

Financial review

Key Highlights for 2006

- Revenue £760,000 (2005: £824,000)
- Research & development costs £19,523,000: increased over 100% from 2005
- Loss for the year £17,626,000: increased £8,541,000 (94%) compared to 2005
- Cash burn £15,876,000: £8,211,000 (107%) more than 2005
- Year end cash, cash equivalents and current asset investments £28,543,000 (2005: £43,817,000)

INCOME STATEMENT OVERVIEW

In line with expectation, investment in research and development more than doubled in 2006 with the start of the TRIST Phase III trial of TroVax, leading to a net loss almost twice the level of 2005 and a comparable increase in cash burn. As in previous years, revenue was not significant compared to the level of R&D spending.

REVENUE £760,000 (2005: £824,000)

Revenue in 2006 derived from licences to the Group's proprietary gene delivery technology. Total revenue was down £64,000 on 2005 due partly to the weaker US Dollar in 2006 but mostly due to the impact on last year's revenue of the initial payment received under the Sigma-Aldrich licence.

Analysis of revenue	2006 £'000	2005 £'000	2004 £'000	2003 £'000
Gene delivery licences	516	679	192	-
LentiVector licence for transgenics	191	145	217	56
Immunotoxin collaboration	-	-	-	287
Other revenue	53	-	93	31
Total revenue	760	824	502	374

Two new gene delivery licenses were signed in 2006; with VIRxSYS for VSV-G viral envelope technology, and with GlaxoSmithKline for LentiVector research use. In addition an existing licence was upgraded to an all-territory perpetual licence. Under the Group's revenue recognition policy, the non-refundable one-off payments under such licences are recognised as revenue in the year in which the agreements are signed.

Revenue was also earned in 2006 from the ongoing collaboration with Viragen Inc, using LentiVector gene delivery in the field of avian transgenics. Viragen has continued to report good progress, and further annual fees are expected in the future, with the possibility of milestone payments and royalties on sales arising on commercialisation of the Viragen process.

In total there were nine active technology licenses at the end of 2006. Seven of these are annually renewable and are expected to generate recurring income. The other two are fully paid-up perpetual licences (for research use only). Three of the licenses also provide for milestones related to product development. The Group expects to increase the scope of its gene delivery technology licence activity in 2007. However, there can be no guarantee that more licenses will be signed, or that the existing licences will be renewed.

The new ocular gene therapy development agreement with the US charity Foundation Fighting Blindness brought revenue of £53,000 (US\$100,000) in 2006.

OPERATING EXPENSES £22,222,000 (2005: £12,192,000)

Operating expenses in 2006 were significantly higher than 2005 due to investment in the TroVax Phase III TRIST study and increased spending on ProSavin. This increase in spending was anticipated at the time that new funds were raised at the end of 2005. Administration costs were £166,000 (6%) lower than in 2005.

	2006 £'000	2005 £'000	2004 £'000	2003 £'000
Operating expenses				
Research & development costs	19,523	9,327	9,013	10,560
Administration expenses excluding reorganisation	2,699	2,865	2,791	2,930
Exceptional administration expenses	–	–	1,568	–
Total operating expenses	22,222	12,192	13,372	13,490

RESEARCH & DEVELOPMENT COSTS £19,523,000 (2005: £9,327,000)

The Group's R&D costs comprise in-house costs (staff salaries and expenses, R&D consumables, IP costs, facilities costs and depreciation of R&D assets) and external preclinical and clinical costs (preclinical development, GMP manufacturing, regulatory costs, clinical trials and clinical consultants). Following the fundraising at the end of 2005, there was a modest increase in in-house R&D spending and a significant increase in external development expenditure, particularly for TroVax and ProSavin.

	2006 £'000	2005 £'000	2004 £'000	2003 £'000
Research and development costs				
In-house R&D costs UK	7,983	7,310	6,647	6,144
In-house R&D costs USA	387	287	405	2,030
External preclinical & clinical costs	11,153	1,730	1,961	2,386
Total research & development cost	19,523	9,327	9,013	10,560

EXTERNAL PRECLINICAL AND CLINICAL COSTS £11,153,000 (2005: £1,730,000)

There were three additional Phase II studies of TroVax (two in renal cancer and one in prostate cancer) in addition to starting the Phase III TRIST study. TroVax manufacturing costs in 2006 included £3,454,000 for large-scale validation of the manufacturing process, which is not expected to be a recurring expense. Increased costs for ProSavin were mainly for preclinical studies (increased from £328,000 in 2005 to £1,487,000 in 2006). Manufacturing and process development costs for ProSavin were up £290,000 at £424,000. Other preclinical programmes and external costs in 2006 included costs of the RetinoStat programme and a new contract for outsourced pharmacovigilance.

	2006 £'000	2005 £'000	2004 £'000	2003 £'000
External clinical & preclinical costs				
TroVax development: Phase III and manufacturing	8,135	462	629	266
TroVax development: Phase II	565	602	526	698
MetXia development	164	140	181	716
ProSavin development	1,937	469	484	651
Other preclinical programmes and external costs	352	57	141	55
Total external clinical & preclinical cost	11,153	1,730	1,961	2,386

External clinical and preclinical costs are expected to remain high in 2007 and 2008 with continuing expenditure on the TRIST programme, and the move of ProSavin into clinical trials.

