epistem

Globally leading technology

Epistem Holdings Plc
Interim Report 2013

Welcome to Epistem

"The first half of the 2013/14 financial year saw continued progress in our Preclinical Research Services and Personalised Medicine divisions as we finalise preparations for the scale up of our Genedrive® product for its first application in TB diagnosis."

Matthew Walls
Chief Executive Officer

About us

Epistem is a personalised medicine and biotechnology company commercialising its expertise in stem cells, infectious disease diagnostics and pharmacogenomics as a guide to therapy selection.

Epistem develops diagnostic and biomarker products alongside providing preclinical research services for drug development companies.

The Group's core expertise comprises a detailed understanding of novel and proprietary molecular (DNA and RNA) tools for use in diagnostics and patient stratification alongside a deep heritage in core cell biology and the regulation of adult epithelial stem cells.

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ibc Directors, Secretary and Advisers

For more information visit:
www.epistem.co.uk

Highlights

- Total revenue and other income of £2.9m (2012: £3.1m) underpinned by a steady performance from the Preclinical Research Services and Personalised Medicine divisions.
- Increased levels of investment in our Personalised Medicine technology (Genedrive®) led to a reported loss of £0.6m (2012: £0.2m loss after tax).
- Cash reserves of £5.2m at 31 December 2013.
- Genedrive® MTB clinical testing now underway, following resolution of the software and firmware issues reported in the 2013 Preliminary results.
- Announcement in September 2013 of 'Hepatitis-C' development collaboration with the Pasteur Institut and INSERM.
- Announcement in December 2013 of development collaboration with the US Department of Defence for pathogen detection.
- Preparations for Indian and FIND/WHO clinical studies in support of regulatory submission are ongoing with launch of Genedrive® expected in calendar H2 2014.
- Initial TB clinical paper published in December 2013 highlighting the sensitivity and strong performance of Genedrive®.
- Ongoing development of our patient stratification platform with successful initial clinical trials for Genedrive® pharmacogenomic applications.

Recent developments

- Ongoing discussions with Global Health Investment Fund to enter into a collaboration for the deployment of Genedrive® in low-income countries and for the extension of the Genedrive® test menu.
- Expanded Genedrive® infrastructure and executive and senior management with recruitment of a COO and Technical Director for Genedrive® Diagnostics.

Strength

Solid performance from Preclinical Research Services with development of Personalised Medicine (Genedrive®) product now moving into the clinical regulatory process.

Technology

Increased investment in our Genedrive® technology and accelerated development. Continued investment in the expansion of our imaging and rheumatoid arthritis service models whilst maintaining our Novel Therapies programme.

Financial

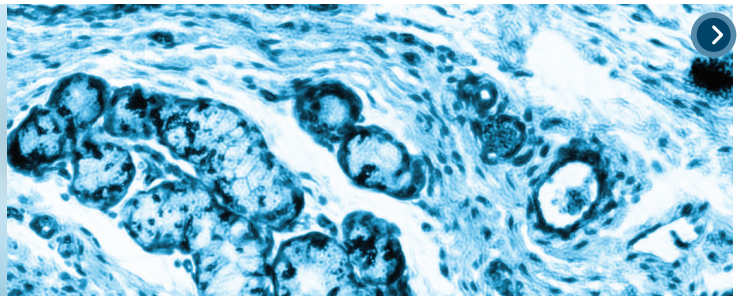
Revenue growth in Preclinical Research Services and the Personalised Medicine – Pharmacogenomics divisions helping to offset the increased investment in our Personalised Medicine – Diagnostics division.

