
M&A

Maturing & Advancing

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Vernalis is a speciality bio-pharmaceutical company focused on products marketed to specialist neurologists. The Company has two marketed products, Frova[®] and Apokyn[®], and a development pipeline focused on neurology and central nervous system disorders. The Company has seven products in clinical development and collaborations with leading, global pharmaceutical companies including Novartis, Biogen Idec and Serono.

Vernalis has established a US commercial operation to promote Apokyn[®] and co-promote Frova[®] alongside its North American licensing partner, Endo Pharmaceuticals, progressing the Company towards its goal of becoming a sustainable, self-funding, R&D-driven, speciality bio-pharmaceutical company. For further information about Vernalis, please visit www.vernalis.com.

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Highlights

£50.9m

Strong cash position

Apokyn[®] & Frova[®]

Growing revenues from Apokyn[®] and Frova[®] increasingly funding pipeline development

Highlights

- US commercial business fully operational detailing Apokyn[®] and Frova[®].
- Strong financial position with closing cash of £50.9 million.
- Losses reduced to £19.4 million (2005: £20 million).
- Frova[®] sNDA acceptance for filing by the US FDA for the prevention of menstrual migraine (MM).
- V1003 (partial opioid agonist) meets primary end point in Phase IIa study for the management of post-operative pain.
- Significant progress towards initiation of four further clinical trials in H2 2006:
 - V1512 (methylester of levodopa) Phase III study in Parkinson's disease.
 - V2006 (A_{2A} antagonist) Phase II study in Parkinson's disease.
 - V24343 (CB₁ antagonist) Phase I study in obesity.
 - Hsp90 (Hsp90 inhibitor) Phase I study in cancer.
- Entered into an agreement with Pfizer to sub-lease approximately half of premises at Granta Park, Cambridge.

Chief Executive's review of operations

Strategy and operational review

Vernalis' strategic goal is to become a sustainable, self-funding, R&D driven speciality bio-pharmaceutical company focused on drugs for the treatment of neurology and CNS disorders. The Company has two marketed products, a pipeline of seven clinical drug candidates as well as a strong research capability that expects to add two clinical programmes to its portfolio in H2 2006. Vernalis has established a commercial operation in North America to market Apokyn® and co-promote Frova® alongside its partner Endo, as well as to promote other proprietary and acquired products.

Marketed products

Apokyn® – advanced Parkinson's disease

Apokyn® is the only acute, intermittent therapy available in the US for the treatment of immobilising "off" episodes associated with advanced Parkinson's disease. It is administered, as needed, by means of an injector pen to treat periods of immobility in people with advanced disease. In April 2004, Apokyn® received FDA approval with Orphan Drug designation to treat advanced Parkinson's disease patients in the US who experience the severe "on/off" motor fluctuations that are unresponsive to other oral Parkinson's disease therapies. Approximately 112,000 patients with Parkinson's disease experience such "off" episodes despite optimal oral Parkinson's disease therapy. Apokyn® was launched in the US in July 2004 and Vernalis acquired the North American commercial rights from Mylan in November 2005.

Mylan stopped promoting Apokyn® in July 2005. When Vernalis re-launched this promotion-sensitive product in February 2006, new prescriptions had diminished to almost zero. Apokyn® is sensitive to promotion due to patients' requirement for close medical supervision during the initial administration in order to ensure that each individual patient is individually titrated to their optimal dose and to minimise the risk of first-dose side effects.

During the first half of 2006, Vernalis established several marketing initiatives as part of its Apokyn® re-launch strategy. Vernalis has worked closely with physicians to communicate the benefits of Apokyn® and reduce the barriers that prevent patients from starting to use the product. These efforts include a nurse support programme (The APOKYN® Circle of Care™) where nurses assist

physicians with the initial titration and may also visit patients in their home to ensure that they are comfortable using the drug and gaining the maximum benefit. In addition, Vernalis has introduced a sampling programme making it easier for the physician to initiate a patient and help ensure the patient will benefit from the drug prior to having incurred any expense.

Vernalis expects these types of activities to begin to impact levels of new prescriptions approximately three months after introduction. As a result, prescriptions initially remained at the low levels inherited from Mylan during the early part of the year, but have begun to increase substantially in recent months. Gross sales in H1 2006 were \$2.3 million and are expected to be at the lower end of the initial guidance of \$6 million to \$7.5 million for the full year.

Apokyn® is indicated for the acute, intermittent treatment of hypomobility or "off" episodes associated with advanced Parkinson's disease. It is used as an adjunct to other Parkinson's disease medications. Apokyn® is associated with severe nausea and vomiting and should be given with a concomitant antiemetic (trimethobenzamide).

Frova® – acute migraine

Frova® is a selective 5-HT_{1B/1D} receptor agonist approved as an acute oral treatment for migraine headache and its associated symptoms. Frova® is a triptan and is distinguished from other triptans by its long half-life.

Vernalis has licensed North American rights for Frova® to Endo who reported net sales of the product of \$20 million for H1 2006. Vernalis has co-promoted Frova® in the US with Endo since February 2006.

