Sareum Holdings plc

ANNUAL REPORT AND ACCOUNTS 2006

Specialists in structure-based drug discovery

HIGHLIGHTS

Established a joint research team with Cancer Research Technology Ltd and the Cancer Research UK Centre for Cancer Therapeutics at the Institute of Cancer Research to develop cancer treatments that are effective against tumours that are resistant to traditional therapeutics

Discovered novel compounds that are effective in cancer cell models

On track to take novel chemical series through to clinical candidate nomination next year

Increased revenues more than four fold

Developed a strong presence in the US through collaborations with three leading biotechnology companies

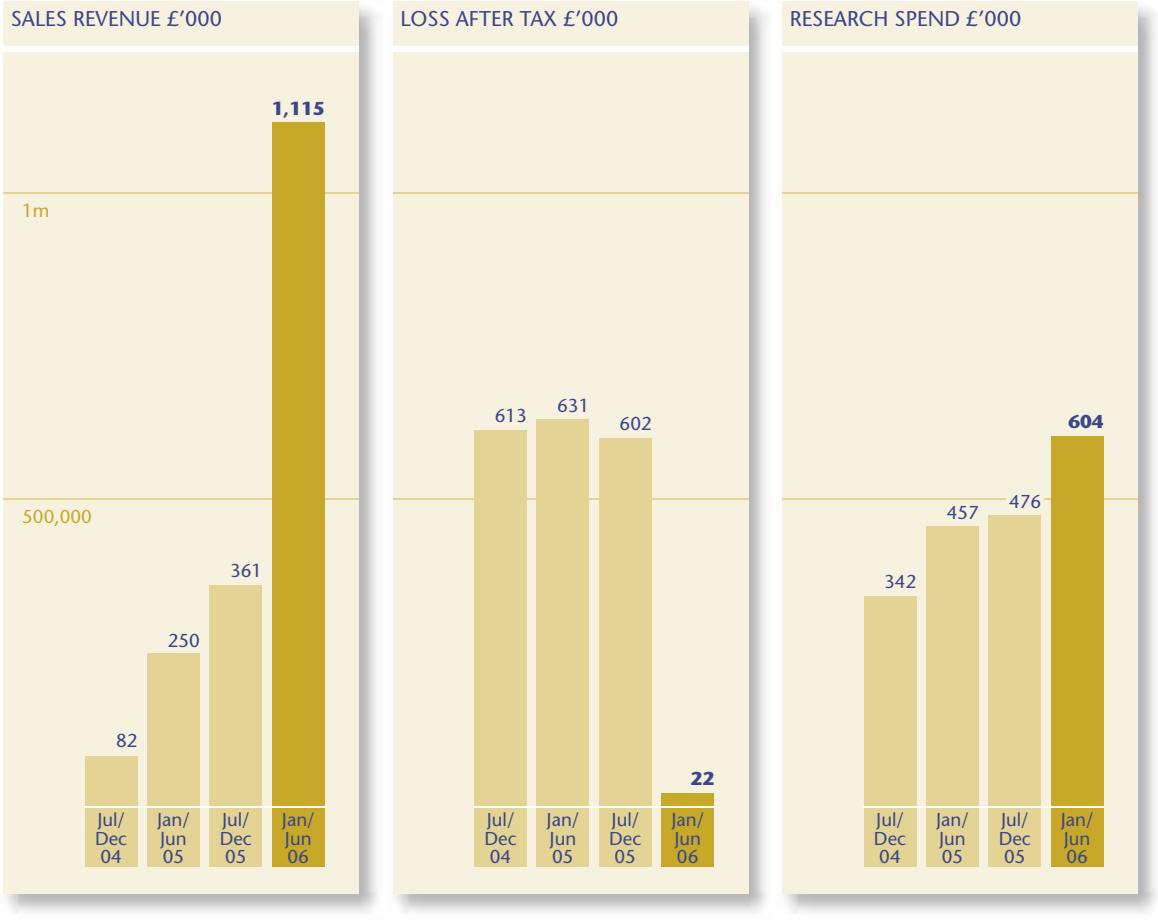
Approaching the stated goal of fully funding its in-house research through revenue generating collaborations

Confirmed the strength of the technology, its attractiveness to major players in drug discovery and the ability of the team to deliver results

CORPORATE STATEMENT

Sareum is a specialist structure-based drug discovery company that generates value by the discovery of new drugs for the treatment of cancer. This in-house drug discovery is funded from revenues generated by the supply of specialist drug discovery expertise to client companies. We accelerate and improve the productivity of discovery research using our proprietary technologies.

Sareum has an experienced team with a track record of delivering high quality results for pharmaceutical and biotechnology clients. Sareum's capabilities span the entire drug discovery value chain, from gene through to pre-clinical candidate. We carry out complete structure-based discovery programmes for creating novel pre-clinical drug candidates. Additionally, we undertake specific projects that enable clients to access our technology, manage their resource demands and complement their internal capabilities.



WHAT WE DO

Sareum Holdings plc is a drug discovery business headquartered in Cambridge in the United Kingdom. Sareum was formed in August 2003 to discover new drugs for the treatment of cancer and to provide a range of structure-based drug discovery services to the pharmaceutical and biotechnology industries.

HOW WE DO IT

01

Gene to structure

To determine a protein's structure, a number of complex steps are taken which culminate in forming crystals of the protein and analysis using X-rays. In order to make protein that has the best chance of forming crystals, Sareum's scientists manipulate bacteria and/or insect cells to generate versions of the protein suitable for analysis. To form crystals, droplets of protein solution are suspended above a cocktail of drying agents. This slowly removes water from the protein solution and encourages the formation of crystals. Computational treatment of the X-ray analysis of the crystal reveals the atomic detail of the protein's three-dimensional structure. Knowing the precise structure of a protein is very valuable but it is still necessary to have chemical starting points, called leads, for development of a small molecule drug.

02

Structure to lead

Sareum has developed a technique called template-based screening to provide leads for drug discovery. We have assembled a collection of diverse small molecules, which we refer to as templates, each of which could serve as a lead for subsequent development into a drug candidate. These templates are tested against the protein to see if they affect its function in a desired way – any that do are then crystallised with the protein and the combined protein-compound structure is determined by X-ray crystallography. This enables our scientists to understand exactly how these templates interact with their protein target; very powerful information when developing a lead into a drug.

CASE STUDY 1:

Discovery of novel anti-cancer compounds

In August 2006 Sareum announced substantial progress in its joint collaboration with The Institute of Cancer Research, Europe's leading cancer research centre, and Cancer Research Technology Limited (CRT). Under the terms of the agreement CRT will commercialise the drug candidates developed by the collaboration to secure future clinical development.

The collaboration, announced in July 2005, has discovered several novel compound series that target a specific enzyme that prevents the effectiveness of traditional cancer therapeutics such as chemotherapy. The new cancer therapeutics developed will potentially allow effective treatment of tumours which do not respond to current treatments, as well as lowering the dose required of existing therapies in order to reduce adverse side effects.

"Sareum's powerful technology platform has allowed us to move forward very rapidly on this exciting and important target," said Professor Paul Workman, Director of The Institute of Cancer Research.

CASE STUDY 2:

Sareum's approach – "an inestimable help"

In July 2006 Sareum announced an extension to its contract with Almirall Prodesfarma SA to provide protein structure determination capabilities to accelerate drug discovery research at Almirall. Almirall is a leading Spanish multinational pharmaceutical company. Sareum had been providing protein structure determination capabilities to Almirall over the previous year. This extension demonstrates the usefulness of Sareum's research.

Sareum will continue to utilise its skills in protein structure determination with the aim of further illustrating the precise nature of how Almirall's potential drug candidates interact with their target proteins. This information has been of great assistance to Almirall's scientists in their design of new and improved therapeutics against inflammatory diseases.

"This has been an inestimable help in the design of novel potential drug candidates. We are, therefore, pleased to extend our successful collaboration with Sareum, so that our scientists can continue to rely on this powerful research tool," said Per-Olof Andersson, Executive Director for R&D, Almirall.

"Structure-based drug design is an important part of a modern drug discovery strategy, and we look forward to using this broadened collaboration with Sareum to enhance the success of our drug discovery process."

Dr. Klaus Peter Bøgesø, VP of Research DK, Lundbeck

03

Lead to candidate

Once leads have been selected, these chemical starting points need to be modified to improve their effectiveness. We use our industry-leading, automated chemistry to rapidly generate focused sets of molecules built around these leads. The ongoing use of three-dimensional protein structures allows us to understand how our molecules interact with the protein and how to develop them further into drug candidates. This approach permits rapid optimisation of leads to provide candidates for clinical trials.