Investor

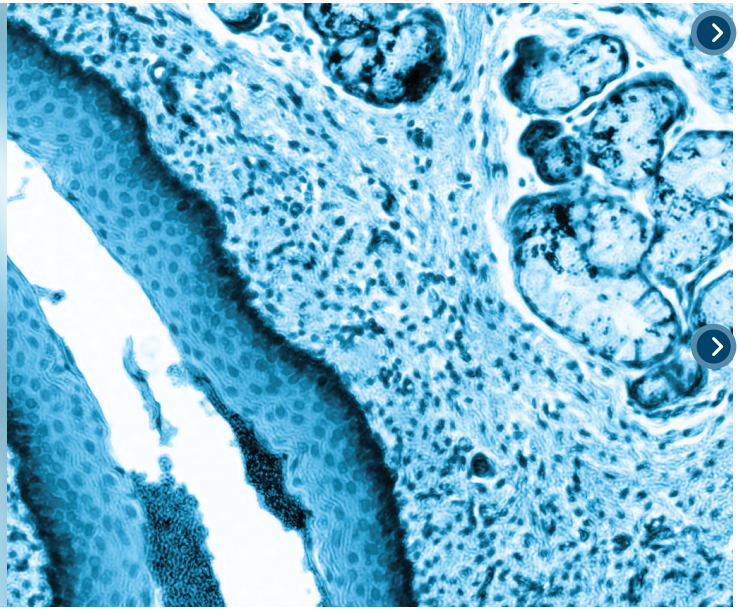
Clear investor communication of the Company's strategy and performance.

What we do

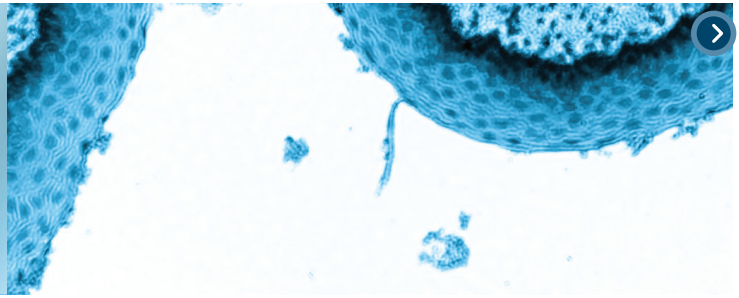
Preclinical Research Services



Personalised Medicine



Novel Therapeutics



Preclinical Services

The Preclinical Research Services division provides specialised preclinical efficacy services primarily for drug development companies. The division operates a 'fee for service' model and is cash-generative and profitable. Our Preclinical Research Services division has a well established record of providing a specialist range of testing services to major pharmaceutical and biotechnology companies globally and to the US National Institutes of Health.

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

- Cancer and cancer supportive care (mucositis);
- Inflammation and inflammatory bowel disease;
- UV-induced skin damage; and
- Wound healing, skin and hair disorders.

Pharmacogenomics

Our Pharmacogenomics division provides highly sensitive RNA and DNA molecular measures of biological targets and processes that improve the precision to guide drug development and disease treatment. The Group provides a broad technology offering to discover, develop and translate biomarkers for clinical drug development.

We work closely with top-tier pharmaceutical groups to better understand drug-induced gene expression change in clinical subjects following treatment. We are also using our DNA amplification technologies to identify disease markers and other gene mutations to help stratify patients for the most effective drug treatment.

Diagnostics

Our Diagnostic division is changing the way healthcare and personalised medicine are delivered at the 'point of care'. We are also developing advanced approaches to provide molecular measures of identification outside of healthcare in 'point of need' settings.

We are completing the clinical development of our Genedrive® 'Point of Care' molecular diagnostic device ready for its first product launch into the TB market. Genedrive® provides a 'near patient', rapid molecular diagnosis with high levels of sensitivity offering the prospect to change the field of medical diagnosis by enabling 'gold standard' molecular testing to be made available at minimal cost.

Novel Therapies

The Novel Therapies division is discovering the body's own key regulators of epithelial stem cells and tissues. Based on our highly sensitive molecular techniques and core cell biology expertise, we discover and develop our own novel drug agents.

Our Novel Therapies division continues to develop our regenerative medicine and oncology leads. We are identifying the key regulators of stem cells and epithelial cell production with the primary focus to discover new drug leads across major epithelial diseases and to expand our technology and commercial discussions with collaborative partners.