In Europe, frovatriptan is marketed in 12 countries by Menarini. The drug was approved throughout the then 15 member states of the European Union via the mutual recognition procedure in January 2002. In the first half of 2006 Menarini launched frovatriptan in Slovakia (January 2006), Finland (March 2006), Czech Republic (June 2006) and Slovenia (June 2006). In Germany and Italy market share has grown to approximately 10 per cent and in excess of 12 per cent, respectively, of the overall triptan market.

Frova® is approved for the treatment of migraines in adults. The most common adverse events include dizziness, fatigue, paresthesia, flushing, and headache.

Development portfolio

Pain franchise

Frova® – prevention of menstrual migraine

Vernalis has completed a series of studies aimed at obtaining approval for Frova® for the intermittent, short-term prevention of MM. The supplemental New Drug Application (sNDA) was accepted by the Food and Drug Administration (FDA) in September 2006 who have confirmed 19 May 2007 as the review completion date for this application.

If approved by the FDA for this new indication, Vernalis will receive a \$40 million milestone payment from Endo.

The Frova® sNDA is supported by data from four clinical studies, the final of which, a second efficacy study, reported in May 2006. Patients in the study had previously failed on other acute therapies and were treated for three peri-menstrual periods (PMPs). The primary end point was the number of menstrual migraine-free PMPs. Both once and twice-daily dose regimens of Frova® demonstrated efficacy, with statistical significance compared to placebo ($p < 0.01$ and $p < 0.001$ respectively). In addition, both dose regimens achieved statistical significance in other measures of effectiveness. These secondary end points included an increased number of PMPs with one or no days of mild headache, reduction in headache intensity and a reduction in the use of rescue medication. The frequency of adverse events was similar across both active treatment arms and placebo.

V1003 – post-operative pain

In March 2006, Vernalis completed a Phase IIa study of V1003 for the management of post-operative pain. The study achieved its primary end point of pain relief over the period of eight hours from drug administration and Vernalis and Reckitt Benckiser are now working together to identify the most appropriate development programme for nasal delivery of buprenorphine.

Vernalis has two other pre-clinical programmes based on the proprietary intranasal formulation for the delivery of buprenorphine in partnership with Reckitt Benckiser; V1004 for the treatment of chronic pain and V1005 for the treatment of opiate addiction.

V3381 – neuropathic pain

V3381 is a novel drug candidate that is being developed as a treatment for neuropathic pain. It has a dual mechanism of action (an NMDA antagonist and an MAO-A inhibitor) which gives it the potential to modulate pain at both central and peripheral targets.

In August 2006 Vernalis started a Phase IIa trial of V3381 in patients with neuropathic pain resulting from long-standing diabetes. The randomised, double-blind, crossover Phase IIa study is designed to assess safety, pharmacokinetics and preliminary efficacy of repeat dosing of V3381, with efficacy being assessed on a numerical point pain rating scale recorded using daily diaries. The trial, which is being conducted in the US and Canada, will include approximately 30 patients and is planned to complete in 12 months.

V3381 is licensed from Chiesi and has previously undergone evaluation in pre-clinical and Phase I clinical studies, including two proof-of-concept studies in a human model of neuropathic pain.

Neurology franchise

During 2005 Vernalis significantly expanded its Parkinson's disease franchise which now consists of the marketed product Apokyn® and two development programmes V1512 and V2006. It is estimated that approximately 1.5 million people in the US have Parkinson's disease, a condition that results from selective degeneration of an area of the brain

called the substantia nigra, which is located towards the base of the brain in the basal ganglia. Normally these nerve cells release dopamine – a chemical that transmits signals between nerve cells (called a neurotransmitter). This central signalling pathway is essential for the fine control of movement and posture, and breakdown results in the symptoms of Parkinson's disease namely tremor, rigidity, slow movements and postural instability. Muscle rigidity can become so severe as to result in "freezing" also referred to as "off" episodes, when patients are rendered immobile. Patients also suffer from problems relating to impaired control of blood pressure (postural hypotension) and gut motility, which can impair the absorption of food and drugs.

The disease is progressive and the signs and symptoms generally worsen over time. However, while Parkinson's disease may eventually be disabling, the disease often progresses gradually and with appropriate treatment many patients have a number of years of productive life after initial diagnosis.

V1512 – Parkinson's disease

V1512 is an innovative, patented effervescent formulation combining levodopa methylester, a more soluble form of levodopa, and carbidopa. Levodopa, commonly known as L-dopa, has been the cornerstone of Parkinson's disease treatment for a number of years. After a number of years of therapy L-dopa may become less effective in controlling symptoms, and other complications such as unwanted movements (dyskinesias) can emerge. There is evidence that some problems such as a delay in the onset of action of some L-dopa doses during the day may be due to erratic absorption of the drug into the bloodstream, resulting from impaired functioning of the stomach and small intestine. Normal gut motility, called peristalsis, is essential for passage of food and solid dose form drugs (tablets and capsules) through the stomach to the parts of the intestine where absorption into the bloodstream takes place. V1512, being fully soluble in water, is administered in liquid form and therefore is less susceptible to impaired gastric motility as it can quickly pass through to the small intestine assisted only by gravity. Studies undertaken by Chiesi in Italy have shown that, in patients with motor complications leading to delayed effects or dose failures, the effervescent form of methylester of L-dopa works more rapidly than conventional L-dopa in tablet form.