ADMINISTRATION EXPENSES £2,699,000 (2005: £2,865,000)

Despite the overall expansion of the Group's activities in 2006, administration expenses were kept under tight control, and were 6% lower than 2005. Over the period 2003 to 2006 administration expenses (excluding exceptional costs of reorganisation) have been in a fairly narrow range approximately £2.7 million to £2.9 million per annum.

HEADCOUNT

There was a small overall increase in R&D headcount in 2006 to 63 at the period end from 61 in 2005. The R&D staff changes in 2006 have been largely associated with the Company's increased emphasis on clinical trial management. The administration headcount was unchanged in 2006 at 10. In total, the Company had a headcount of 73 at the end of 2006, and currently it is 72.

Analysis of headcount	2006 Number	2005 Number	2004 Number	2003 Number
R&D headcount UK at period end	61	59	55	43
R&D headcount USA at period end	2	2	1	6
Administration headcount at period end	10	10	10	12
Total headcount at period end	73	71	66	61
R&D headcount UK average	60	58	50	45
R&D headcount USA average	2	1	2	14
Administration headcount average	10	10	10	13
Total headcount average	72	69	62	72

GRANT INCOME £360,000 (2005: £135,000)

Grant income was higher in 2006, due to the full-year effect of two grants that started in 2005. The UK Department of Health is supporting a development programme for haemophilia which contributed £127,000 in 2006 (2005: £89,000). The UK charity Motor Neurone Disease Association (MNDA) is supporting development in motor neurone disease, and contributed £190,000 to other operating income in 2006 (2005: £48,000). In addition the MNDA grant has contributed £79,000 towards laboratory equipment in 2005-2006. Cash flow from grants was much better in 2006 with the move away from DTI and EU controlled grants. The Eureka and Link programmes that ran in 2003 to 2005 were very slow to pay and only covered a small part of the programme costs. In 2006 the final settlements were received and these grant programmes were closed.

Grant income	2006 £'000	2005 £'000	2004 £'000	2003 £'000
UK Government (Eureka, Link, DoH)	146	73	179	443
European Community framework 5&6	24	14	48	71
Charity grants	190	48	137	155
Total grants	360	135	364	669
Debtor at year end for grants	69	516	405	244

NET INTEREST RECEIVABLE £1,714,000 (2005: £938,000)

The Group places its cash on deposit for periods of up to 12 months and generates interest on those deposits. The maturity profile of deposits is intended to match planned patterns of expenditure. As a result of the cash received from the share issue in December 2005, net interest receivable in 2006 was considerably higher than 2005. The average balance invested during 2006 was £37,689,000 (2005: £19,555,000). The average interest rate on deposits in 2006 was 4.6% (2005: 4.8%). This followed changes in market rates, which were reduced in the second half of 2005, and rose again in the second half of 2006. Total interest receivable in 2006 was £1,743,000 (2005: £969,000).

The Group has no debt, but is recognising as an interest charge the discount on an onerous lease provision and, from 2006, a dilapidation provision.

Net interest receivable	2006 £'000	2005 £'000	2004 £'000	2003 £'000
Interest receivable – bank	1,743	969	1,171	712
Interest payable – discount on provisions	(29)	(19)	(13)	–
Interest payable on overdue tax	–	(12)	–	–
Total net interest receivable	1,714	938	1,158	712
Average balance on deposit in the year	37,689	19,955	26,570	19,118
Average interest on deposits	4.62%	4.77%	4.40%	3.62%

LOSS FOR THE FINANCIAL YEAR £17,626,000 (2005: £9,085,000)

The net effect of higher operating expenses, offset by increased grant income, interest receivable and tax credit was an increase of £8,541,000 in the loss for the year to £17,626,000.

TAXATION

The UK operating subsidiary Oxford BioMedica (UK) Limited is entitled to claim R&D tax credit. The credit is based on certain eligible expenses, to which a 50% mark-up and a tax rate of 16% is applied. The R&D tax credit in any year cannot exceed the total amount of payroll tax (Income Tax and National Insurance) paid in the year.

The US subsidiary BioMedica Inc supplies services to the UK subsidiary subject to a 5% mark-up, generating a low level of taxable income in the USA. The net tax credit for 2006 was £1,762,000 (2005: £1,210,000).

	2006 £'000	2005 £'000	2004 £'000	2003 £'000
Tax credit				
UK R&D tax credit – current year	1,709	1,175	1,000	1,200
UK R&D tax credit – prior year adjustment	75	101	(115)	(3)
Overseas tax payable – current year	(38)	(43)	(1)	–
Overseas tax payable – prior year adjustment	16	(23)	–	–
Deferred tax	–	–	–	6
Net tax credit	1,762	1,210	884	1,203
Debtor for R&D tax credit	2,309	1,175	1,685	1,200

R&D costs in 2006 were more than double the level of 2005, but due to the capping rules for R&D credit, the 2006 claim was up by just 45% on the year before, and was capped at the total of Income Tax and National Insurance on the UK payroll. The prior year credit of £75,000 reflects the release of a contingency provision following agreement with the UK tax authorities on the R&D claim for 2005. However, agreement was not secured in time to receive payment in 2006, and the year end debtor comprises £600,000 for 2005 and £1,709,000 for 2006. The final part of the 2005 claim was received in February 2007.