Chairman and Chief Executive Officer's statement

"The launch of our first Genedrive® product in TB offers very attractive growth opportunities."

Recent clinical and commercial progress has provided much confidence and excitement at the prospect of our next steps. The Board of Epistem remains confident that we are developing a strategically valuable asset in the field of molecular diagnostics.

In the results for the six months ended 31 December 2013, we report a steady trading position and increasing investment in our Genedrive® molecular diagnostic technology, giving rise to first-half reported losses. Following the termination in September 2013 of the Becton Dickinson supply and distribution agreement, we have made significant progress towards finalising our Genedrive® unit and assay product development and we have bolstered our management team to transition our initial Tuberculosis ('TB') product from the development phase into final manufacture. Recent positive independent clinical testing has helped increase our confidence, as we finalise the pre-launch stages for our TB assay. Whilst we continue to remain vigilant, we are confident that the technical and manufacturing issues reported in the preliminary results have been resolved with final preparations to commence formal independent regulatory clinical trials of our TB assay and Genedrive® unit now in hand.

In line with the progress achieved, we are in discussion with the Global Health Investment Fund. The Global Health Investment Fund is a new social impact investment fund designed to provide financing to advance the development of drugs, vaccines, diagnostics and other interventions against diseases that disproportionately burden low-income countries.

We are also in discussions with prospective distribution partners in relation to tests from our broader infectious disease and pharmacogenomic portfolios.

We are now finalising preparations for the scale up of our Genedrive® platform for its first application in TB diagnosis. We expect to complete our in-house clinical testing as a forerunner to entering into the Indian TB regulatory process in April 2014 and we continue to plan for a market launch of our TB test in the second half of 2014.

We believe that the launch of our first Genedrive® product in TB under the previously reported India supply and distribution agreement with Xcelris, offers very attractive growth opportunities.

£2.9m

Revenue

This interim report covers the six-month period from 01 July 2013 to 31 December 2013.

Financial results

Results for the first six months delivered revenues of £2.9m (2012: £3.1m). Based on the increased levels of investment made in our Personalised Medicine (Genedrive®) programme, the Company reported a loss of £0.6m (2012: £0.2m loss after tax). Reported cash reserves at 31 December 2013 were £5.2m (£6.5m at 30 June 2013).

Progress across each of the Company's three divisions is outlined below:

- Preclinical Research Services income for the first six months was £1.6m (2012: £1.3m) with a strengthening performance in the US territory supported by our US government bio-defence contract. We recently announced the opening of a US laboratory in Baltimore to help support our bio-defence work and foster a closer relationship with the US Department of Defence and provide local support for our US clients. We are continuing to develop our range of high margin service offerings, investing in our rheumatoid arthritis ('RA') and oncology imaging leukaemia models. The division continues to build its core scientific strengths, especially in the US, to maintain a solid platform for future growth.
- Personalised Medicine first-half revenues were £1.3m (2012: £1.8m) primarily reflecting the business generated by our pharmacogenomic (Biomarker) sub division. Revenues were down partly due to reduced 'revenue recognition' in relation to the Genedrive® US department of defence pathogen detection contract. Revenues from this contract (£0.4m) are expected to be recognised in the second half of the current financial year. The division continues to make significant investment in Genedrive® including design and development, software and engineering support, clinical development and broadening the management team. During the first half, alongside preparing for our India clinical studies, we also entered into an agreement with the Foundation for Innovative New Diagnostics ('FIND') for clinical testing of our TB assay with the objective of targeting a World Health Organisation ('WHO') recommendation in 2015. The large, (1200 patients) FIND study has been kindly sponsored by the US National Institutes of Allergies and Infectious Diseases ('NIAID').
- In September 2013, we announced the commencement of a three (3) year, FP7 funded €1.5m collaboration with INSERM and the Pasteur Institute for development of a 'Hepatitis C' ('HCV') Point-of-Care test. Development work on the HCV Point-of-Care test is progressing with the first public testing successfully completed in Paris, in October 2013 of our initial IL28B (biomarker) assay, intended for patient stratification for HCV therapeutic treatment. The global need for an improved HCV test is a key area of unmet medical need and we will be developing the HCV assay panel (including genotype, viral load, IL28B and protein marker) as part of our expanding menu of infectious disease assays.
- In addition to the application of Genedrive® in infectious disease, the Personalised Medicine division continues its pharmacogenomic development of near-patient clinical management in cancer treatment and 'patient stratification' for drugs covering a broad spectrum of disease indications. Following the successful completion of our first two 'patient stratification' clinical studies, we are now preparing to undertake further 'patient stratification' clinical assessments with our pharmaceutical partners GSK and Novartis. We expect this area to emerge as an exciting area of growth for the Company.
- We have largely completed the in-house phase of development of our Genedrive® unit and TB assay in readiness for 'in country' regulatory (clinical) trials in India over the coming months. In addition, the FIND TB study intended to lead to WHO approval will be undertaken in Brazil and South Africa.
- We are working closely with GE Healthcare in Cardiff for the manufacturing scale up of our TB assay ready for sales of Genedrive® expected in the second half of calendar year 2014. This will mark the beginning of Epistem's first Genedrive® product-related revenues which we believe will

