

Avecia Group plc

**Directors' report and consolidated
financial statements**

Registered number 3768265

31 December 2006

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Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 2006 for Avecia Group plc (the "company" or the "parent company") and its subsidiary undertakings (the "group").

Principal activities

The group now operates two main businesses within the Biotechnology segment, Biologics and Oligo Medicines, having disposed of its remaining specialty chemicals business segments during 2005 and 2006. These two businesses provide contract manufacturing and development services to drug development companies.

The Biologics business is based in Billingham in the North East of England and manufactures medicines based on recombinant proteins using microbial fermentation processes.

The Oligo Medicines business is based in Milford, Massachusetts, USA and makes oligonucleotide based medicines using solid-phase synthesis. These medicines are effectively short strands of DNA or RNA.

Both businesses develop and carry out the manufacturing processes on behalf of customers who own the intellectual property to the compounds. The businesses are currently making a number of medicines which are in late stages of clinical trials. It is hoped that the customers will get regulatory approval of their drugs in the next few years.

The Biologics business is also developing defence vaccines, specifically for anthrax and plague, funded by the US and UK Governments. These vaccines, in respect of which Avecia has intellectual property rights, are based on Avecia's core technology in microbially derived recombinant proteins and, if successful, Avecia may seek to obtain regulatory approval for their use.

Business review

During the year the Group completed further divestments yielding net proceeds of £136.1m at a profit of £98.2m. This resulted in a significant improvement in the strength of the Group balance sheet, with net assets increasing from £62.7m to £131.6m. The proceeds of the disposals were used to redeem all the outstanding high yield bonds and a major portion of the Group's redeemable preference shares such that external debt has been reduced from £109.3m down to £15.2m while cash reserves at the balance sheet date were £29m. Also during 2006 the Group eliminated many of its retirement and employee benefit obligations in the USA, and moved the UK Pension Fund FRS 17 funding from a significant deficit to a small surplus, all of which in balance sheet terms means the elimination of the net pension liability of £48.0m as at 31 December 2005.

Sales from continuing operations increased during the year by some 5%, while their operating costs reduced substantially following the closure of the Group's Oligonucleotide facility in Grangemouth in the UK and the concentration of all this business in Milford Massachusetts. These factors resulted in profitability within the operating Biotechnology businesses improving from a loss of £13.8m in 2005 to break-even in 2006, while profits before depreciation and amortisation improved from £2.2m in 2005 to £7.4m in 2006. Net costs from continuing operations in total reduced from £105.7m to £81.5m and profitability significantly improved from a loss of £38.7m in 2005 to a net loss of £10.9m in 2006. At the consolidated Group level costs from continuing operations include activities associated with the recent sales of former Group undertakings, shown within Central and Other costs, and these costs reduced from £32.2m in 2005 to £18.5m in 2006. Capital investment in the Biotechnology businesses increased in 2006, with capital expenditure rising to £3.6m for the year.

At the balance sheet date the business remains focused on its core Biotechnology businesses and is well positioned to continue the development seen in these businesses over the last two years, seeking to improve utilisation of available capacity and increase the number of contracts with customers. With improving profitability in the trading businesses based on a broad spread of customer projects, cash reserves of over £29m compared with external debt of £15m and the pension deficit eliminated the directors feel the Group is very well placed to exploit the opportunities which lie ahead.

Directors' report *(continued)*

The key risks and uncertainties facing the business are:

- Most customers are not bound by long term contracts, and future growth is dependent on the ability to retain existing customers, and obtain contracts with new customers.
- All the products are manufactured to a high level of technical specification under rigorous quality standards. The businesses must continue to meet these specifications and standards if they are to retain existing customers and attract new business, and to pass regulatory inspections and audits.

The Directors monitor the businesses with a number of performance indicators. The principal measures are operating profit and cash generation, but other indicators such as order cover, asset utilisation, and resource efficiency are also considered. In addition the Directors monitor indicators and issues relating to safety, health and environment, and compliance with quality assurance standards. The Group produces an annual Budget, and updates its forecasts on a monthly basis to help monitor and manage business performance.

The directors have considered the appropriateness of the going concern concept in relation to the preparation of the financial statements and more detail in respect of this can be found in note 1 to the accounts.

Results and proposed dividend

During the year the group made a profit of £76.0 million (*2005: £40.0 million*). The directors do not recommend the payment of an equity dividend (*2005: £Nil*).