CASE STUDY 3:

Milestone confirms Sareum's expertise

In June 2006 Sareum was able to announce that it had received milestone payments for solving the structure of an important target protein for Schering AG. Sareum has succeeded in using X-ray crystallography to determine, on schedule, the three-dimensional structure of one of Schering's drug discovery research targets. To the best of our knowledge, Sareum is the only organisation to have successfully determined the structure of this target. Sareum will continue to provide structure information to support Schering's drug discovery research on this target in return for further success milestone payments.

"The successful determination of this difficult and previously unsolved protein structure further demonstrates our leading position in structure-based drug discovery research," said Dr Tim Mitchell.

CASE STUDY 4:

$5m research collaboration with Idenix Pharmaceuticals Inc

In February 2006 Sareum announced that it had entered into a collaborative research agreement with Idenix Pharmaceuticals Inc to discover novel hepatitis C compounds. Idenix is based in Cambridge, Mass, United States, and is engaged in the discovery, development and commercialisation of innovative anti-viral therapeutics.

The aim is to generate lead chemical series for development by Idenix into novel drug therapies for hepatitis C virus infection. This is the second collaboration with Idenix, the first collaboration targetted HIV.

Dr Tim Mitchell said, "This provides further validation of our capabilities and demonstrates that we are a partner of choice for structure-based lead generation and optimisation."

CHAIRMAN'S STATEMENT

SUMMARY OF CHAIRMAN'S STATEMENT

Sareum has enjoyed a particularly productive and successful year, substantially meeting market expectations

Established a joint research team with Cancer Research Technology Ltd and the Cancer Research UK Centre for Cancer Therapeutics at the Institute of Cancer Research to develop cancer treatments that are effective against tumours that are resistant to traditional therapeutics

Continued making good progress in obtaining revenue-generating service collaborations, with the announcement of ten agreements, including top-50 global pharmaceutical companies

A particularly creditable performance confirming the strength of the technology, its attractiveness to major players in drug discovery and the ability of the team to deliver results

Sareum Holdings plc has enjoyed a successful second financial year of trading. Our in-house drug discovery activity has made excellent progress, generating active compounds that we believe will ultimately lead to a candidate for pre-clinical development. The fee for service business has been strong with, particularly in the second half of the financial year, a series of collaborations with leading pharmaceutical companies.

Our in-house drug discovery was significantly enhanced by the announcement in July 2005 that the Company had established a joint research team with Cancer Research Technology Ltd and the Cancer Research UK Centre for Cancer Therapeutics at the Institute of Cancer Research, to develop cancer treatments that are effective against tumours that are resistant to traditional therapeutics. The Institute of Cancer Research is one of the world's leading cancer research organisations and thus a prestigious partner for Sareum's in-house research, and this collaboration continues to progress on-track. We are currently working on a number of cancer targets for our in-house programmes in addition to the joint venture activities. If all goes to plan we aim to have a candidate molecule ready to enter pre-clinical development by this time next year.

Sareum continued making good progress in obtaining revenue-generating service collaborations, with the announcement of ten agreements, including top-50 global pharmaceutical companies such as Schering AG, Organon, UCB and Lundbeck.

Notable agreements included a total of three integrated Structural Biology, Fragment Screening and Discovery Chemistry projects, with Organon and Idenix Pharmaceuticals, announced in January and February 2006. The two collaborative projects with Idenix have a combined success dependent value of up to $5m.

"We aim to have a candidate molecule ready to enter pre-clinical development by this time next year."

In addition to Idenix, Sareum has established itself in the USA, announcing collaborations with Infinity Pharmaceuticals in September 2005 and Sirtris Pharmaceuticals in June 2006. The Company was also very pleased to announce the achievement of success milestones in its collaboration with Schering AG, an extension to its collaboration with Almirall Prodesfarma and recently, a second collaboration with Lundbeck.

The Crystal Bank protein structure resource was launched during the period. This provides the Company with a source of additional revenue as well as being an effective demonstration of Sareum's success in its core capability of protein structures determination. In November 2005, we announced additions to the Crystal Bank, increasing the number of therapeutically relevant proteins to 16 and, in January 2006, the addition of the first reported structure of Bcl-2, an important oncology target, was announced. A number of the collaborations referred to above involve Crystal Bank targets and some others are expected to provide additional proteins to Crystal Bank.

Progress in the period has been close to market expectations. Sareum has demonstrated that it is able to considerably advance its in-house research by developing programmes to plan whilst at the same time investing in strategic alliances to develop candidate drug molecules, whilst increasing its revenue generating activities by more than four fold. This is a particularly creditable performance confirming the strength of the technology, its attractiveness to major players in drug discovery and the ability of the team to deliver results that satisfy the needs of our internal programmes and those of our client companies.

FINANCIALS

During this period revenues amounted to almost £1.5m with approximately 75% of this figure being earned in the second half of the year, reflecting the continuing increase in business development activity throughout the year. Losses after taxation for the period were £624,000 representing a loss per share of 0.18p. Encouragingly, the after tax loss for the second half of the period was £22,000, indicating that the Company is close to its stated goal of fully funding its in-house research through its revenue-generating collaborations. The cash position increased to £528,000, underpinned by the £0.5m Put and Call Option exercised by Billam AG in February 2006.

OUTLOOK

Sareum has enjoyed a particularly productive and successful year, substantially meeting market expectations and continuing to deliver on its business strategy. The Directors continue to work to develop the Company's structure-based drug discovery programmes and services business and remain confident about future prospects.

DR PAUL HARPER
Chairman
4 September 2006

"The Company is close to its stated goal of fully funding its in-house research through its revenue-generating collaborations."

CHIEF EXECUTIVE'S REVIEW OF OPERATIONS

SUMMARY OF CHIEF EXECUTIVE'S REVIEW OF OPERATIONS

Recently announced the discovery of novel compounds that are effective in cancer cell models

During the next period we will rapidly optimise the selected lead compounds with the aim of selecting a candidate for pre-clinical scale-up and toxicology studies in mid 2007

During this period we established a strong presence in the US with Infinity, Idenix and Sirtris

The collaborations with Organon and Idenix mark our first multi-disciplinary collaborations that deploy our fragment screening and discovery chemistry capabilities

STRATEGY AND BUSINESS MODEL

Sareum's strategy is to advance its own in-house research into novel cancer therapies whilst generating revenues through the provision of specialist drug discovery services to the pharmaceutical industry.

Our business model comprises two main components:

1) Investment in proprietary research into novel cancer therapeutics to generate drug candidates for partnering with pharmaceutical companies at the early clinical or pre-clinical trials stage.

   Our collaboration with the Cancer Research UK Centre for Cancer Therapeutics at the Institute of Cancer Research enables us to share the risks involved in drug discovery and to access specialist biology capabilities from one of the world's leading cancer research organisations. We entered this collaboration in July 2005 and recently have announced the discovery of novel compounds that are effective in cancer cell models.

   During the next period we will continue to apply our unique and innovative structure-based approaches in these programmes to rapidly optimise the selected lead compounds with the aim of selecting a candidate for pre-clinical scale-up and toxicology studies in mid 2007.

2) Generation of revenues through the provision of specialist drug discovery services to pharmaceutical company customers.

   During this period we signed collaborations in Europe with Almirall Prodesfarma, Schering AG, Organon, Lundbeck and UCB and established a strong presence in the US with Infinity, Idenix and Sirtris. The collaborations with Organon and Idenix mark our first multi-disciplinary collaborations that deploy our fragment screening and discovery chemistry capabilities in addition to our ability to solve protein structures.

"Our unique technology platforms and experienced scientific staff have enabled us to meet and often exceed our customers' expectations."

We also launched Crystal Bank, a collection of therapeutically relevant proteins that we are using to accelerate the discovery of potential drug candidates. Crystal Bank demonstrates our ability to successfully solve the structures of important target proteins in drug discovery, for example the important oncology target, Bcl-2, which to date has been the basis of three collaborations.

Our unique technology platforms and experienced scientific staff, combined with our integrated chemistry and biology capabilities have enabled us to meet and often exceed our customers' expectations, as exemplified by the announcements of success in our collaborations with Schering AG and Almirall. As well as leading to repeat business, this track record provides solid evidence of our capabilities.

We will continue to build on this tremendous business development record. In addition to our ongoing activities in Europe and the USA we have been active in Japan, a major market for outsourced pharmaceutical research.

OBJECTIVES FOR THE COMING YEAR

We look forward to successfully building on the solid foundation created in our second trading year.

Our primary objective is to advance our in-house drug discovery pipeline to deliver drug candidates positioned to attract lucrative partnering deals with pharmaceutical companies. We will continue to advance these programmes, filing drug patent applications during the coming year, and developing drug candidates for pre-clinical studies in 2007/8. Additionally, we will seek to add further programmes to this pipeline, either by licence, collaboration or acquisition.

