are also being progressed with other partners in the areas of Regenerative Medicine and Oncology.

Revenue and earnings growth continue to remain key to de-risking our business model and to enabling portfolio flexibility around the differing speeds of growth, investment and development for each of our business divisions.

Financial Review

Sales revenues from business operations for the six months of this financial year were £3.0m (£2.8m: 2009/10), a year-on-year increase of £0.2m.

Contract Research Services and Personalised Medicine provided the firmest support for revenue growth with demand for both these businesses continuing to build around our core scientific expertise. Novel Therapies revenues remained constant throughout the first half based on the fixed funded resources in support of the Novartis discovery programme.

Costs remained broadly in line with the prior year, enabling the business to report a profit of £0.1m (£0.0m: 2009/10) for the first half.

The corresponding Basic Earnings Per Share figure for the first half was 0.9p (2009/10: 0.0p).

Chairman and Chief Executive Officer Statement (continued)

Strengthening revenue and earnings growth coupled with advancing our globally leading technologies.

New investment in our Personalised Medicine diagnostics platform Genedrive™ (£0.2m) and non-cash related profit and loss adjustments (£0.8m) brought cash reserves at the 31 December 2010 to £4.3m (£5.3m: 30 June 2010).

Operational Review

Contract Research Services

Our Contract Research Services division continues to build its core biology and scientific reputation around complex drug efficacy modeling and high quality of service. An improving first half revenue performance in Europe and the US enabled the division to show strong growth, especially around our inflammatory bowel disease models.

Personalised Medicine

Biomarker divisional growth improved over the first half and will be further supported by the recently announced Sanofi-Aventis biomarker and commercialisation collaboration. The collaboration will provide oncology biomarker support to Sanofi-Aventis across its oncology division over the next three years. We anticipate further biomarker revenue collaborative growth over the second half.

Diagnostics

Epistem's new diagnostic device Genedrive™, is targeting a near patient, low cost and rapid turnaround (~25mins) molecular diagnosis across a broad spectrum of disease areas. Genedrive™ is now in production and assay build has commenced in sexually transmitted

diseases (STDs). External beta testing is underway with collaborative discussions ongoing with a number of major groups for use in infectious diseases and oncology. Genedrive™ is expected to be both novel and disruptive in its market position and we anticipate generating significant growth and interest in our diagnostic strategy.

The Novel Therapies collaboration with Novartis has completed the research phase and we are considering next steps around the development of our novel hits/leads under the collaboration. Hits/leads generated to date are being characterised across a number of disease areas and these will be further developed over the coming months. We will carefully select and prioritise those hits/leads for further development. Alongside the Novartis collaboration we are also advancing our discussions with other pharmaceutical/biotech groups.

Strategy

Epistem remains focused on continuing to strengthen its revenue and earnings growth coupled with advancing our globally leading technologies and scientific expertise. Where appropriate, we will carefully consider acquisition of new technology and business to complement our growth strategy.

The Board believes that Epistem's growing business model differentiates us within the sector as a lower risk investment proposition with significant upside potential.

Outlook

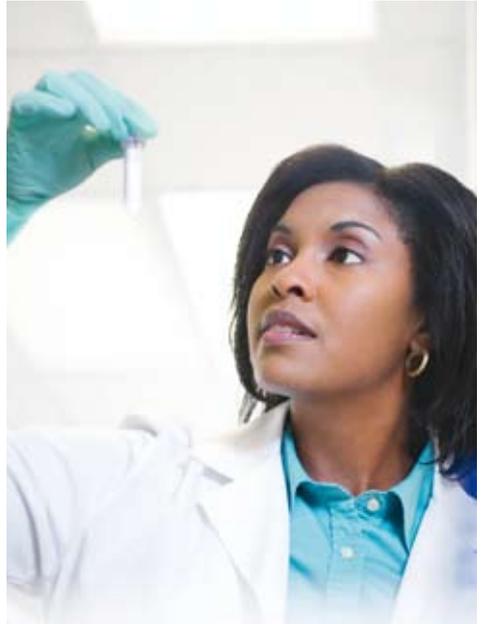
Over the second half we expect to see improving Contract Research Services and Biomarker revenues alongside the advance of the first revenues from our Genedrive™ diagnostic platform. Novel Therapies discussions will continue across a group of partners, including Novartis, but there may be some uncertainty around the timings, duration and outcome of these discussions.

We remain committed to advancing our expertise and heritage in stem cells and to extending our international profile in scientific excellence across the pharmaceutical, diagnostic and regenerative medicine industries.