Disclosure of information to auditors

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware; and each director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Directors' report *(continued)*

Research and development

The group's research, development and process technology activities for its Biotechnology business are located with its manufacturing facilities at Teeside, UK, and Milford, Massachusetts, USA. Its research, development and process technology efforts are driven by the specific requirements of customers and market trends.

Policy and practice on payment of creditors

Given the international nature of the group's operations, there is no group standard in respect of payments to suppliers. Local operational management are responsible for agreeing terms and conditions for their business transactions when orders for goods and services are placed, ensuring that suppliers are aware of the payment terms and including the relevant terms in contracts where appropriate. These arrangements are adhered to when making payments, subject to the terms and conditions being met by the supplier.

At the year end there were 73 days (2005: 69 days) purchases in trade creditors for the group. Creditor days have not been calculated for the company as the company had no trade creditors at 31 December 2006, nor 2005.

Financial Instruments

The group holds or issues financial instruments to finance its operations and to manage the interest rate and currency risks arising from its operations and from its sources of finances. The group now finances its operations by a combination of redeemable preference shares and cash retained from proceeds arising on the disposal of businesses. All derivatives previously used for interest rate management have matured.

The main risks arising from the group's financial instruments are interest rate risk, liquidity risk, foreign currency risk and market price risk.

For further information please refer to Note 19.

Market value of land and buildings

In the opinion of the Directors, the current open market value of land and buildings does not differ materially from the net book value of £4.7m (2005: £5.5m) shown in the accounts.

Directors

The directors who held office during the year were as follows:

A Buckmaster	
KP Cox	
D McLellan	
DC Greensmith	(Resigned 17 February 2006)
DA Nicholson	(Resigned 22 March 2006)
JP Scudamore	(Resigned 22 March 2006)

Directors' report *(continued)*

Employees

Employee involvement

The group adopts an approach of being honest and open with employees about matters affecting the business. The group is fully committed to keeping employees informed about the performance, progress and issues relating to their business or work unit, and about wider business issues. Certain formal national and local employee consultation arrangements previously operated by the group have ceased to have application having regard to the reduced business segments, number of locations and employees in the group but the group maintains employee communications through line managers and informal processes, as well as formal structures and processes as required by applicable laws.

Equal opportunities

The group believes that every employee should be treated with the same respect and dignity. It values the rich diversity and creative potential of people with differing backgrounds and abilities, and encourages a culture of equal opportunities in which personal success depends on personal merit and performance. It is group policy that there should be no discrimination against any person for any reason that is not relevant to the effective performance of their job. All judgements about people for the purposes of recruitment, development and promotion will be made solely on the basis of their ability and potential in relation to the needs of the job. Every manager is responsible for implementing this policy.

Employment of people with disabilities

It is group policy that people with disabilities should have the same consideration as others with respect to recruitment, retention and personal development. Depending on their skills and abilities, they enjoy the same career prospects as other employees and the same scope for realising potential. The group also takes all reasonable steps to ensure that its working environments can accommodate special needs. The group also makes every effort to continue to employ staff who may become disabled while employed, providing appropriate training and adapting facilities to allow them to continue working wherever possible.

Political and charitable contributions

The group made no political contributions during the year. Donations to UK charities amounted to £9,000 (2005: £45,000).

Auditors

In accordance with Section 384 of the Companies Act 1985, a resolution for the re-appointment of KPMG Audit Plc as auditors of the company is to be proposed at the forthcoming Annual General Meeting.

By order of the board

[D MCLELLAN]

D McLellan
Director

Hexagon Tower
Blackley
Manchester
M9 8ZS

Statement of directors' responsibilities in respect of the directors' report and the financial statements

The directors are responsible for preparing the Directors' Report and the group and parent company financial statements, in accordance with applicable laws and regulations.

Company law requires the directors to prepare group and parent company financial statements for each financial year. Under that law the directors are required to prepare the group financial statements in accordance with IFRSs as adopted by the EU and have elected to prepare the parent company financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

The group financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position and the performance of the group; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

The parent company financial statements are required by law to give a true and fair view of the state of affairs of the parent company.