We will continue to advance our worldwide business development pipeline to generate the revenues to support our current drug discovery pipeline. In addition to securing repeat business from our impressive list of current customers, we will seek to sign longer term collaborations, potentially including clinical development milestones, with major international pharmaceutical companies. We look forward to announcing successful results from these existing and developing relationships.

DR TIM MITCHELL
Chief Executive Officer
4 September 2006

"Our primary objective is to advance our in-house drug discovery pipeline to deliver drug candidates."

DIRECTORS AND ADVISERS

PAUL HARPER PhD
Non-executive Chairman
Dr Paul Harper, aged 60, has over 30 years' experience in the life sciences industry covering both drug development and medical devices. Paul has served as Chief Executive of Cambridge Antibody Technology and Provensis. He has also served as Corporate Development Director of Unipath, then the medical diagnostics business of Unilever and as Director of Research and Development for Johnson & Johnson. Formerly head of Antimicrobial Chemotherapy for Glaxo, Paul has a PhD in Molecular Virology and is the author of over 50 publications. Paul is currently Executive Chairman of Angel Biotechnology, Chairman of RegenTec and is on the boards of Physiomics and ReNuron.

TIM MITCHELL PhD
Founder and Chief Executive Officer
Dr Tim Mitchell, aged 46, has 19 years' experience in the industry with key management and business expertise gained from his positions at Millennium Pharmaceuticals and Cambridge Discovery Chemistry. At Millennium he was a member of the management team and Director of the Structure-based Discovery Department. As Director of Computational Chemistry at Cambridge Discovery Chemistry, Tim was responsible for the management of many drug discovery projects, both in the UK and overseas. He was also a key member of the business development team that secured these collaborations. Prior to that, he was a Team Leader in the Computational and Structural Sciences Department at SmithKline Beecham Pharmaceuticals. Tim has a PhD in Computational Chemistry and a BSc in Chemistry.

DAVID WILLIAMS PhD
Founder and VP Biological and Structural Sciences
Dr David Williams, aged 43, has 21 years' experience in the pharmaceutical and biotechnology sectors, establishing and running teams of drug discovery scientists, as well as managing pre-clinical pipelines. David was Director of Structural Sciences at Millennium Pharmaceuticals, a world-class department that he built in both the UK and US to service the needs of the company's four therapeutic areas. Prior to this role, he was Associate Director of Biomolecular Sciences at Medivir, Section Head of Molecular Immunology at Peptide Therapeutics (Acambis) and a Research Scientist at Roche Discovery Research. David has a PhD in Cell Signalling obtained with the former Imperial Cancer Research Fund, and a BSc in Applied Biology.

JOHN READER PhD
Founder and VP Chemistry
Dr John Reader, aged 39, has 13 years' experience within the industry and was formerly Associate Director of Chemical Technologies at Millennium Pharmaceuticals. Prior to that he worked with Pharmacopeia Inc and Cambridge Discovery Chemistry in the provision of high throughput chemistry services to external and internal clients. John has extensive experience of leading large research teams and in the invention and application of new technologies to the drug discovery process, with an excellent track record of delivering successful projects to clients and has authored or co-authored many patents and publications. John is a member of the Engineering and Physical Sciences Research Council Peer Review College and has a PhD in Chemistry and a BSc in Applied Chemistry.

EDWARD OLIVER FCA
Finance Director
Edward Oliver, aged 64, is a Chartered Accountant with considerable experience both in professional practice and in industry. Formerly a senior partner at the London based firm of Chartered Accountants, AGN Shipleys, Edward has, since 2002, provided consultancy and advisory services to companies through his firm, Olivers. He is currently Finance Director of Angel Biotechnology and Zyzygy.

ALAN LAMONT PhD
Non-executive Director
Dr Alan Lamont, aged 45, has over 17 years' experience in the pharmaceuticals sector covering both research and business development. Alan is currently the VP of Business Development at Acambis PLC where he develops and finalises deals and collaborations for both in-licensing and out-licensing. Prior to this role he was Business Development Manager at Catalyst BioMedica (a subsidiary of the Wellcome Trust) and Director of Biology at Peptide Therapeutics with previous senior positions at Roche Products, Cantab Pharmaceuticals and Cytel Corp Inc. Alan has a PhD in Immunology/Physiology.

AUDITORS
Shipleys LLP
10 Orange Street
Haymarket
London WC2H 7DQ
www.shipleys.com

BROKER
Seymour Pierce Ellis
Talisman House
Jubilee Walk
Three Bridges
Crawley
West Sussex RH10 1LQ
www.seymourpierce.com

CORPORATE SOLICITORS
Bircham Dyson Bell
50 Broadway
Westminster
London SW1H 0BL
www.bdb-law.co.uk

NOMINATED ADVISER
Grant Thornton
Grant Thornton House
Melton Street
Euston Square
London NW1 2EP
www.grant-thornton.co.uk

REGISTRARS
Capita Registrars
The Registry
34 Beckenham Road
Beckenham
Kent BR3 4TU
www.capitaregistrars.com

DIRECTORS' REPORT

The Directors submit their report and the audited financial statements of Sareum Holdings plc (the Company) for the year ended 30 June 2006.

PRINCIPAL ACTIVITIES AND PERFORMANCE REVIEW

The principal activity of the Company is that of a holding company. The principal activity of the Group is the discovery and development of new therapeutic drugs by a combination of skills in biology, computational chemistry and medicinal chemistry. Sareum's drug discovery research is structure-based; the three dimensional shapes of proteins and molecules are determined using X-ray crystallography. This was evidenced by the announcement of the discovery of novel compound series showing efficacy in cancer cell models in collaboration with the Institute of Cancer Research and Cancer Research Technology.

Sareum has financed its drug discovery programme by raising money on AIM and by the profits that it makes on research that it undertakes for other companies. During the year the Group made progress at establishing a reputation as a world-class provider of structure-based drug discovery services. As a consequence the Group's revenue increased more than four fold from £0.3m to £1.48m. Not only did revenue increase but the value and duration of its contracts also increased. The increase in revenue has enabled the Group to reduce its loss after tax from £1.2m in 2005 to £0.6m in 2006. This improvement is also evident during 2006 as only around £22,000 of the loss for the year is attributable to the second half year. The Directors expect this trend to continue. A detailed review of the Group's achievements and future developments is given in the Chairman's statement and Chief Executive's review of operations on pages 4 to 7.

FUTURE RISKS

Sareum faces many risks on the way to building shareholder value. The process of winning major contracts in a competitive environment is rarely simple or even and can be delayed for reasons outside the Group's control. This means that the Group faces major uncertainties in its cash flow. The process of discovering the novel medicinal compounds that build the intellectual property assets of the Group is also uncertain.

ADDRESSING THE RISKS

The Board addresses the financial uncertainties by careful budget monitoring and by quickly responding to variations. If there are delays in signing contracts then recruitment and capital expenditure are frozen until the anticipated income is achieved. The drug discovery uncertainties are addressed through the Group's rigorous selection process that ensures that only the best opportunities are pursued.

SHARE ISSUES DURING THE YEAR

At the start of the year 347,750,000 shares of 0.025p had been issued. On 22 February 2006 a further 25,000,000 shares were issued under a Put and Call Option which had been established as part of the offer arrangements when Sareum floated on AIM on 11 October 2004. At 30 June 2006 372,750,000 shares had been issued.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Group and of the profit or loss of the Group for that period. In preparing those financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and which enable them to ensure that the financial statements comply with the requirements of the Companies Act 1985. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

DIVIDENDS

No dividends will be distributed for the year ended 30 June 2006.

DIRECTORS

The Directors in office during the year under review and their interests in the equity of the Company were:

	30 June 2006		
	Ordinary shares	Holding %	30 June 2005 Ordinary shares
Dr PB Harper, Non-executive Chairman	1,333,333	0.4	1,333,333
Dr AG Lamont, Non-executive Director	60,000	0.0	60,000
Dr TJ Mitchell, Chief Executive Officer	42,669,360	11.4	42,669,360
EM Oliver, Finance Director	700,000	0.2	700,000
Dr JC Reader, VP Chemistry	43,336,000	11.6	43,336,000
Dr DH Williams, VP Biology and Structural Science	42,669,360	11.4	42,669,360

The holding of ordinary shares by Dr John Reader includes 3,333,320 ordinary shares registered in the name of his spouse, Valerie Reader.

SUBSTANTIAL SHAREHOLDINGS

The Company has been informed that on 10 August 2006 the following shareholder held substantial holdings in the issued ordinary shares of the Company:

	Number of ordinary shares	Holding %
Pershing Keen Nominees Limited	20,016,911	5.4

PAYMENT POLICY

The Group pays its suppliers as it would wish to be paid itself and supports initiatives aimed at ensuring good practice in this area. Its regular payment runs select invoices so that payments will be received into its suppliers' bank accounts within 30 days of the invoice date. During the year the average number of days between the invoice date and its payment into the suppliers' bank accounts was 30 days (2005: 28 days). There are, of course, occasions when invoices are not received or are in dispute when this norm is not achievable. At 30 June 2006, the invoices representing the trade creditors of the Group had an average age of 34 days.