The Board remains confident that the Group is well placed to deliver increasing shareholder value in the medium term based on its current performance and on the opportunities now emerging.

David Evans
Non-executive Chairman

Matthew Walls
Chief Executive Officer
29 March 2011



£3.0m

Year-on-year revenue

£0.1m

Profit for the first half

Statement of Consolidated Comprehensive Income

For the six months ended 31 December 2010

	Six months to 31 Dec 2010 (unaudited) £'000	Six months to 31 Dec 2009 (unaudited) £'000	Year ended 30 June 2010 (audited) £'000
Revenue	2,978	2,763	5,740
Contract costs	(1,467)	(1,315)	(2,697)
Discovery and development costs	(646)	(747)	(1,433)
General administrative costs	(772)	(700)	(1,298)
Operating profit	93	1	312
Finance income	11	7	40
Finance costs	(2)	(3)	(2)
Profit on ordinary activities before taxation	102	5	350
Taxation on ordinary activities	(29)	–	(60)
Total Comprehensive Income for the financial period	73	5	290
Earnings per share (pence)			
- basic	0.9p	0.0p	3.8p
- fully diluted	0.8p	0.0p	3.3p

Consolidated Statement of Changes in Equity

For the six months ended 31 December 2010

	Equity Share Capital £'000	Share Premium Account £'000	Employee Share Incentive Plan Reserve £'000	Share Options Reserve £'000	Reverse Acquisition Reserve £'000	Retained Earnings £'000	Total Equity £'000
At 1 July 2009	108	8,467	–	606	(2,484)	(3,937)	2,760
Allotment of ordinary shares	11	2,873	–	–	–	–	2,884
Share issue costs	–	(135)	–	–	–	–	(135)
Recognition of equity settled share-based payments	–	–	–	14	–	–	14
Total Comprehensive Income for the financial period	–	–	–	–	–	5	5
At 31 December 2009	119	11,205	–	620	(2,484)	(3,932)	5,528
Purchase of own shares	–	–	(43)	–	–	–	(43)
Exercise/lapse of options	–	1	–	(1)	–	–	–
Recognition of equity settled share-based payments	–	–	–	14	–	–	14
Total Comprehensive Income for the financial period	–	–	–	–	–	285	285
At 30 June 2010	119	11,206	(43)	633	(2,484)	(3,647)	5,784
Purchase of own shares	–	–	(23)	–	–	–	(23)
Recognition of equity settled share-based payments	–	–	–	6	–	–	6
Total Comprehensive Income for the financial period	–	–	–	–	–	73	73
At 31 December 2010	119	11,206	(66)	639	(2,484)	(3,574)	5,840

Consolidated Balance Sheet

As at 31 December 2010

	31 Dec 2010 (unaudited) £'000	31 Dec 2009 (unaudited) £'000	30 June 2010 (audited) £'000
Non-current assets			
Intangible assets	388	137	135
Plant and equipment	584	587	608
Deferred taxation	505	594	536
	1,477	1,318	1,279
Current assets			
Trade and other receivables	1,199	1,107	1,011
Tax receivables	75	150	150
Cash and cash equivalents	4,320	5,598	5,371
	5,594	6,855	6,532
Liabilities			
Current liabilities			
Deferred income	230	1,380	974
Trade and other payables	987	895	1,014
Obligations under finance leases	14	46	37
Corporation taxation	–	–	2
Bank overdrafts and loans	–	77	–
	1,231	2,398	2,027
Net current assets	4,363	4,457	4,505
Total assets less current liabilities	5,840	5,775	5,784
Non-current liabilities			
Deferred income	–	(230)	–
Obligations under finance leases	–	(17)	–
Net assets	5,840	5,528	5,784
Capital and reserves			
Called-up equity share capital	119	119	119
Share premium account	11,206	11,205	11,206
Employee share incentive plan reserve	(66)	–	(43)
Share options reserve	639	620	633
Reverse acquisition reserve	(2,484)	(2,484)	(2,484)
Retained earnings	(3,574)	(3,932)	(3,647)
Total shareholders' equity	5,840	5,528	5,784