INTANGIBLE ASSETS £1,665,000 (2005: £1,641,000)

Since the adoption of IFRS the balance sheet has contained substantial intangible assets for purchased intellectual property rights. These assets are either amortised or reviewed for impairment at each balance sheet date. No amortisation has been charged to date, as the products underpinned by the intellectual property have not yet generated positive cashflows. Previously, under UK GAAP, the costs of purchased intellectual property rights were written off in the accounting period in which they were incurred. Purchased intellectual property costs of £24,000 were capitalised in 2006 (2005: £14,000).

TRADE AND OTHER RECEIVABLES £2,202,000 (2005: £1,777,000)

Trade and other receivables (debtors) were £425,000 higher in 2006 than in 2005. Increased trade receivables and accrued income at 31 December 2006 reflect the increased revenue receivable under two new gene delivery licence agreements signed in December 2006. Included in other receivables is grant income receivable, which was reduced from £516,000 in 2005 to £65,000 in 2006. However, this reduction was offset by higher interest accrued on bank deposits in 2006 and by legal costs incurred in the litigation with Open Biosystems that are to be reimbursed by Sigma-Aldrich. Increased prepayments in 2006 included prepaid insurance for the expanded clinical trial programme.

	2006 £'000	2005 £'000	2004 £'000	2003 £'000
Trade and other receivables				
Trade receivables	241	119	162	–
Accrued income	223	93	–	–
Other receivables	765	676	619	374
Prepayments	603	442	499	442
Other tax receivable (mostly VAT)	220	242	124	107
Rent deposit on US lease	150	205	214	263
Total trade and other receivables	2,202	1,777	1,618	1,186

TRADE AND OTHER PAYABLES £4,763,000 (2005: £2,180,000)

Trade and other payables (creditors) were dramatically higher in 2006, reflecting the increased costs of the expanded clinical programme. Trade payables at December 2006 included £800,000 for two of the key contractors in the TRIST programme (manufacturing and trial management). Accrued costs for clinical programmes rose from £721,000 in 2005 to £1,782,000 in 2006.

	2006	2005	2004	2003
	£'000	£'000	£'000	£'000
Trade and other payables				
Trade payables	1,579	397	351	310
Accruals	2,777	1,415	1,171	996
Other taxation and social security (mostly payroll taxes)	315	263	219	195
Deferred income	92	105	-	-
Total trade and other payables	4,763	2,180	1,741	1,501

SHARE ISSUES IN 2006

During 2006 a total of 2,446,260 shares were issued on the exercise of share options, raising proceeds of £466,000. In September 2006 485,185 shares were issued under the Foundation Fighting Blindness collaboration for ocular gene therapy, raising proceeds of £160,000. This is modest when compared to 2005, when share option exercises raised proceeds of £1,038,000 and an open offer, placing and subscription raised £28,013,000 net of costs.

CASH AND DEPOSITS £28,543,000 (2005: £43,817,000), CASH BURN £15,876,000 (2005: £7,665,000)

The placing, open offer and subscription in December 2005 raised the total of cash, cash equivalents and available for sale investments (bank deposits) to £43,817,000 at the end of 2005. Over the course of 2006 this total fell by £15,274,000 to £28,543,000 as the result of the significantly increased clinical spending and relatively low proceeds from share issues. However, the present balance keeps the Group in a strong position as it negotiates the licensing deal for TroVax, while keeping up the pace of investment in the Phase III programme.

The format of the cash flow statement under IFRS does not make it easy to assess the overall level of operational cash outflow (the 'cash burn') that has traditionally been a key performance indicator for development-stage biotechnology companies. However, it can be calculated by taking the total of cash used in operating activities, less proceeds of sale of property, plant and equipment, plus purchases of property, plant and equipment and purchases of intangible assets. On this measure, cash burn for 2005 was £7,665,000 while 2006 was more than double at £15,876,000. 2005 was a little lower than might have been expected due to receipt of overdue R&D tax credits in that year, and 2006 was affected by delays to some of the tax credit expected to be received. But even allowing for this, cash outflow in 2006 was much higher than the year before because of the increased research and development expenditure.

FINANCIAL OUTLOOK

The present level of spending will continue through 2007 if, as expected, the Group continues to be responsible for paying the costs of the Phase III TRIST trial of TroVax. However, the Directors expect these costs will be covered by the proceeds of a global licensing deal for TroVax. Progress by Wyeth with its CME-548 Targeted Antibody Therapy, advances in the Company's other existing collaborations, and new technology licensing agreements are expected to generate additional revenue. The Group's good financial position at the end of 2006, its exciting commercial potential and the pipeline of novel products provide a strong platform from which to deliver value to shareholders in the future.