DISCLOSURE OF INFORMATION TO AUDITORS

So far as the Directors are aware, there is no relevant audit information (as defined by section 234ZA of the Companies Act 1985) of which the Group's auditors are unaware, and each Director has taken all the steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Group's auditors are aware of that information.

AUDITORS

On 1 May 2006 the Group auditors, AGN Shipleys, transferred its business to Shipleys LLP. The Group has deemed that the appointment of AGN Shipleys extends to Shipleys LLP from that date. A resolution to re-appoint Shipleys LLP as auditors will be proposed at the Annual General Meeting (AGM).

By order of the Board

JOHN STEWART
Company Secretary
24 August 2006

CORPORATE GOVERNANCE REPORT

INTRODUCTION

Sareum Holdings plc was listed on AIM on 11 October 2004. Although the rules of AIM do not require the Company to comply with the Combined Code on Corporate Governance (the Code), the Company fully supports the principles set out in the Code and will attempt to comply wherever possible, given the resources available to the Company. Details are provided below of how the Company applies the Code.

THE BOARD

The Board of Directors comprises four Executive Directors and two independent Non-executive Directors, one of whom is the Chairman. Of the Executive Directors, the Finance Director is part-time and holds prominent positions in other companies, and as such adds to the breadth of vision of the Board.

The Board generally meets monthly and receives reports covering finance, compliance, business development, safety, operations and science together with any other material deemed necessary for the Board to discharge its duties. It is the Board's responsibility to review and approve the Group's strategy, budgets, staff recruitment, major items of expenditure and acquisitions.

Under the Articles of Association all Directors must offer themselves for re-election at least once every three years. One third of the Directors retire by rotation at every AGM and are eligible for re-appointment.

BOARD COMMITTEES

The Board has established an Audit Committee and a Remuneration Committee with written terms of delegated responsibilities. The terms of reference are as close to the model terms of the Institute of Chartered Secretaries and Administrators as is possible for a Board with two independent Non-executive Directors. The terms of reference of the Committees are published on the Company's web site (www.sareum.co.uk).

AUDIT COMMITTEE

The Audit Committee comprises the Chairman, the other Non-executive Director and the Finance Director. It is scheduled to meet twice a year. It is the Audit Committee's role to provide formal and transparent arrangements covering the financial reporting and internal control requirements of the Code, whilst maintaining an appropriate relationship with the independent auditors of the Group.

In 2005 the Committee changed the Group's auditors after going through a competitive tender process to ensure that shareholders were receiving value for money. It also met with the auditors after the 2005 audit to receive their report and probe them on the robustness of the Group systems and procedures. In 2006 the Committee met with the auditors to agree the audit plan for this year's audit under the new auditing standards.

REMUNERATION COMMITTEE

The Remuneration Committee comprises the Chairman, the other Non-executive Director and the Finance Director. It meets at least once a year. It is the Remuneration Committee's role to establish a formal and transparent policy on Executive remuneration and to set remuneration packages for individual Directors. The Committee also ensures that recommendations made by the Executive Directors on staff remuneration are fair from a shareholder's perspective. Further information on the work of the Committee can be found on pages 14 and 15.

SHAREHOLDER RELATIONS

The Company meets with its institutional shareholders and analysts as appropriate and will use the AGM to encourage communication with private shareholders. In addition, the Company intends to use the Annual Report and Accounts, Interim Statement and web site (www.sareum.co.uk) to provide further information to shareholders. The Company uses the services of Buchanan Communications to assist in the communication with shareholders. During the year the Chairman and Chief Executive Officer made presentations to private client brokers in London, Dublin, Leeds and Birmingham.

The Board considers Dr Alan Lamont to be the Senior Independent Director. He chairs the Audit Committee and Remuneration Committee.

The Company publishes information for shareholders on its web site, www.sareum.co.uk.

INTERNAL CONTROL AND RISK MANAGEMENT

The Board is responsible for the systems of internal control and for reviewing their effectiveness. The internal controls are designed to manage rather than eliminate risk and provide reasonable but not absolute assurance against material misstatement or loss. The Audit Committee reviews the effectiveness of these systems annually. This it does primarily by discussions with the external auditors and by considering the risks potentially affecting the Group.

The Group does not have an internal audit function since the administrative function consists of only one and a half people. Instead there is detailed Director review and authorisation of transactions. A systems audit by the Group auditors reported that no significant improvements were required to eliminate risk. The minor recommendations that were suggested have been implemented.

A comprehensive budgeting process is completed once a year and is reviewed and approved by the Board. The Group's results, compared with budget, are reported to the Board on a monthly basis and discussed in detail.

The Group maintains appropriate insurance cover in respect of the lives of the Executive Directors and actions taken against them because of their role, as well as against material loss or claims against the Group. The insured values and type of cover were comprehensively reviewed when the main insurance was put to tender in the autumn of 2005. During the year the Group invested in a 44 kVA standby generator to maintain its valuable biological assets, which are kept at very low temperatures, in the event of a prolonged power cut.

CORPORATE SOCIAL RESPONSIBILITY

Sareum is a small, motivated team of professional people which operates to high standards. These standards include a commitment to best practice in meeting the Company's social responsibilities. Although the Group made no charitable or political donations during the year, its staff held fund raising events to raise money for cancer and third world charities.

HEALTH AND SAFETY

The Company is proactive in considering the safety of staff, visitors and the public. It operates a safety committee and has regular inspections by an independent specialist adviser. It had no notifiable safety incidents during the year and no working days were lost due to accidents.

EMPLOYEES

Sareum is committed to a policy of equal opportunities in the recruitment, engagement and treatment of its staff.

The motivation of staff and the maintenance of an environment where innovation and team working is encouraged are seen as key objectives by the Board. Regular Company meetings are held with staff where issues are discussed in an open manner.

ENVIRONMENT

Sareum disposes of its waste products through regulated channels using reputable agents. It has changed agents to be able to continue to recycle its waste as appropriate.

REMUNERATION COMMITTEE REPORT

INTRODUCTION

The Company recognises the value of the Combined Code on Corporate Governance issued by the London Stock Exchange. It seeks to comply with the Combined Code so far as is practicable and appropriate for a public company of its size and nature. The Company also seeks to follow the Guidance for Smaller Quoted Companies on the Combined Code issued by the Quoted Companies Alliance in August 2004. Companies trading on AIM are not required to provide a formal remuneration report. However, in line with current best practice, this report provides information to enable a greater level of understanding as to how remuneration is determined by the Board.

The Remuneration Committee of the Board is responsible for considering staff and Directors' remuneration packages and makes its recommendations to the Board. The Committee comprises the two Non-executive Directors and the Finance Director. It meets at least once a year to review salaries and share option schemes for staff and Directors. During the year it met to consider the granting of further share options under the scheme established the previous year and to consider the annual cost-of-living awards for staff and Directors.

REMUNERATION POLICY

Remuneration packages are designed to be competitive and to reward above average performance. At present, Executive Directors receive salary, death-in-service benefit, critical illness and medical cover and a 6% pension contribution. No share option agreements have been introduced for Directors.

EXECUTIVE DIRECTOR SERVICE CONTRACTS

The three full-time Executive Directors have executive service agreements with the Company dated 7 July 2004.

The Finance Director has an executive service agreement dated 20 September 2004. The service agreements are subject to termination upon six months' notice being given by either party.

In May 2006 the Committee approved a new remuneration package for the full-time Directors whose pay had not changed since June 2004. The Directors' salaries were raised to a level that was considered to be the market value. A market value had been well established during the recruitment of a Business Development Director. The new salaries are given in the table on page 15 and are fixed until 30 June 2007. For the year from 1 July 2007 a Directors' bonus scheme will come into effect that will reward the Directors against performance targets that build shareholder value.

PENSIONS

The Group does not have a pension scheme but makes contributions to Executive Directors' personal pension schemes of 6% of annual salary.

SHARE OPTION SCHEMES

In setting up share option schemes for staff the Committee took into account the recommendations of shareholder bodies, such as that of the insurance companies, on the number of options to issue, the criteria for vesting and the desirability of granting share options to Executive Directors. As a result the Committee did not initiate a share option scheme for Executive Directors. It approved the following share incentive arrangements for staff:

- an Inland Revenue approved (EMI) share option scheme (approved scheme);
- an unapproved share option scheme (unapproved scheme), identical to the approved scheme but for part-time staff who do not fulfil the EMI employment criteria.