Vernalis plans to initiate a Phase III programme of V1512 in H2 2006 aimed at obtaining regulatory approval in North America and Europe. Also in H2 2006, Vernalis plans to initiate a pharmacokinetic study of V1512 in Parkinson's disease patients in order to compare the plasma levels of L-dopa with Sinemet®, the most widely prescribed form of L-dopa treatment for Parkinson's disease patients in the US.

Chief Executive's review of operations

V2006 – Parkinson's disease

V2006 is an adenosine A_{2A} receptor antagonist in development as a potential novel treatment for Parkinson's disease. A_{2A} receptor antagonists act indirectly on dopaminergic systems and may possess advantages over conventional dopaminergic therapies. V2006 is anticipated to help restore motor function in patients with Parkinson's disease with potentially fewer of the side-effects such as nausea and dyskinesia (uncontrolled movements) associated with conventional directly acting dopaminergic treatments.

Phase I development of V2006 has been completed by Vernalis. Biogen Idec is conducting and funding future development and will pay milestones and royalties on the successful development and commercialisation of products. Vernalis has an option to co-promote products arising out of this collaboration in the US. Biogen Idec filed an Investigational New Drug Application (IND) in December 2005 and plans to commence Phase II studies in H2 2006.

V10153 – ischaemic stroke

V10153 is a novel thrombolytic protein which is being developed for the treatment of acute ischaemic stroke; a type of stroke that is caused by blockage of a blood vessel, unlike a hemorrhagic stroke which is caused by bleeding. Ischaemic stroke is the most common type of stroke, accounting for over 80 per cent of all strokes and occurs when a blood clot (thrombus) forms and blocks blood flow in an artery bringing blood to part of the brain. Current therapeutic options for stroke sufferers are severely limited.

In late 2005 Vernalis started a multi-centre Phase II clinical study of V10153 to determine whether this novel thrombolytic can safely benefit patients who have recently experienced an acute ischaemic stroke if administered up to nine hours after the stroke has occurred (the only current approved therapy, recombinant tissue plasminogen activator (rtPA), must be administered within the first three hours after a stroke has occurred). The study is being conducted in two parts, with Part A designed to identify a safe and potentially efficacious dose of V10153 which is targeted to complete patient enrolment in H2 2006. Part B of the study will be a placebo controlled extension of the study to confirm the initial indications of efficacy from Part A, subject to satisfactory regulatory review.

Apomorphine – Parkinson's disease

In November 2005, Vernalis entered into a collaboration with Britannia Pharmaceuticals Limited (Britannia) to explore the development of new formulations of apomorphine for the US market. Vernalis has rights to Britannia's technology to develop a continuous sub-cutaneous infusion of apomorphine and rights to negotiate terms for a nasal powder formulation of apomorphine, which is currently in clinical development in Europe.

Other programmes

V24343 – obesity

Vernalis' research group has successfully progressed a series of potent and selective cannabinoid receptor antagonists as novel treatments for obesity. CB₁ receptors, initially identified in the brain, are also present in several other peripheral tissues, including adipocytes (fatty tissues). These receptors are part of the endocannabinoid system, a natural physiological system that is thought to play a role in the regulation of both appetite and peripheral energy metabolism, thereby affecting body weight.

In August 2005, V24343 was selected as the lead clinical candidate and a pre-clinical programme, which includes process and formulation development, pre-clinical safety and drug metabolism and pharmacokinetics, is underway. Phase I studies are expected to commence in H2 2006.

MMP-12 – multiple sclerosis

In January 2005, Vernalis' partner, Serono, started a Phase I clinical trial of a selective inhibitor of MMP-12 (matrix metalloprotease inhibitor 12). This is the first compound to enter the clinic resulting from the research collaboration, and, in accordance with the terms of the agreement, Vernalis received a milestone payment. The Phase I trial, which has now completed, was performed in healthy volunteers, with a primary objective of elucidating the safety, tolerability and pharmacokinetic properties of the compound. Serono is conducting and funding all development activities associated with any programme that enters the clinic, with Vernalis receiving milestone payments and royalties upon successful commercialisation of any product.

Hsp90 inhibitors – oncology

Inhibition of Hsp90 is believed to have significant potential in the treatment of a broad range of cancers. This programme is utilising Vernalis' structure-based design technology to identify potent and specific inhibitors of this novel drug target for use against various cancers. Vernalis has a research collaboration with Novartis to investigate inhibitors of Hsp90 and the two companies are conducting a joint research programme under which Novartis provides research funding to Vernalis for an initial three-year period from August 2004. In addition, Novartis is responsible for funding and conducting the development of product candidates as well as for commercialisation. In December 2005, Vernalis announced that Novartis had selected a clinical development candidate. The compound is expected to enter clinical development in H2 2006.

Research

Vernalis has a strong research capability focused on the discovery of drug development candidates to treat diseases of the central nervous system (CNS) and cancer. The current therapeutic focus in CNS is pain and Parkinson's disease, where both symptomatic and neuron-protection strategies are being pursued. Emphasis is placed on drug targets for which there is both strong evidence of therapeutic relevance and which are amenable to the Company's drug candidate discovery technology. Where appropriate Vernalis forms collaborations in this area, an example of which is its adenosine A_{2A} receptor antagonist programme partnered with Biogen Idec. In cancer the emphasis is on targets that are capable of having pleiotropic effects on cancer cells i.e. single targets that can modulate the action of multiple growth promoting pathways used by cancer cells. With this approach it is hoped to produce effective treatments by preventing a tumour being able to survive by using a different complementary growth pathway as illustrated by the Company's Hsp90 programme partnered with Novartis.