Chairman and Chief Executive Officer's statement (continued)

bring about a breakthrough in rapid, high-sensitivity and low-cost molecular (DNA) diagnostic testing across a broad range of disease areas.
- Novel Therapies' drug development programme continues at a reduced investment level whilst we complete the launch of our first Genedrive® product. We are carefully investing in a limited number of leads with the division reporting £nil revenues for the first half (2012: £0.0m). Collaborative discussions with potential partners are on hold pending the further development of our leads in the areas of Regenerative Medicine and Oncology.
- Based on the ongoing investment in our Genedrive® system and reducing investment in our Novel Therapies programmes, the Company reports a loss for the first half of £0.6m (2012: £0.2m loss for the period) and loss per share of 6.0p (2012: 4.8p loss per share).

Outlook

Alongside the continued revenue growth and development of our Preclinical and Personalised Medicine divisions, the outlook for the second half of the financial year remains firmly focused on clinical regulatory approval of our first TB assay, preparation for launch of Genedrive® later in the calendar year and broadening our menu of new assays in clinical and non-clinical fields. We are dedicated to delivering the strategic value of Genedrive® and to driving the shareholder returns from the disruptive market response we expect to create.

The delivery of a new Point-of-Care healthcare diagnostic is technically challenging. However, whilst development timescales and technical obstacles are difficult to predict, we have made major progress over the past few months towards preparations for our first product launch and we are building a management team capable of delivering this vision. With our TB assay and Genedrive® product development largely complete, we anticipate the following key objectives over the coming months:

- In April, we expect to enter the Indian regulatory approval process to complete our TB clinical studies, alongside commencing supplementary Nigerian TB studies in readiness for launch of our TB assay later in the year.
- Also in April, Genedrive® is expected to enter preliminary TB clinical studies in the US as a forerunner to a WHO recommendation in 2015.
- Ongoing discussions with the Global Healthcare Investment Fund.
- Progressing our HCV assay developments and other core development programmes.
- Discussions with potential pharmaceutical and other distribution partners in relation to the use of Genedrive® for use as a companion diagnostic in clinical trials for patient stratification.

We expect continued revenue growth in our cornerstone Preclinical Research Services and the Personalised Medicine – Pharmacogenomics business to help offset the increased investment in our emerging Personalised Medicine – Diagnostics business. At this critical time of increased investment and carefully focused delivery, we will limit our investment in our Novel Therapies business programme pending the launch of our Genedrive® product.

We would like to thank our investors for their patience and commitment over the reporting period. The past six months have been an extremely busy and challenging period for the Company and we are grateful for our investors' support which has provided a stable platform for our continued growth.

Our recent clinical and commercial progress has provided much confidence and excitement within the business at the prospect of our next steps. The Board of Epistem remains confident that we are developing a strategically valuable asset in the field of molecular diagnostics.