Share options on 10,170,000 ordinary shares were granted to staff under these schemes on 15 May 2005 at an offer price of 2p at which date the market price was 1.25p. In setting this offer price the Committee was mindful that the offer price to shareholders at the time of the AIM float had been 2p. During the year a further 500,000 options were granted to new staff at an offer price of 2p. This brings the total share options granted, as at 30 June 2006, to 10,670,000.

Under the schemes, options will vest in four equal amounts under the following vesting events:

Vesting events
The date falling one calendar year from the date of the option holder's contract of employment
The date on which the cumulative sales invoices issued by the Group exceeds £1m (this occurred in December 2005)
The date falling two calendar years from the date of the option holder's contract of employment
The date on which the Group nominates its first pre-clinical candidate

NON-EXECUTIVE DIRECTORS

The Non-executive Directors entered into letters of engagement dated 19 September 2004. Members may request copies of these letters by sending a stamped addressed envelope to the Company Secretary. The appointments can be terminated by either party giving six months' notice. During the year the Chief Executive Officer in consultation with the Group's Nominated Adviser reviewed the salaries of Non-executive Directors. As a result the annual salary for the Senior Independent Director, Dr Alan Lamont, will be increased to £12,000 from 1 July 2006. This reflects his additional work and responsibilities as Chairman of the Audit and Remuneration Committees.

DIRECTORS' REMUNERATION

Details of Directors' annual remuneration as at 30 June 2006 are set out below:

	Salary £	Healthcare £	Emoluments £	Pension £	Total £
EXECUTIVE DIRECTORS					
Dr TJ Mitchell	90,000	441	90,441	5,400	95,841
Dr JC Reader	85,000	391	85,391	5,100	90,491
Dr DH Williams	85,000	441	85,441	5,100	90,541
EM Oliver	30,000	—	30,000	1,800	31,800
NON-EXECUTIVE DIRECTORS					
Dr PB Harper	50,000	—	50,000	—	50,000
Dr AG Lamont	10,000	—	10,000	—	10,000
TOTAL	350,000	1,273	351,273	17,400	368,673

STAFF REMUNERATION REVIEW

In May 2006 the Remuneration Committee undertook an annual review of staff salaries. In doing so it considered the demands that had been placed on staff, the Company's achievements and the awards being made within the industry in the Cambridge area. The Committee took the opportunity to introduce a performance element to the pay award. The performance element is likely to be from 40% to 60% of the award.

INDEPENDENT AUDITORS' REPORT

TO THE MEMBERS OF SAREUM HOLDINGS PLC

We have audited the financial statements on pages 17 to 28.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

As described on page 10 the Company's Directors are responsible for the preparation of financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read the Directors' report and consider the implications for our report if we become aware of any apparent misstatements within it.

BASIS OF OPINION

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

OPINION

In our opinion the financial statements:

- give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of affairs of the Company and the Group as at 30 June 2006 and of the loss of the Group for the year then ended; and
- have been properly prepared in accordance with the Companies Act 1985.

In our opinion the information given in the Directors' report is consistent with the financial statements.

SHIPLEYS LLP
Chartered Accountants and Registered Auditors
10 Orange Street
Haymarket
London WC2H 7DQ
24 August 2006

CONSOLIDATED PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED 30 JUNE 2006

	Notes	2006 £	2006 £	2005 £	2005 £
TURNOVER	1		1,475,792		332,335
Cost of sales			1,080,278		798,599
GROSS PROFIT/(LOSS)			395,514		(466,264)
Administrative expenses			1,145,792		912,350
OPERATING LOSS	2		(750,278)		(1,378,614)
Interest receivable	3	10,478		28,846	
Interest payable	4	(12,586)		(13,786)	
			(2,108)		15,060
LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION			(752,386)		(1,363,554)
Tax on loss on ordinary activities	6		(128,040)		(119,796)
LOSS ON ORDINARY ACTIVITIES AFTER TAXATION			(624,346)		(1,243,758)
BASIC AND DILUTED EARNINGS PER SHARE	7		(0.0018)		(0.0042)

The loss on ordinary activities before taxation arises from the Group's operations all of which are continuing.

There are no recognised gains or losses other than as stated in the profit and loss account.

CONSOLIDATED BALANCE SHEET

AS AT 30 JUNE 2006

	Notes	2006 £	2006 £	2005 £	2005 £
FIXED ASSETS					
Intangible assets	9		17,499		23,498
Tangible fixed assets	10		792,072		964,455
			809,571		987,953
CURRENT ASSETS					
Debtors	12	436,982		362,191	
Cash at bank		528,476		441,435	
		965,458		803,626	
CREDITORS: amounts falling due within one year	13	517,010		378,762	
NET CURRENT ASSETS			448,448		424,864
TOTAL ASSETS LESS CURRENT LIABILITIES			1,258,019		1,412,817
CREDITORS: amounts falling due after more than one year	14		62,702		93,154
NET ASSETS			1,195,317		1,319,663
CAPITAL AND RESERVES					
Called up share capital	18		93,187		86,937
Share premium account	19		3,088,108		2,594,358
Merger reserve	19		27		27
Profit and loss account	19		(1,986,005)		(1,361,659)
EQUITY SHAREHOLDERS' FUNDS	24		1,195,317		1,319,663

Approved by the Board on 24 August 2006

DR TJ MITCHELL
Chief Executive Officer

COMPANY BALANCE SHEET
AS AT 30 JUNE 2006

	Notes	2006 £	2006 £	2005 £	2005 £
FIXED ASSETS					
Investment in subsidiary	11		30,000		30,000
DEBTORS					
Long term debt – subsidiary	12	2,958,387		2,549,971	
NET CURRENT ASSETS			2,958,387		2,549,971
NET ASSETS			2,988,387		2,579,971
CAPITAL AND RESERVES					
Called up share capital	18		93,187		86,937
Share premium account	19		3,088,108		2,594,358
Profit and loss account	19		(192,908)		(101,324)
EQUITY SHAREHOLDERS' FUNDS			2,988,387		2,579,971

Approved by the Board on 24 August 2006

DR TJ MITCHELL
Chief Executive Officer

CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 30 JUNE 2006

	Notes	2006 £	2005 £
Net cash outflow from operating activities	26	(362,664)	(1,553,557)
Returns on investment and servicing of finance	26	(2,108)	15,060
Taxation		119,796	
CAPITAL EXPENDITURE	26	(66,145)	(880,983)
CASH FLOW BEFORE FINANCING		(311,121)	(2,419,480)
Financing	26	398,162	2,719,287
INCREASE IN CASH	26	87,041	299,807

ACCOUNTING POLICIES

BASIS OF ACCOUNTING

The financial statements have been prepared under the historical cost convention and in accordance with applicable UK accounting standards.

BASIS OF PREPARATION

Sareum Holdings plc was incorporated on 7 June 2004. On 5 July 2004, the Company acquired the entire share capital of Sareum Limited. In consideration, the Sareum Limited shareholders received ordinary shares in Sareum Holdings plc. In accordance with the requirements of Financial Reporting Standard 6, this acquisition has been dealt with using merger accounting principles. As a consequence, although the combination did not take place until 5 July 2004, the financial information is presented as though the merged business had always been a single group. There had been no significant financial events during the four day period 1 July to 4 July 2004.

GOING CONCERN

Sareum Holdings plc is a research and development based business, with at present no marketed products. As of now it is funding its research and development programmes with fee for services contracts. The Directors, who regularly review forecasts of trading and cash flows and compare these with available funding, consider that the Group has sufficient resources for the foreseeable future and thus they continue to adopt the going concern basis in the preparation of these financial statements.

RESEARCH AND DEVELOPMENT

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

FIXED ASSETS

All fixed assets are initially recorded at cost.

DEPRECIATION

Depreciation is calculated to write off the cost of an asset over its useful economic life as follows:

Leasehold improvements	–	the remaining life of the lease
Fixtures and fittings	–	four years, straight-line basis
Laboratory equipment	–	four years, straight-line basis
Computer equipment	–	three years, straight-line basis

AMORTISATION OF INTANGIBLES

Amortisation is calculated so as to write off the cost of an asset over the useful economic life of that asset as follows:

Intellectual property	–	five years, straight-line basis

FINANCE LEASES AND HIRE PURCHASE CONTRACTS

Tangible assets acquired under finance leases and hire purchase contracts are capitalised at their estimated fair value at the date of inception of the contract or each lease. The total finance charges are allocated over the period of the lease in such a way as to give a reasonable constant charge on the outstanding liability.

OPERATING LEASE AGREEMENTS

Rentals applicable to operating leases where substantially all of the benefits and risks of ownership remain with the lessor are charged against profits on a straight-line basis over the period of the lease.

PENSION CONTRIBUTIONS

The Group does not operate a pension scheme for the benefit of its employees, but instead makes contributions to their personal pension policies. The contributions due for the period are charged to the profit and loss account.