Vernalis uses and develops structure-based drug discovery methods for its programmes in order to increase the quality and discovery rate of drug candidate compounds. The Company's approach is to generate as much three dimensional protein-molecule structural information as possible in the hit identification phase using virtual screening, a distinctive fragment (small parts of molecules) based discovery process, and molecular modelling. In turn, this structural information is used to design novel hit compounds, often combining key interaction features from a number of fragments and compounds together. These hits are then optimised using structure-guided medicinal chemistry. Drug candidate compounds emerging from this discovery process in both therapeutic areas are regularly reviewed and considered for partnering or internal development.

Expected development progress

- V1512: Start of Phase III in Parkinson's disease H2 06
- V2006: Start of Phase II in Parkinson's disease (Biogen)* H2 06
- V24343: Start of Phase I in obesity H2 06
- Hsp90: Start of Phase I (Novartis)* H2 06
- V10153: Completion of recruitment of Phase IIa in stroke H2 06

* Milestone due to Vernalis

Simon Sturge

Chief Executive Officer

Financial review

Income statement

Revenue for the six months ended 30 June 2006 was £6.6 million (2005: £5.9 million) and comprised £1.0 million (2005: £nil) in respect of sales of Apokyn®, £1.5 million (2005: £1.6 million) in respect of European revenues from frovatriptan, a release of a £0.3 million (2005: £nil) provision in relation to returns and rebates for frovatriptan and £3.8 million (2005: £4.3 million) in respect of revenue recognised under collaboration agreements. The Apokyn® sales this year follow the acquisition of the rights to the product from Mylan in November 2005 and represent gross sales of \$2.3 million less provisions of \$0.5 million for potential returns and rebates. Revenue in respect of collaboration agreements of £3.8 million results from the release of deferred income of previously received initial payments from Endo, Biogen Idec and Novartis and the funding from Endo in respect of the US co-promotion of Frova®.

Cost of sales increased to £3.1 million (2005: £2.3 million) and comprised £0.2 million (2005: £nil) in respect of Apokyn®, £0.5 million (2005: £0.6 million) in respect of European revenues from frovatriptan and £2.4 million (2005: £1.7 million) in respect of amortisation of acquisition costs of Apokyn® and frovatriptan.

Other income of £0.6 million (2005: £nil) relates to compensation for damaged inventory of Frova®.

Research and development expenditure increased to £15.4 million (2005: £12.4 million). In 2006, expenditure of £9.4 million (2005: £8.3 million) was incurred on internally funded R&D and £6.0 million (2005: £4.1 million) on external costs associated with development of the product portfolio. The increase to internally funded R&D is due to inflation and higher average headcount levels. The increase of external costs is due to the broader development portfolio following the acquisition of Cita Neuropharmaceuticals Inc. (Cita) and Ionix Pharmaceuticals Limited in 2005 and costs incurred on product manufacture and Phase II studies for V10153.

Selling, general and administrative expenses increased to £10.9 million (2005: £10.6 million). Following establishment of the US commercial operations in the second half of 2005 and the acquisition of Apokyn® in November 2005; sales and marketing expenditure of £4.7 million (2005: £0.2 million) was incurred. A provision for future rental costs associated with properties not utilised within the Group of £1.4 million (2005: £nil) was made following reassessment of the likely occupancy periods of tenants. Other administration expenses amounted to £4.8 million (2005: £4.0 million) with the increase due to inflation, insurance costs and higher levels of professional fees. In 2005 a goodwill impairment charge of £6.4 million was incurred.

Interest receivable and similar income increased to £4.7 million (2005: £2.3 million) and comprised interest receivable of £1.3 million (2005: £1.0 million), exchange gains of £3.3 million (2005: £1.0 million) and an implicit interest receipt of £0.1 million (2005: £0.4 million) relating to the fair value accounting for the deferred payments due from Endo. The increase in interest receivable reflects higher average cash balances following the fund raising in December 2005. The exchange gains in 2006 principally relate to retranslation of the \$50 million loan from Endo and the deferred consideration which may become payable to the former shareholders of Cita, the Canadian company which Vernalis acquired in 2005. The gain arises because of the strengthening of sterling compared to the US\$ in the first half of 2006 (in the first half of 2005 sterling weakened compared to the US\$). Interest payable and similar charges decreased to £1.8 million (2005: £3.0 million) and comprised interest payable of £0.8 million (2005: £0.7 million), exchange losses of £0.6 million (2005: £2.0 million) and an implicit finance charge of £0.4 million (2005: £0.3 million) on loans repayable by instalments. The exchange loss in 2006 results from retranslation of the \$15 million deferred consideration due from Endo in September 2006 and arises due to the strengthening of sterling referred to above.

The loss for the six months ended 30 June 2006 was £18.4 million (2005: £19.0 million).