David Evans
Chairman
25 March 2014

Matthew Walls
Chief Executive Officer

Consolidated Statement of Comprehensive Income

For the six months ended 31 December 2013

	Notes	Six months ended 31 December 2013 (unaudited) £000	Six months ended 31 December 2012 (unaudited) £000	Twelve months ended 30 June 2013 (audited) £000
Revenue		**2,544**	2,751	5,032
Other income – development grant funding		**344**	300	324
Revenue & other income	(1)	**2,888**	3,051	5,356
Contract costs		**(2,022)**	(2,290)	(3,800)
Discovery and development costs		**(716)**	(400)	(1,679)
General administrative costs		**(853)**	(705)	(1,396)
Operating (loss)	(2)	**(703)**	(344)	(1,519)
Finance income		**8**	15	60
Finance costs		**(35)**	–	–
(Loss) on ordinary activities before taxation		**(730)**	(329)	(1,459)
Taxation on ordinary activities		**146**	80	296
Total comprehensive income for the financial period		**(584)**	**(249)**	**(1,163)**
(Loss) per share (pence)				
Basic	(3)	**(6.0)p**	(4.8)p	(12.5)p
Diluted	(3)	**(6.0)p**	(4.8)p	(12.5)p

Consolidated Statement of Changes In Equity

For the year ended 31 December 2013

	Share capital £000	Share premium account £000	Employee share incentive plan reserve £000	Share options reserve £000	Reverse acquisitions reserve £000	Retained earnings £000	Total £000
Balance at 1 July 2012	133	14,007	(136)	847	(2,484)	(3,505)	8,862
Allotment of ordinary shares	11	4,313	–	–	–	–	4,324
Share issue costs	–	(140)	–	–	–	–	(140)
Exercise of options	1	18	–	(7)	–	7	19
Purchase of own shares (SIP)	–	–	(15)	–	–	–	(15)
Recognition of equity-settled share-based payments	–	–	–	87	–	–	87
Total comprehensive income for the period	–	–	–	–	–	(249)	(249)
At 31 December 2012	145	18,198	(151)	927	(2,484)	(3,747)	12,888
Allotment of ordinary shares	1	(1)	–	–	–	–	–
Share issue costs delete	–	–	–	–	–	–	–
Exercise of options	–	33	–	(6)	–	(7)	20
Purchase of own shares (SIP)	–	–	(31)	–	–	–	(31)
Lapse of options	–	–	–	(8)	–	–	(8)
Recognition of equity-settled share-based payments	–	–	–	100	–	–	100
Total comprehensive income for the period	–	–	–	–	–	(914)	(914)
At 30 June 2013	146	18,230	(182)	1,013	(2,484)	(4,668)	12,055
Allotment of ordinary shares	–	–	–	–	–	–	–
Share issue costs	–	–	–	–	–	–	
Exercise of options	–	69	–	(25)	–	25	69
Purchase of own shares (SIP)	–	–	(23)	–	–	–	(23)
Recognition of equity-settled share-based payments	–	–	–	87	–	–	87
Total comprehensive income for the period	–	–	–	–	–	(584)	(584)
At 31 December 2013	**146**	**18,299**	**(205)**	**1,075**	**(2,484)**	**(5,227)**	**11,604**