REVENUE RECOGNITION

The revenue shown in the profit and loss account relates to the provision of research and development services and the hire of equipment. The revenue recognised represents the value of work completed within the period where the Group has a right to that consideration.

DEFERRED TAXATION

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or a right to pay less or to receive more tax, with the following exception:

- deferred tax assets are recognised only to the extent that the Directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

EMPLOYEE SHARE SCHEME

The Company operates share based incentive schemes as outlined in the Remuneration Committee's report. The cost of awards to employees, being the difference between the market price at the date of award and the amount of consideration due, is recognised over the period of the employee's related performance where there is a reasonable expectation that the performance criteria will be met. The share options granted during the year are calculated to have zero fair value under International Financial Reporting Standard 2 using the Black-Scholes pricing model.

NOTES TO THE FINANCIAL STATEMENTS

1. TURNOVER AND SEGMENTAL REPORTING

The Group's turnover was derived in the UK from its principal activity. An analysis of turnover by geographical destination is given below.

	2006 %	2005 %
United Kingdom	6	79
Rest of Europe	35	7
USA	59	14
	100	100

2. OPERATING LOSS

	2006 £	2005 £
Operating loss is stated after charging:		
Amortisation	5,999	5,999
Research and development expenditure	1,108,026	703,588
Depreciation of fixed assets		
Owned	181,028	143,625
Leased	57,500	9,583
Auditors' remuneration		
Audit	9,000	7,000
Tax	800	800
Rentals under operating leases		
Land and buildings	122,740	117,360
Foreign exchange differences	16,650	—

3. INTEREST RECEIVABLE

	2006 £	2005 £
Bank interest receivable	10,478	28,846

4. INTEREST PAYABLE

	2006 £	2005 £
Loan for leasehold improvements	12,586	13,786

5. EMPLOYEES

STAFF COSTS DURING THE PERIOD (INCLUDING DIRECTORS)	2006 £	2005 £
Wages and salaries	841,210	669,320
Social security costs	95,661	76,547
Pension costs	45,156	36,853
	982,027	782,720

AVERAGE NUMBER OF EMPLOYEES	2006 Number	2005 Number
Office and management	6	6
Research	15	10
	21	16

5. EMPLOYEES CONTINUED

DIRECTORS' EMOLUMENTS	2006 £	2005 £
Directors' emoluments	313,733	289,704
Pension contributions to money purchase schemes	15,150	14,303
	328,923	304,007

HIGHEST PAID DIRECTOR	2006 £	2005 £
Emoluments	75,441	69,919
Pension contributions to money purchase schemes	4,500	4,168
	79,941	74,087

NUMBER OF DIRECTORS RECEIVING PENSION BENEFITS	2006 Number	2005 Number
Directors with money purchase schemes	4	4

6. GROUP TAXATION

(a) Analysis of charge for current year

CURRENT TAX	2006 £	2005 £
Corporation tax based on the results for the year at 19% (2005: 19%)	(128,040)	(119,796)

(b) Factors affecting current tax charge

The tax assessed on the loss on ordinary activities for the year is higher than the standard rate of corporation tax in the UK of 19% (2005: 19%).

	2006 £	2005 £
Loss on ordinary activities before taxation	(752,386)	(1,363,554)
Loss on ordinary activities multiplied by rate of tax	(142,953)	(259,075)
Expenses not allowable for tax purposes	482	904
Capital allowances for period in excess of depreciation	(4,050)	29,110
Unutilised tax losses	49,155	134,672
Losses surrendered for research and development tax credits	97,366	94,389
Research and development tax credits claimed	(128,040)	(119,796)
TOTAL CURRENT TAX	(128,040)	(119,796)

(c) Factors that may affect future tax charges

Tax charges in future periods will be affected by unrelieved tax losses of approximately £1,065,872, which remain available to offset against future taxable trading profits.

7. EARNINGS PER SHARE

The basic and diluted earnings per share is calculated on the loss after tax of £624,346 and a weighted average number of shares of 359,403,542 (2005: 295,115,883). The calculation of diluted earnings per share takes account of share options that have vested.

8. LOSS ATTRIBUTABLE TO THE PARENT COMPANY

No separate profit and loss account is presented for the Company as a part of these accounts, as permitted by section 230(4) of the Companies Act 1985. The loss for the year for the Company was £91,584 (2005: loss £101,324).

The loss represents costs associated with the Company's obligations to maintain its AIM listing.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

9. INTANGIBLE FIXED ASSETS

GROUP	Intellectual property £
COST	29,997
Amortisation 30 June 2005	6,499
NET BOOK VALUE 30 JUNE 2005	23,498
Amortisation charge for the year	5,999
NET BOOK VALUE 30 JUNE 2006	17,499

10. TANGIBLE FIXED ASSETS

GROUP	Leasehold improvements £	Laboratory equipment £	Fixtures and computers £	Total £
COST				
1 July 2005	313,646	781,259	24,494	1,119,399
Additions	26,341	27,387	12,417	66,145
30 JUNE 2006	339,987	808,646	36,911	1,185,544
DEPRECIATION				
1 July 2005	25,797	121,439	7,708	154,944
Charge in the year	32,485	197,674	8,369	238,528
30 JUNE 2006	58,282	319,113	16,077	393,472
NET BOOK VALUE 30 JUNE 2006	281,705	489,533	20,834	792,072
30 June 2005	287,849	659,820	16,786	964,455

Finance lease agreements

Included within the net book value of £792,072 is £162,917 (2005: £220,417) relating to a £230,000 asset under finance lease agreements. The depreciation charged which related to this asset was £57,500 (2005: £9,583). This asset became an owned asset on 5 July 2006.

11. INVESTMENTS

COMPANY	Group companies £
COST	30,000
Additions	—
At 1 July 2006	30,000
NET BOOK VALUE 30 JUNE 2006	30,000

On 5 July 2004, the Company acquired 100% of the issued share capital of Sareum Limited; a company incorporated in England and Wales and operating in the United Kingdom. In consideration the shareholders in Sareum Limited received ordinary shares in Sareum Holdings plc and a loan to finance its operations. This event was not an acquisition in the normal way but purely a mechanism for floating Sareum Limited on AIM.

12. DEBTORS

	2006 Group £	2006 Company £	2005 Group £	2005 Company £
Trade debtors	141,186	—	114,896	—
Amounts owed by Group undertakings	—	2,958,387	—	2,549,971
Corporation tax – research and development tax credit	128,040	—	119,796	—
Other debtors	12,551	—	28,119	—
Prepayments and accrued income	155,205	—	99,380	—
	436,982	2,958,387	362,191	2,549,971

The Directors have confirmed that they will not seek repayment of the inter-company balance owing from Sareum Limited within the next twelve months and therefore this balance is considered to be repayable in more than a year from the balance sheet date.

13. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2006 Group £	2006 Company £	2005 Group £	2005 Company £
Loan for leasehold improvements	30,452	—	27,588	—
Trade creditors	243,262	—	59,760	—
Finance leases	103,000	—	177,250	—
Other taxation and social security	35,283	—	25,220	—
Other creditors	6,394	—	5,240	—
Accruals and deferred income	98,619	—	83,704	—
	517,010	—	378,762	—

14. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	2006 Group £	2006 Company £	2005 Group £	2005 Company £
Loan for leasehold improvements	62,702	—	93,154	—

The amount included above is repayable by quarterly instalments within the next three years.

15. CREDITORS – CAPITAL INSTRUMENTS

Creditors include finance capital, which is due for repayment as follows:

AMOUNTS REPAYABLE	2006 Group £	2006 Company £	2005 Group £	2005 Company £
One year or less	133,452	—	204,838	—
More than one year but under two	33,613	—	30,452	—
More than two years but under five	29,089	—	62,702	—
	196,154	—	297,992	—

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

16. COMMITMENTS UNDER FINANCE LEASE AGREEMENTS

GROUP	2006 £	2005 £
Amounts payable within one year	103,000	177,250

17. CONTINGENT LIABILITIES

There are no contingent liabilities (2005: £Nil).

18. CALLED UP SHARE CAPITAL

Ordinary shares of 0.025p each	Authorised Number of shares	Allotted, called up and fully paid Number of shares	£
30 JUNE 2006	40,000,000,000	372,750,000	93,187
30 June 2005	40,000,000,000	347,750,000	86,937

On 22 February 2006, 25,000,000 ordinary shares of 0.025p were issued at 2p per share. This was part of the arrangements surrounding the Company's flotation on AIM on 12 October 2004.

As part of the AIM float, Seymour Pierce Ellis holds share options until 2009 on 6,955,000 shares at an option price of 2p per ordinary share.