Balance sheet

Non-current assets at 30 June 2006 amounted to £89.1 million (31 December 2005: £91.7 million) with the decrease resulting principally from the amortisation charge in respect of acquired product rights carried on intangible assets. The carrying value of intangible assets amounts to £82.0 million (31 December 2005: £84.3 million) and reflects amounts paid to third parties to acquire the rights to frovatriptan, Apokyn®, V1512, V3381 and V1003.

Current assets at 30 June 2006 amounted to £70.2 million (31 December 2005: £93.1 million). Inventories were £0.5 million (31 December 2005: £0.8 million) and principally related to Apokyn®. Current trade and other receivables were £18.8 million (31 December 2005: £24.0 million). The reduction is due to the receipt in the period of £2.1 million in respect of R&D tax credits and the unwinding of a tax-assisted financing arrangement entered into by Cita. This resulted in a decrease to both other receivables the other payables of £3.6 million. Cash resources comprising held-to-maturity financial assets of £35.1 million (31 December 2005: £28.1 million) and cash and cash equivalents of £15.8 million (31 December 2005: £40.2 million) reduced to £50.9 million (31 December 2005: £68.3 million). The reasons for the decrease are explained in the cash flow section below.

Non-current liabilities amounted to £54.9 million (31 December 2005: £69.6 million). The reduction is principally due to the classification of £12.1 million (\$20 million) in respect of the \$50 million loan from Endo within current liabilities. For the purpose of classification of creditors, it is assumed that frovatriptan is approved by the FDA for the short-term prevention of menstrual migraine thus triggering a payment from Endo to Vernalis of \$40 million. Endo has the right to withhold 50 per cent of this payment and use it to reduce the balance outstanding on the loan and therefore \$20 million has been classified within current liabilities. In addition £2.4 million of deferred income has been transferred from non-current to current liabilities.

Current liabilities amounted to £39.5 million (31 December 2005: £32.3 million) with the increase due to the reclassification of £12.1 million of the Endo loan referred to above. This increase was offset by a reduction of £3.6 million in respect of the tax-assisted financing referred to above and a reduction in the provision for frovatriptan returns of £0.5 million.

Cash flow

Cash resources, comprising held-to-maturity financial assets and cash and cash equivalents, decreased from £68.3 million at 31 December 2005 to £50.9 million at 30 June 2006. The decrease of £17.4 million results from utilisation of £20.6 million in the operations of the business and £0.1 million on the purchase of tangible fixed assets offset by receipt of R&D tax credits of £2.0 million and net interest received of £1.3 million. The cash utilised in the operations of the business will benefit from the receipt of \$15 million from Endo in the second half of the year.

Property

In September 2006, Vernalis entered into an agreement with Pfizer to sub-lease approximately half of its premises at Granta Park, Cambridge for an initial period of five years.

Outlook

We continue to concentrate our activities on building the commercial business in North America and progressing our pipeline of product candidates. We are confident that the marketing initiatives undertaken to re-launch Apokyn® will increase prescription levels substantially.

We are continuing to make significant progress with our growing development pipeline and a number of milestone payments are potentially becoming payable in respect of projects being developed by our partners. The sNDA for Frova® for the short-term prevention of MM has been accepted by the FDA and their review is expected to be completed by 19 May 2007. If approved, a milestone of \$40 million is payable to Vernalis. V10153 and V3381 are progressing in Phase II clinical studies. A Phase III study with V1512 and a Phase I study with V24343 are both planned to start shortly. Our partners plan to start a Phase II study with V2006 and a Phase I study with an Hsp90 inhibitor later this year with a milestone payable to Vernalis in each case. As a result, the second half of the year is expected to be a busy period of clinical development.

Tony Weir

Chief Financial Officer

Independent review report to Vernalis plc

Introduction

We have been instructed by the Company to review the financial information for the six months ended 30 June 2006 which comprises the unaudited consolidated interim balance sheet as at 30 June 2006 and the related unaudited consolidated interim statements of income, cash flows and changes in shareholders' equity for the six months then ended and related notes. We have read the other information contained in the Interim Report and considered whether it contains any apparent misstatements or material inconsistencies with the financial information.

Directors' responsibilities

The Interim Report, including the financial information contained therein, is the responsibility of, and has been approved by the directors. The Listing Rules of the Financial Services Authority require that the accounting policies and presentation applied to the interim figures should be consistent with those applied in preparing the preceding annual accounts except where any changes, and the reasons for them, are disclosed.

The Interim Report has been prepared in accordance with the basis set out in note 1.

Review work performed

We conducted our review in accordance with guidance contained in Bulletin 1999/4 issued by the Auditing Practices Board for use in the United Kingdom. A review consists principally of making enquiries of management and applying analytical procedures to the financial information and underlying financial data and, based thereon, assessing whether the disclosed accounting policies have been applied. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance. Accordingly we do not express an audit opinion on the financial information. This report, including the conclusion, had been prepared for and only for the Company for the purpose of the Listing Rules of the Financial Services Authority and for no other purpose. We do not, in producing this report, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial information as presented for the six months ended 30 June 2006.

PricewaterhouseCoopers LLP
Chartered Accountants
London
12 September 2006

Notes:

- (a) The maintenance and integrity of the Vernalis plc web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Interim Report since it was initially presented on the web site.
- (b) Legislation in the United Kingdom governing the preparation and dissemination of financial information may differ from legislation in other jurisdictions.