Consolidated Balance Sheet
As at 31 December 2013

	31 December 2013 (unaudited) £000	31 December 2012 (unaudited) £000	30 June 2013 (audited) £000
Non-current assets			
Intangible assets	**4,044**	2,611	3,495
Plant and equipment	**706**	534	710
Deferred taxation	**1,123**	1,082	977
	5,873	4,227	5,182
Current assets			
Trade and other receivables	**1,657**	2,956	2,006
Tax receivables	**362**	46	362
Cash and cash equivalents	**5,190**	7,332	6,522
	7,209	10,334	8,890
Liabilities			
Current liabilities			
Deferred income	**466**	677	210
Trade and other payables	**1,012**	996	1,807
	1,478	1,673	2,017
Net current assets	**5,731**	8,661	6,873
Total assets less current liabilities	**11,604**	12,888	12,055
Non-current liabilities			
Liabilities payable 1–5 years	**–**	–	–
Net assets	**11,604**	**12,888**	**12,055**
Capital and reserves			
Called-up equity share capital	**146**	145	146
Share premium account	**18,299**	18,198	18,230
Employee share incentive plan reserve	**(205)**	(151)	(182)
Share options reserve	**1,075**	927	1,013
Reverse acquisition reserve	**(2,484)**	(2,484)	(2,484)
Retained earnings	**(5,227)**	(3,747)	(4,668)
Total shareholders' equity	**11,604**	**12,888**	**12,055**

Consolidated Statement of Cash Flows

For the year ended 31 December 2013

	31 December 2013 (unaudited) £000	31 December 2012 (unaudited) £000	30 June 2013 (audited) £000
Cash flows from operating activities			
Operating (loss) for the year	**(703)**	(344)	(1,519)
Depreciation, amortisation and impairment	**161**	243	284
Share-based payment expense	**87**	87	179
Operating (loss)/profit before changes in working capital and provisions	**(455)**	(14)	(1,056)
Decrease/(increase) in trade and other receivables	**349**	(978)	(28)
Increase in deferred income	**256**	479	12
Increase/(decrease) in trade and other payables	**(795)**	(411)	400
Net cash (outflow) from operations	**(645)**	(924)	(672)
Finance income	**8**	15	60
Finance costs	**(35)**	–	–
Tax received	**–**	(5)	–
	(27)	10	60
Net cash (outflow)/inflow from operating activities	**(672)**	(914)	(612)
Cash flows from investing activities			
Acquisition of fixed assets	**(706)**	(626)	(1,727)
Net cash outflow from investing activities	**(706)**	(626)	(1,727)
Cash flows from financing activities			
Proceeds from issue of share capital	**–**	4,324	4,363
Expenses of share issue	**–**	(140)	(140)
Exercise of share options	**69**	19	–
Purchase of own shares	**(23)**	(15)	(46)
Net cash inflow from financing activities	**46**	4,188	4,177
Net increase in cash equivalents	**(1,332)**	2,648	1,838
Cash and cash equivalents at beginning of year	**6,522**	4,684	4,684
Cash and cash equivalents at end of year	**5,190**	**7,332**	**6,522**
Analysis of net funds			
Cash at bank and in hand	**5,190**	7,332	6,522
Net funds	**5,190**	**7,332**	**6,522**

Notes to the Interim Results
to 31 December 2013

1. Revenue and other income

	31 December 2013 £000	31 December 2012 £000	30 June 2013 £000
Revenue	**2,544**	2,751	5,032
Other income – development grant funding	**344**	300	324
Revenue & other income	**2,888**	**3,051**	**5,356**

2. Business segments

	Preclinical Research Services £000	Personalised Medicine £000	Novel Therapies £000	Unallocated £000	Total £000
Six months ended 31 December 2013					
Revenue and other income	1,603	1,285	–	–	2,888
Segment trading result	492	129	(299)	(777)	(455)
less depreciation and amortisation	(59)	(55)	(31)	(16)	(161)
less equity-settled share-based payments	(11)	(14)	(2)	(60)	(87)
Operating profit/(loss)	422	60	(332)	(853)	(703)
Six months ended 31 December 2012					
Revenue and other income	1,252	1,799	–	–	3,051
Segment trading result	348	619	(356)	(625)	(14)
less depreciation and amortisation	(57)	(128)	(43)	(15)	(243)
less equity-settled share-based payments	(5)	(16)	(1)	(65)	(87)
Operating profit/(loss)	286	475	(400)	(705)	(344)
Twelve months ended 30 June 2013					
Revenue and other income	2,851	2,505	–	–	5,356
Segment trading result	878	15	(718)	(1,231)	(1,056)
less depreciation and amortisation	(108)	(79)	(62)	(35)	(284)
less equity-settled share-based payments	(13)	(33)	(3)	(130)	(179)
Operating profit/(loss)	**757**	**(97)**	**(783)**	**(1,396)**	**(1,519)**

3. Earnings per share

The basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders for the year by the weighted average number of ordinary shares in issue during the year.