Consolidated Statement of Cash Flows

For the six months ended 31 December 2010

	31 Dec 2010 (unaudited) £'000	31 Dec 2009 (unaudited) £'000	30 June 2010 (audited) £'000
Cash flows from operating activities			
Operating profit for the year	93	5	312
Depreciation, amortisation and impairment	99	80	169
Share-based payment expense	6	14	28
Operating profit before changes in working capital and provisions	198	99	509
(Increase)/decrease in trade and other receivables	(188)	(287)	(191)
(Decrease)/increase in deferred income	(744)	(690)	(1,326)
(Decrease)/increase in trade and other payables	(27)	174	293
Net cash outflow from operations	(761)	(704)	(715)
Interest received	11	7	40
Tax received	75	–	–
	86	7	40
Net cash outflow from operating activities	(675)	(697)	(675)
Cash flows from investing activities			
Investment in intangible assets and plant & equipment	(328)	(200)	(308)
Net cash outflow from investing activities	(328)	(200)	(308)
Cash flows from financing activities			
Proceeds from issue of share capital	–	2,884	2,884
Expenses of share issue	–	(135)	(135)
Purchase of own shares	(23)	–	(43)
Repayment of borrowing	(25)	(27)	(48)
Net cash (outflow)/inflow from financing activities	(48)	2,722	2,658
Net increase/(decrease) in cash equivalents	(1,051)	1,825	1,675
Cash and cash equivalents at beginning of period	5,371	3,696	3,696
Cash and cash equivalents at end of period	4,320	5,521	5,371
Analysis of Net Funds			
Cash at bank and in hand	4,320	5,598	5,371
Bank overdrafts	–	(77)	–
Net Funds	4,320	5,521	5,371

Notes to the Interim Financial Statements

Six months ended 31 December 2010

1. General Information

The interim financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union and therefore comply with Article 4 of the EU IAS Regulation, International Financial Reporting Interpretations Committee ('IFRIC') interpretations and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

These interim financial statements have not been audited and do not constitute statutory accounts within the meaning of section 435 of the Companies Act 2006. The comparative figures for the financial year ended 30 June 2010 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 29 March 2011.

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

2. Significant Accounting Policies

Basis of Consolidation

The consolidated financial statements consolidate those of the Company and its subsidiaries (together referred to as the 'Group'). They are presented in pounds sterling and all values are rounded to the nearest one thousand pounds (£k) except where otherwise indicated.

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

a. Contract Revenue

Contract revenue is recognised by reference to the stage of completion of the transaction at the end of the reporting period.

b. Collaboration and Licensing Revenue

Contractually agreed upfront payments and similar non-refundable payments in respect of collaboration or licence agreements which are not directly related to ongoing research activity are recorded as deferred income and recognised as revenue over the anticipated duration of the agreement. Where the anticipated duration of the agreement is modified, the period over which revenue is recognised is also modified.

Non-refundable milestone and other payments that are linked to the achievement of significant and substantive technological or regulatory hurdles in the research and development process are recognised as revenue upon the achievement of the specified milestone.

Income which is related to ongoing research activity is recognised as the research activity is undertaken, in accordance with the contract.

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.

Intangible Assets

Research and development expenditure is carried forward with intangible assets where associated income can be anticipated. Otherwise, the expenditure is written off in the year in which it is incurred.

Intangible assets are stated at cost less accumulated amortisation and any accumulated impairment losses. Amortisation is calculated so as to write off the cost of an intangible asset, less its estimated residual value, over the useful economic life of that asset.

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 2010

2. Segment Information

	Contract Research Services £'000	Personalised Medicine £'000	Novel Therapies £'000	General Administrative Costs £'000	Total £'000
Six months ending 31 December 2010					
Revenue	1,386	383	1,209	–	2,978
Segment trading result	424	(68)	601	(759)	198
Less depreciation and amortisation	(26)	(24)	(36)	(13)	(99)
Less equity settled share-based payments	–	(4)	(2)	–	(6)
Operating profit/loss	398	(96)	563	(772)	93
Six months ending 31 December 2009					
Revenue	1,166	307	1,290	–	2,763
Segment trading result	328	(134)	584	(685)	93
Less depreciation and amortisation	(12)	(18)	(38)	(10)	(78)
Less equity settled share-based payments	–	(6)	(3)	(5)	(14)
Operating profit/loss	316	(158)	543	(700)	1
Twelve months ending 30 June 2010					
Revenue	2,519	800	2,421	–	5,740
Segment trading result	759	(51)	1,067	(1,265)	510
Less depreciation and amortisation	(31)	(36)	(80)	(22)	(169)
Less equity settled share-based payments	(6)	(12)	–	(11)	(29)
Operating profit/loss	722	(99)	987	(1,298)	312

Directors, Secretary and Advisers

Directors

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

Company Secretary

John Rylands

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Notes

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Front Cover Imagery: Red Blood Cells

epistem

Controlling life-long tissue renewal

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