Unaudited consolidated income statement

for the six months ended 30 June 2006

	Note	6 months ended 30 June 2006 £000	6 months ended 30 June 2005 £000	12 months ended 31 December 2005 £000
Revenue	2	6,619	5,901	14,131
Cost of sales		(3,137)	(2,299)	(4,991)
Other income		621	–	–
Research and development expenditure		(15,427)	(12,438)	(26,491)
Selling, general and administrative expenses		(10,941)	(10,556)	(15,483)
Selling, general and administrative expenses are as follows:				
Goodwill impairment		–	6,371	6,371
Restructuring costs		–	–	102
Sales and marketing		4,749	175	1,601
Provision for vacant leases		1,356	34	29
Other		4,836	3,976	7,380
		10,941	10,556	15,483
Operating loss		(22,265)	(19,392)	(32,834)
Interest receivable and similar income	3	4,703	2,322	3,892
Interest payable and similar charges	3	(1,793)	(2,966)	(5,490)
Loss on ordinary activities before taxation		(19,355)	(20,036)	(34,432)
Tax credit on loss on ordinary activities		921	1,016	1,584
Loss for the period		(18,434)	(19,020)	(32,848)
Loss per share (basic and diluted)	9	(5.9)p	(10.6)p	(16.3)p

Unaudited consolidated balance sheet

as at 30 June 2006

	Note	30 June 2006 £000	30 June 2005 £000	31 December 2005 £000
Assets				
Property, plant and equipment		1,998	1,120	1,910
Goodwill		4,869	1,643	4,851
Intangible assets	4	81,964	31,811	84,345
Available-for-sale financial assets	5	230	585	601
Other receivables		–	8,132	–
Non-current assets		89,061	43,291	91,707
Inventories		526	62	752
Trade and other receivables	6	18,773	20,550	24,013
Held-to-maturity financial assets		35,134	34,736	28,052
Cash and cash equivalents		15,730	15,175	40,243
Current assets		70,163	70,523	93,060
Total assets		159,224	113,814	184,767
Liabilities				
Borrowings	7	(17,740)	(28,758)	(30,938)
Other non-current liabilities	8	(7,153)	(2,702)	(7,412)
Deferred income		(24,037)	(28,876)	(26,457)
Provisions		(5,981)	(6,413)	(4,780)
Non-current liabilities		(54,911)	(66,749)	(69,587)
Borrowings	7	(12,119)	–	(33)
Trade and other liabilities	8	(19,248)	(11,639)	(22,971)
Deferred income		(5,119)	(5,182)	(5,147)
Provisions		(3,051)	(2,837)	(4,169)
Current liabilities		(39,537)	(19,658)	(32,320)
Total liabilities		(94,448)	(86,407)	(101,907)
Net assets		64,776	27,407	82,860
Shareholders' equity				
Share capital		47,280	41,655	47,280
Share premium		369,633	331,777	369,324*
Other reserves		180,999	154,849	180,958*
Retained deficit		(533,136)	(500,874)	(514,702)
Total shareholders' equity		64,776	27,407	82,860

* Restated – see note 1.

Unaudited consolidated statements of changes in shareholders' equity

for the half year ended 30 June 2006

	Share capital £000	Share premium (restated) £000	Other reserves (restated) £000	Retained deficit £000	Total £000
Balance at 1 January 2005	39,492	305,842	154,417	(481,854)	17,897
Revaluation of assets available for sale	-	-	(95)	-	(95)
Net expense recognised directly in equity	-	-	(95)	-	(95)
Loss for the period	-	-	-	(19,020)	(19,020)
Total recognised expense for the period	-	-	(95)	(19,020)	(19,115)
Issue of equity share capital	2,163	28,112	-	-	30,275
Expenses on issue of share capital	-	(2,177)	-	-	(2,177)
Equity share options charge	-	-	527	-	527
Balance at 30 June 2005	41,655	331,777	154,849	(500,874)	27,407
Revaluation of assets available for sale	-	-	16	-	16
Exchange loss on translation of overseas subsidiaries	-	-	(31)	-	(31)
Net expense recognised directly in equity	-	-	(15)	-	(15)
Loss for the period	-	-	-	(13,828)	(13,828)
Total recognised expense for the period	-	-	(15)	(13,828)	(13,843)
Issue of equity share capital	5,625	63,791	-	-	69,416
Reclassification of share premium to merger reserve	-	(24,400)	24,400	-	-
Expenses on issue of share capital	-	(1,844)	-	-	(1,844)
Shares to be issued	-	-	1,034	-	1,034
Equity share options charge	-	-	690	-	690
Balance at 31 December 2005	47,280	369,324	180,958	(514,702)	82,860
Revaluation of assets available for sale	-	-	(371)	-	(371)
Exchange loss on translation of overseas subsidiaries	-	-	(168)	-	(168)
Net expense recognised directly in equity	-	-	(539)	-	(539)
Loss for the period	-	-	-	(18,434)	(18,434)
Total recognised expense for the period	-	-	(539)	(18,434)	(18,973)
Refunded expenses on issue of share capital	-	309	-	-	309
Equity share options charge	-	-	580	-	580
Balance at 30 June 2006	47,280	369,633	180,999	(533,136)	64,776