The weighted average number of shares in issue during the period was 9,701,568 (2012: 9,565,772).

Notes to the Interim Results (continued)
to 31 December 2013

4. Post Balance Sheet event

The Company's financial statements for the year ended 30 June 2013 and prior years noted the acquisition of Visible Genomics Limited by Epistem Holdings Plc, which included provision for payment of an earnout. On 5 March, 2014, agreement was reached with the vendor of Visible Genomics Limited ('Vendor') to vary the terms of the earnout as follows:

a. Cash payments

- £50,000 upon Epistem products entering a clinical trial registered with the Directorate of Health Services Office of Drugs Controller General (India) 'DCG(I)';
- £50,000 upon Epistem making a DCG(I) regulatory submission.

b. Issue of Consideration Shares In Epistem Holdings Plc

- Consideration Shares to a value of £1.4m upon receipt of regulatory approval from DCG(I);
- Consideration Shares to a value of £1.25m upon the achievement of commercial milestones related to the recognition of £5m of Genedrive® related income or contractual commitments from any of a list of 16 IVD companies which provide a minimum combined value of £5m.

The value at which Consideration Shares are to be issued is to be calculated by reference to LSE daily share price over a five-day period commencing 30 days after the date that the achievement of the milestone(s) is announced.

The Consideration shares are subject to a 'Lock-In' provision, under which the Vendor covenants not to sell Consideration Shares for a period of up to 24 months without the consent of the Company, except in the event that an offer for the whole of the issued share capital of the Company is received and which is either recommended by the Board or becomes unconditional as to acceptances.

In the event that an offer for the whole of the issued share capital of the Company or for the Genedrive® business is received and which is either recommended by the Board or is declared unconditional as to acceptances, then, the Vendor will become entitled to be allotted shares in the Company up to a maximum value of £2.65m, save to the extent that Consideration Shares, as detailed above, have already been issued. The value at which these shares are issued will be the relevant offer price.

The effect on the financial statements of this transaction will be to increase Intangible Fixed Assets and Current Liabilities by £2.75m.

5. 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 2013 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 24 March 2014.

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

6. Significant accounting policies

6.1 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.

6.2 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 & licensing revenue

Contractually-agreed upfront payments and similar non-refundable payments in respect of collaboration or licence agreements which are not directly related to on-going 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 on-going research activity is recognised as the research activity is undertaken, in accordance with the contract.

Notes to the Interim Results (continued)
to 31 December 2013

6. Significant accounting policies continued

c. Other Income – development grant funding

Income receivable in the form of Government grants to fund product development is recognised as development grant funding over the periods in which the Group recognises, as expenses, the related eligible costs which the grants are intended to compensate and when there is reasonable assurance that the Group will comply with the conditions attaching to them and that the income will be received. Government grants whose primary condition is that the Group should purchase or otherwise acquire non-current assets are recognised as deferred revenue in the Consolidated Balance Sheet and transferred to the Statement of Comprehensive Income on a systematic and rational basis over the useful lives of the related assets.

6.3 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.

6.4 Research and development

Research expenditure is written off as it is incurred. Development expenditure is written off as it incurred up to the point of technical and commercial validation. Thereafter, costs are carried forward as intangible assets, subject to having met the following criteria – technical feasibility, intention and ability to sell the product or model and the availability of resources to complete the development. All intangible assets are subject to impairment review and amortisation in each financial reporting period. In assessing value in use, the estimated future cash flows are discounted to their net present values using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to that asset.

6.5 Intangible assets

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.

6.6 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

Notes

Directors, Secretary and Advisers

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Matthew Walls
Catherine Booth
Allan Brown
Roger Lloyd
Robert Nolan
John Rylands

Company Secretary
John Rylands

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