19. RESERVES

GROUP	Merger reserve account £	Share premium account £	Profit and loss account £
Balance brought forward	—	2,594,358	(1,361,659)
Loss for the year	—	—	(624,346)
Merger reserve adjustment	27	—	—
New equity share capital subscribed	—	493,750	—
BALANCE CARRIED FORWARD	27	3,088,108	(1,985,005)

COMPANY		
Balance brought forward	2,594,358	(101,324)
Loss for the year	—	(91,584)
New equity share capital subscribed	493,750	—
BALANCE CARRIED FORWARD	3,088,108	(192,908)

20. PENSION COMMITMENTS

The Group makes contributions to its employees' own personal pension schemes. The contributions for the year of £45,156 (2005: £36,853) are charged to the profit and loss account. At the balance sheet date contributions of £6,394 (2005: £5,240) were owed and are included in creditors.

21. DEFERRED TAXATION

No provision has been made in the Group's accounts and the amounts not provided for at the end of the year are as follows:

	2006 £	2005 £
Excess of depreciation on fixed assets over taxation allowances claimed	(21,237)	(27,567)
Tax losses available	(202,516)	(150,737)
	(223,753)	(178,304)

A potential deferred tax asset of £223,753 (2005: £178,304) has not been recognised, as the Directors do not believe that the Company will make sufficient taxable profits in the foreseeable future to justify their provision. The deferred tax asset would be recognised should sufficient profits be generated in the future against which it may be recovered.

22. OPERATING LEASE COMMITMENTS

At 30 June 2006 the Group was committed to making the following payments during the next year in respect of operating leases:

	2006 £	2005 £
Land and buildings:		
Leases which expire between two and five years	129,960	122,740

23. CAPITAL COMMITMENTS

At 30 June 2006 the Group had no capital commitments (2005: £Nil).

24. RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	2006 £	2006 £	2005 £	2005 £
Loss for the year		(624,346)		(1,243,758)
New equity share capital	6,250		56,937	
Premium on new share capital	493,750		2,594,358	
		500,000		2,651,295
Net addition/(reduction) in shareholders' equity		(124,346)		1,407,537
OPENING SHAREHOLDERS' EQUITY DEFICIT		1,319,663		(87,874)
CLOSING SHAREHOLDERS' EQUITY FUNDS/(DEFICIT)		1,195,317		1,319,663

25. RELATED PARTY TRANSACTIONS

There were no related party transactions during the year.

26. NOTES TO THE STATEMENT OF CASH FLOWS

(a) Reconciliation of operating loss to net cash (outflow) from operating activities

	2006 £	2005 £
Operating loss	(750,278)	(1,378,614)
Amortisation	5,999	5,999
Depreciation	238,528	153,208
Increase in debtors	(66,547)	(149,778)
(Decrease)/increase in creditors	209,634	(184,372)
NET CASH (OUTFLOW)	(362,664)	(1,553,557)

(b) Returns on investments and servicing of finance

	2006 £	2005 £
Interest received	10,478	28,846
Interest paid	(12,586)	(13,786)
NET CASH INFLOW	(2,108)	15,060

(c) Capital expenditure

	2006 £	2005 £
Payments to acquire tangible fixed assets	(66,145)	(880,983)
NET CASH (OUTFLOW)	(66,145)	(880,983)

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

26. NOTES TO THE STATEMENT OF CASH FLOWS CONTINUED

(d) Financing

	2006 £	2005 £
Issue of equity share capital	6,250	56,937
Share premium on issue of equity share capital	493,750	2,548,004
Share issue costs	—	(403,646)
Convertible loan proceeds	—	450,000
Loan for leasehold improvements	—	150,000
Repayment of loan for leasehold improvements	(27,588)	(29,258)
Capital element of finance leases	(74,250)	(52,750)
NET CASH INFLOW	398,162	2,719,287

(e) Reconciliation of net cash flow to movement in net funds

	2006 £	2006 £	2005 £	2005 £
Increase in cash in the year	87,041		299,807	
Net cash outflow/(inflow) from loans	27,588		(120,742)	
Cash outflow from finance leases	74,250		52,750	
CHANGE IN NET FUNDS RESULTING FROM CASH FLOWS		188,879		231,815
New finance leases		—		(230,000)
Movement in net funds in the year		188,879		1,815
Net funds at 1 July 2005		143,443		141,628
NET FUNDS AT 30 JUNE 2006		332,322		143,443

(f) Analysis of changes in net funds

	At 1 July 2005 £	Cash flows £	At 30 June 2006 £
NET CASH			
Cash in hand and at bank	441,435	87,041	528,476
DEBT			
Due within one year	(27,588)	(2,864)	(30,452)
Due after one year	(93,154)	30,452	(62,702)
Finance lease agreements	(177,250)	74,250	(103,000)
	(297,992)	101,838	(196,154)
Net funds	143,443	188,879	332,322

(g) Major non-cash transactions

There were no major non-cash transactions during the year.

NOTICE OF ANNUAL GENERAL MEETING

Notice is hereby given that the Annual General Meeting (AGM) of Sareum Holdings plc (the Company) will be held on 19 October 2006, at 10am at 2 Pampisford Park, Cambridge CB2 4EE for the following purposes:

ORDINARY BUSINESS

To consider and, if thought fit, pass the following ordinary resolutions:

1. To receive and adopt the Directors' report and financial statements for the year ended 30 June 2006.
2. To receive and adopt the Remuneration Committee report for the year ended 30 June 2006.
3. To re-elect Dr David Williams who retires by rotation under sections 76 and 77 of the Articles of Association, and who being eligible, offers himself for re-election as Director.
4. To re-elect Mr Edward Oliver who retires by rotation under Sections 76 and 77 of the Articles of Association, and who being eligible, offers himself for re-election as Director.
5. To confirm the appointment of Shipleys LLP as auditors of the Company to hold office until the conclusion of the next AGM at which accounts are laid before the Company and to authorise the Directors to fix their remuneration.

SPECIAL BUSINESS

To consider and, if thought fit, pass the following resolutions:

Ordinary resolution – power to allot securities

6. That the Directors be and they are generally and unconditionally authorised for the purposes of section 80 of the Companies Act 1985 (the Act) to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of £90,000 provided that this authority is for a period expiring at the Company's next AGM but the Company may before such expiry make an offer or agreement which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such offer or agreement notwithstanding that the authority conferred by this resolution has expired. This authority is in substitution for all earlier authorities, to the extent unused.

Special resolution – disapplication of pre-exemption rights

7. That subject to the passing of the previous resolution the Directors be and they are empowered in accordance with section 95 of the Act to allot equity securities (as defined in section 94 of the Act) wholly for cash pursuant to the authority conferred by the previous resolution as if section 89 (1) of the Act did not apply to any such allotment, provided that this power shall be limited to the allotment of equity securities:

   (a) in connection with an offer of such securities by way of rights to holders of ordinary shares in proportion (as nearly as may be practicable) to their respective holdings of such shares, but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or any legal or practical problems under the laws of any territory, or the requirements of any regulatory body or stock exchange; and

   (b) otherwise than pursuant to sub-paragraph (a) above up to an aggregate nominal amount of £50,000;

   and shall expire on the conclusion of the next AGM of the Company after the passing of this resolution, save that the Company may before such expiry, make an offer or agreement which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities of any such offer or agreement notwithstanding that the power conferred by this resolution has expired.

By order of the Board

JOHN STEWART
Company Secretary
24 August 2006

NOTICE OF ANNUAL GENERAL MEETING CONTINUED

NOTES

1. Any member entitled to attend and vote at the AGM is entitled to appoint one or more proxies (who need not be a member of the Company) to attend and, on a poll, vote instead of the member. Completion and return of a form of proxy will not preclude a member from attending and voting at the meeting in person, should he subsequently decide to do so.

2. In order to be valid, any form of proxy, power of attorney or other authority under which it is signed, or a notarially certified or office copy of such power or authority, must reach the Company's Registrars, Capita Registrars (Proxies), PO Box 25, Beckenham, Kent BR3 4BR, not less than 48 hours before the time of the meeting or of any adjournment of the meeting.

3. As permitted by Regulation 41 of the Uncertificated Securities Regulations 2001, shareholders who hold shares in uncertificated form must be entered on the Company's share register at 10am on 19 October 2006 in order to be entitled to attend and vote at the AGM. Such shareholders may only cast votes in respect of shares held at such time. Changes to entries on the relevant register after that time shall be disregarded in determining the rights of any person to attend or vote at the meeting.

4. Copies of the service contracts of each of the Directors, and the register of Directors' interests in shares of the Company kept pursuant to section 325 of the Act will be available for inspection at the registered office of the Company during usual business hours on any weekday (Saturdays and public holidays excluded) from the date of this notice until the date of the AGM and at the place of the AGM from at least 15 minutes prior to and until the conclusion of the AGM.

FORM OF PROXY

I/We (block capital) .....