Unaudited consolidated cash flow statements

for the six months ended 30 June 2006

	6 months ended 30 June 2006 £000	6 months ended 30 June 2005 £000	12 months ended 31 December 2005 £000
Cash flows from operating activities			
Loss for the period	(18,434)	(19,020)	(32,848)
Taxation	(921)	(1,016)	(1,584)
Depreciation	865	568	921
Loss on disposal of tangible fixed assets	2	1	12
Amounts written off goodwill	–	6,371	6,371
Amortisation and disposal of intangible fixed assets	2,381	2,031	3,983
Option charge	580	527	1,217
Interest receivable	(4,703)	(2,322)	(3,892)
Interest payable	1,793	2,966	5,490
Exchange loss/(gain)	5	(12)	(511)
	(18,432)	(9,906)	(20,841)
Changes in working capital			
Decrease/(increase) in inventories	231	(13)	(703)
Decrease/(increase) in receivables	3,610	(587)	7,914
Decrease in liabilities	(2,993)	(90)	(133)
Decrease in provisions	(201)	(1,528)	(1,807)
Decrease in deferred income	(2,448)	(2,075)	(4,529)
Cash used in operations	(20,233)	(14,199)	(20,099)
Taxation received	2,074	2,307	4,284
Taxation paid	(40)	–	–
Interest paid	(27)	(5)	(8)
Net cash used in operating activities	(18,226)	(11,897)	(15,823)
Purchase of tangible fixed assets	(127)	(211)	(589)
Acquisition of subsidiary undertakings net of cash acquired	(418)	–	(3,104)
Sale of tangible fixed assets	–	1	–
Purchase of intangible fixed assets	–	(575)	(16,570)
Interest received	664	398	710
Interest received on financial assets held to maturity	593	312	898
Net cash used in investing activities	712	(75)	(18,655)
Cash flows from financing activities			
Movement in held-to-maturity financial assets	(7,082)	(19,737)	(13,052)
Issue of shares	–	30,275	72,958
Share issue refunds/(costs)	310	(1,880)	(3,996)
Capital element of finance lease payments	(75)	(18)	(23)
Net cash generated from financing activities	(6,847)	8,640	55,887
Foreign exchange on cash and cash equivalents	(152)	184	511
Movements in cash and cash equivalents in the period	(24,513)	(3,148)	21,920
Cash and cash equivalents at the beginning of the period	40,243	18,323	18,323
Cash and cash equivalents at the end of the period	15,730	15,175	40,243

Notes to the financial statements

1 Basis of preparation

This financial information comprises the consolidated interim balance sheets as of 30 June 2006, 30 June 2005 and 31 December 2005 and related consolidated interim statements of income and cash flows for the 6 months and 12 months then ended of Vernalis plc.

In preparing this financial information management has used the principal accounting policies as set out in the Group's annual financial statements for the year ended 31 December 2005.

The Group has chosen not to adopt IAS 34, "Interim financial statements", in preparing its 2006 interim statements and, therefore, this interim financial information is not in compliance with IFRS.

The interim financial information has not been audited and does not constitute statutory accounts within the meaning of Section 240 of the Companies Act 1985 but has been reviewed by the auditors in accordance with Bulletin 1999/4 issued by the Auditing Practices Board. The Group's statutory accounts for the year ended 31 December 2005, prepared under IFRS, have been delivered to the Registrar of Companies; the report of the auditors on these accounts was unqualified and did not contain a statement under Section 237 (2) or (3) of the Companies Act 1985.

In 2005 the Group acquired Cita NeuroPharmaceuticals Inc. and Ionix Pharmaceuticals Limited. Both acquisitions included consideration satisfied by the issue of equity shares in the Group, in exchange for 100 per cent of the equity share capital of the acquired companies. These shares qualified for merger relief (s131) under the Companies Act, and any premium is required to be credited to a merger reserve. This was credited to the share premium reserve in the 2005 financial statement. Accordingly, the comparative figures as at 31 December 2005 for share premium and other reserves have been restated.

2 Revenue

The revenue analysis in the table below is based on the country of registration of the fee-paying party.

	6 months ended 30 June 2006 £000	6 months ended 30 June 2005 £000	12 months ended 31 December 2005 £000
United Kingdom	29	153	2,178
Rest of Europe	1,513	1,623	3,622
North America	5,070	4,118	8,317
Rest of the world	7	7	14
	6,619	5,901	14,131

An analysis of revenue by category is set out in the table below:

	6 months ended 30 June 2006 £000	6 months ended 30 June 2005 £000	12 months ended 31 December 2005 £000
Product sales	2,777	1,565	3,602
Royalties	29	85	110
Collaborative	3,813	4,251	10,419
	6,619	5,901	14,131

Notes to the financial statements

3 Finance credit/(charge) (net)

	6 months ended 30 June 2006 £000	6 months ended 30 June 2005 £000	12 months ended 31 December 2005 £000
Interest receivable and similar income			
Interest on cash, cash equivalents and held-to-maturity assets	1,326	969	1,997
Exchange gains on other payable	202	–	–
Exchange gains on long-term loan	2,263	–	–
Exchange gain on deferred consideration	839	–	–
Exchange gains on other receivable	–	956	1,320
Unwinding of discount on other receivable	69	374	531
Other interest receivable	4	23	44
	4,703	2,322	3,892
Interest payable and similar charges			
Loans repayable wholly or partly within five years	787	675	1,489
Finance leases	27	3	4
Exchange loss on other receivable	625	–	–
Exchange loss on long-term loan	–	1,683	2,987
Exchange loss on other payables	–	324	429
Exchange loss on deferred consideration	–	–	257
Unwinding of discount on deferred consideration on purchase of intangible assets	250	–	–
Unwinding of discount on royalty buy-out from GSK	34	121	94
Unwinding of discount on provision	70	112	226
Other interest payable	–	48	4
	1,793	2,966	5,490
Net finance credit/(charge)	2,910	(644)	(1,598)

4 Goodwill

	30 June 2006 £000	30 June 2005 £000	31 December 2005 £000
Cost			
At 1 January	20,431	17,223	17,223
Additions through business combinations	–	–	3,208
Other	18	–	–
At end of period	20,449	17,223	20,431
Aggregate impairment			
At 1 January	15,580	9,209	9,209
Impairment charge for the period	–	6,371	6,371
At end of period	15,580	15,580	15,580
Net book value at end of period	4,869	1,643	4,851
Net book value at beginning of period	4,851	8,014	8,014

5 Intangible assets

	Assets in use £000	Assets not yet in use £000	Total £000
Cost			
At 1 January and 30 June 2006	50,400	42,425	92,825
Aggregate amortisation			
At 1 January 2006	8,480	–	8,480
Charge for the period	2,381	–	2,381
At 30 June 2006	10,861	–	10,861
Net book value at 30 June 2006	39,539	42,425	81,964
Cost			
At 1 January 2005	37,408	600	38,008
Additions separately acquired	–	631	631
Disposals	–	(300)	(300)
At 30 June 2005	37,408	931	38,339
Aggregate amortisation			
At 1 January 2005	4,797	–	4,797
Charge for the period	1,731	–	1,731
At 30 June 2005	6,528	–	6,528
Net book value at 30 June 2005	30,880	931	31,811
Cost			
At 1 January 2005	37,408	600	38,008
Additions through business combinations	–	41,327	41,327
Additions separately acquired	12,992	798	13,790
Disposals	–	(300)	(300)
At 31 December 2005	50,400	42,425	92,825
Aggregate amortisation			
At 1 January 2005	4,797	–	4,797
Charge for the period	3,683	–	3,683
At 31 December 2005	8,480	–	8,480
Net book value at 31 December 2005	41,920	42,425	84,345

6 Trade and other receivables

	30 June 2006 £000	30 June 2005 £000	31 December 2005 £000
Other receivables	–	8,132	–
Non-current trade and other receivables	–	8,132	–
Trade receivables	2,817	1,211	2,292
Interest receivable	595	403	524
Research and development tax credits	2,897	5,142	3,996
Other receivables	8,808	9,024	12,969
Prepayments and accrued income	3,656	4,770	4,232
Current trade and other receivables	18,773	20,550	24,013
Total trade and other receivables	18,773	28,682	24,013

Notes to the financial statements

7 Borrowings

	30 June 2006 £000	30 June 2005 £000	31 December 2005 £000
US dollar secured loan	17,391	28,758	30,839
Obligations under finance leases	349	–	99
Non-current borrowings	17,740	28,758	30,938
US dollar secured loan	11,970	–	–
Obligations under finance leases	149	–	33
Current borrowings	12,119	–	33
Total borrowings	29,859	28,758	30,971

The US dollar secured loan relates to \$50 million borrowed from Endo, net of the finance charges of £0.2 million, and interest payable of \$4.7 million (£2.6 million) which the Group has elected to roll up into the loan at June 2005, December 2005 and June 2006. It is secured against all royalty and milestone income receivable by Vernalis in respect of the licence deal with Endo. Endo has the right to offset half the royalty payments and milestones payable to Vernalis against the loan from 2007. The weighted average interest rate is 5 per cent fixed for the term of the loan.

8 Trade and other liabilities

	30 June 2006 £000	30 June 2005 £000	31 December 2005 £000
Royalty buy out from GSK	2,621	2,702	2,788
Deferred consideration	4,532	–	4,624
Non-current trade and other liabilities	7,153	2,702	7,412
Trade payables	3,293	2,379	3,975
Taxation and social security payable	861	736	301
Other payables	–	21	3,626
Accruals	8,742	5,721	7,825
Royalty buy-out from GSK	–	2,782	–
Deferred consideration for acquisitions	6,352	–	7,244
Current trade and other liabilities	19,248	11,639	22,971
Total trade and other liabilities	26,401	14,341	30,383

9 Loss per share

Basic loss per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period.

For diluted loss per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares. Since the Group is loss-making there is no such dilutive impact.

	6 months ended 30 June 2006	6 months ended 30 June 2005	12 months ended 31 December 2005
Attributable loss (£000)	18,434	19,020	32,848
Weighted average number of shares in issue (000)	311,464	179,834	202,174
Loss per share (basic and diluted)	(5.9)p	(10.6)p	(16.3)p

All potential ordinary shares including options and deferred shares are anti-dilutive.

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