Being a member/members of Sareum Holdings plc hereby appoint the chairman of the meeting or (see note 1)

of .....

as my/our proxy to attend and on a poll to vote for me/us and on my/our behalf at the Annual General Meeting of the Company to be held on 19 October 2006 at 10am and at any adjournment thereof. I/We direct, by inserting a cross or other mark in the appropriate box below, how my/our votes are to be cast on each of the resolutions to be proposed at the meeting as indicated below. If no indication is given, the proxy will exercise his/her discretion as to how he/she votes and as to whether or not he/she abstains from voting. All items are ordinary resolutions. Please complete, sign and date this form where indicated below (see notes below).

ORDINARY RESOLUTION	FOR	AGAINST
1. To receive and adopt the Directors' report and financial statements for the year ended 30 June 2006.		
2. To receive and adopt the Remuneration Committee report for the year ended 30 June 2006.		
3. To re-elect Dr David Williams who retires by rotation under sections 76 and 77 of the Articles of Association, and who being eligible, offers himself for re-election as Director.		
4. To re-elect Mr Edward Oliver who retires by rotation under sections 76 and 77 of the Articles of Association, and who being eligible, offers himself for re-election as Director.		
5. To confirm the appointment of Shipleys LLP as auditors of the Company to hold office until the conclusion of the next AGM at which accounts are laid before the Company and to authorise the Directors to fix their remuneration.		
6. That the Directors be and they are generally and unconditionally authorised for the purposes of section 80 of the Companies Act 1985 (the Act) to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of £90,000 provided that this authority is for a period expiring at the Company's next AGM but the Company may before such expiry make an offer or agreement which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such offer or agreement notwithstanding that the authority conferred by this resolution has expired. This authority is in substitution for all earlier authorities, to the extent unused.		
SPECIAL RESOLUTION		
7. That subject to the passing of the previous resolution the Directors be and they are empowered in accordance with section 95 of the Act to allot equity securities (as defined in section 94 of the Act) wholly for cash pursuant to the authority conferred by the previous resolution as if section 89 (1) of the Act did not apply to any such allotment, provided that this power shall be limited to the allotment of equity securities: (a) in connection with an offer of such securities by way of rights to holders of ordinary shares in proportion (as nearly as may be practicable) to their respective holdings of such shares, but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or any legal or practical problems under the laws of any territory, or the requirements of any regulatory body or stock exchange; and (b) otherwise than pursuant to sub-paragraph (a) above up to an aggregate nominal amount of £50,000; and shall expire on the conclusion of the next AGM of the Company after the passing of this resolution save that the Company may before such expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities of any such offer or agreement notwithstanding that the power conferred by this resolution has expired.		

Signature(s) .....

Dated this..... day 2006

NOTES ON COMPLETION OF THE PROXY FORM:

1. You are entitled to appoint a proxy of your own who need not be a shareholder of the Company. If you wish to appoint a proxy other than the Chairman of the meeting, please delete the words "the Chairman of the meeting or" and initial the alteration and PRINT the name and address of the proxy, in the space provided.
2. Any alteration to the form of proxy should be initialled.
3. The form of proxy should be signed by the appointer or his attorney duly authorised in writing or, if the appointer is a Company, either under seal or under hand of a duly authorised officer or attorney of the Company.
4. In the case of joint holders the signature of any one holder is sufficient. If more than one joint holder of any share is present at the meeting personally or by proxy, that one present whose name stands first on the register of members in respect of that share is alone entitled to vote in respect of that share.
5. To be valid this form of proxy and any power of attorney or other authority under which it is signed or a notarially certified copy of such power of authority must be lodged at the offices of the Company's Registrars, Capita Registrars (Proxies), PO Box 25, Beckenham, Kent BR3 4BR not later than 48 hours before the time of the meeting.

SECOND FOLD

Business Reply
Licence Number
MB122

Capita Registrars (Proxies)
PO Box 25
Beckenham
Kent BR3 4BR

THIRD FOLD AND TUCK IN

FIRST FOLD

GLOSSARY AND ABBREVIATIONS

ABSORPTION
The transfer of compound across an external physiological barrier

ADME
Absorption, distribution, metabolism and excretion. A study of how and to what extent a substance is taken up by the body and the substance's subsequent fate

BACULOVIRUS
An insect virus that can be modified to express proteins (protein expression system)

COMPUTATIONAL CHEMISTRY
A discipline used for computer aided drug design in which computer modelling can predict the type of compounds most chemically suitable for binding to a drug target

CRYSTAL STRUCTURE
Term used to describe the high resolution molecular structure derived by x-ray crystallographic analysis of protein or other biomolecular crystals

DRUG
A modulating agent approved by a regulatory authority used to treat, diagnose, mitigate or prevent a disease state

DRUG CANDIDATE
A molecule being developed as a potential drug

DRUG DISCOVERY
The process of researching new substances that may become treatments for various human conditions

ENZYME
Proteins that catalyse (enable) and increase the speed of a biochemical transformation without altering the nature or direction of the reaction

EXPRESSION
The manufacture of a specific protein by a cell

FUNCTIONAL DOMAIN
A region within the three-dimensional structure of a protein that may encompass regions of several distinct protein sequences that accomplishes a specific function

GENOME
The entire DNA contained in an organism or a cell, which includes both the chromosomes within the nucleus and the DNA in mitochondria

HIT
A chemical compound identified as having some interaction with a biological target

HTS
High Throughput Screening. The use of miniaturised, robotics-based technology to screen large compound libraries against an isolated target protein, cell or tissue in order to identify hits that may be further developed into potential new drugs

INFECTION
Invasion and reproduction of micro-organisms in cells or tissues

INFLAMMATION
The body's reaction to injury, infection or irritation, characterised by pain, swelling, redness and heat

INHIBITOR
A molecule that is able to prevent or reduce the normal function of a protein

LEAD
A molecule that interacts with a biological target and modulates its behaviour in a desirable way

LEAD DISCOVERY
The process of identifying a lead from a pool of hits. Leads may be discovered directly from HTS, or through synthetic modification of hits, or structure-based drug design, which streamlines the process

LEAD OPTIMISATION
The process of creating the most advantageous lead compound in terms of its modulation of the target's biological activity, its ADME properties and its effect in disease state models for the discovery and production of drugs

LIGAND
A molecule that interacts with a target

MEDICINAL CHEMISTRY
The discipline of designing and synthesising potential drug candidates

METABOLISM
The universe of chemical changes occurring in a tissue. This consists of creating large molecules from smaller ones (anabolic changes) and small molecules from larger ones (catabolic changes)

MOLECULE
The result of two or more atoms combining by chemical bonding: a molecule of any substance is the smallest physical unit of that particular substance

NEOPLASM
A new growth of tissue. This can be referred to as benign or malignant

NUCLEUS
The central cell structure that houses the chromosomes

ONCOLOGY
The study of cancer, encompassing the physical, chemical, and biologic properties of tumours

ORGANISM
Any living thing

PHARMACOKINETIC
The study of the absorption, distribution, metabolism and elimination of drugs by the body

PHASE I
A Phase I clinical trial is a small-scale test of the safety of a new drug. Trial participants are usually healthy volunteers

PHASE II
Phase II is the second clinical trial in humans, usually in patients rather than healthy volunteers

PHYSICO-CHEMICAL
The study of non-biological properties of a substance e.g. solubility, chemical stability

PRE-CLINICAL
Additional studies that support Phase I safety and toxicity data the results of which are used to establish safety and tolerance boundaries for future human trials. Good laboratory practices (GLP) must be followed

PROTEIN
Large, complex biological molecules that are essential to the structure, function and regulation of cells, organs and tissues

PROTEIN KINASE
Enzymes capable of adding a phosphate group to specific proteins. Protein kinases play crucial roles in the regulation of signalling within and between cells, and are important drug discovery targets

RECEPTOR
A molecule (usually a protein) that spans a cell membrane that "receives" a signal and transmits it inside the membrane-bound structure

RECOMBINANT PROTEIN
Proteins made using DNA cloning technology wherein engineered DNA coding for a specific therapeutic protein of choice facilitates the protein's mass production

TARGET
A biological molecule, usually a protein, whose function can be modulated by a drug's action to affect a disease state

TISSUE
A group or layer of cells similar to each other, along with their associated intercellular substances, which perform the same function within a multicellular organism

TOXICOLOGICAL
To be poisonous or harmful

TUMOUR
An abnormal mass of tissue, also called a neoplasm, that is the result of uncontrolled cell division

VIRUS
A small organism that is often pathogenic. Viruses have a simple structure that is composed of a protein shell, which surrounds the viral genetic material

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Sareum

Sareum Holdings plc
2 Pampisford Park
Cambridge CB2 4EE
www.sareum.co.uk
info@sareum.co.uk

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