In preparing each of the group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- for the group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- for the parent company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the parent company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

Under applicable law, the directors are also responsible for preparing a Directors' Report that complies with that law.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

KPMG Audit Plc

St James' Square
Manchester
M2 6DS
United Kingdom

Report of the independent auditors to the members of Avecia Group plc

We have audited the group and parent company financial statements (the "financial statements") of Avecia Group plc for the year ended 31 December 2006 which comprise the Group Income Statement, the Group and Parent Company Balance Sheets, the Group Cash Flow Statement, the Group Statement of Recognised Income and Expenses and the related notes. These financial statements have been prepared under the accounting policies set out therein.

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 auditor's 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

The directors' responsibilities for preparing the Directors' Report and the group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU, and for preparing the parent company financial statements in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities on page 5.

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 whether the financial statements have been properly prepared in accordance with the Companies Act 1985 and, as regards, the group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, 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 other information contained in the Directors' Report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit 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 judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and 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 group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the group's affairs as at 31 December 2006 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and as regards the group financial statements, Article 4 of the IAS Regulation;
- the parent company financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the parent company's affairs as at 31 December 2006 and of its loss for the year then ended;
- the parent company financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

[KPMG AUDIT PLC 8 JUNE 2007]

KPMG Audit Plc
Chartered Accountants
Registered Auditor

Consolidated Income Statement
for the year ended 31 December 2006

	Note	2006 £m	2005 £m
Continuing operations			
Group revenue	2	70.6	67.0
Operating costs (excluding restructuring costs)		(80.8)	(100.4)
Restructuring costs	3	(1.0)	(7.8)
	3	(81.8)	(108.2)
Other operating income	3	0.3	2.5
		(10.9)	(38.7)
Operating loss		(10.9)	(38.7)
Finance income	8	4.4	14.7
Finance costs	9	(14.8)	(69.4)
		(21.3)	(93.4)
Loss before tax		(21.3)	(93.4)
Taxation	10	0.1	(1.6)
		(21.2)	(95.0)
Loss after tax from continuing operations		(21.2)	(95.0)
Profit from discontinued operations and gain on disposal of discontinued operations, net of tax		97.2	135.0
		76.0	40.0
Profit for the year		76.0	40.0
Attributable to equity holders of the parent			
		76.0	40.0
Discontinued operations is broken down as follows:			
Group revenue	2	8.1	146.7
Operating costs		(8.6)	(140.5)
Loss on sale of assets		(0.7)	-
	3	(9.3)	(140.5)
Other operating income	3	-	2.5
		(1.2)	8.7
(Loss)/profit from discontinued operations		(1.2)	8.7
Share of profit/(loss) of joint ventures		0.2	(3.7)
Gain on disposal of discontinued operations	4	98.2	130.0
		97.2	135.0
Profit from discontinued operations & gain on disposal of discontinued operations		97.2	135.0

Consolidated balance sheet

as at 31 December 2006

	Note	2006 £m	2005 £m
ASSETS			
Non-current assets			
Property, plant and equipment	12	63.4	71.8
Goodwill	11	20.6	20.6
Intangible assets	11	-	0.3
Investment in joint controlled entities	13	-	-
Amounts due from parent undertakings		43.8	42.7
Total non current assets		127.8	135.4
Current assets			
Inventories	14	11.7	7.2
Trade and other receivables	15	16.6	17.6
Cash and cash equivalents		29.4	49.1
Assets classified as held for sale	4	-	71.7
Total current assets		57.7	145.6
Total assets		185.5	281.0
LIABILITIES			
Non-current liabilities			
Financial liabilities	18	15.2	109.3
Other payables	17	2.8	0.2
Deferred tax liabilities	21	-	0.2
Pension liabilities	26	-	48.4
Total non-current liabilities		18.0	158.1
Current liabilities			
Trade and other payables	16	33.4	34.9
Financial liabilities	18	1.2	3.5
Current tax liabilities		0.1	0.1
Provisions	20	1.2	8.8
Liabilities classified as held for sale	4	-	12.9
Total current liabilities		35.9	60.2
Total liabilities		53.9	218.3
Net assets		131.6	62.7
Equity			
Called up share capital	22	179.1	329.1
Capital redemption reserve	23	1.1	-
Share premium account	23	23.8	-
Retained earnings	23	(52.6)	(251.0)
Other reserves	23	(19.8)	(15.4)
Equity attributable to equity holders of parent		131.6	62.7

These financial statements were approved by the board of directors on 6 June 2007 and were signed on its behalf by:

[D MCLELLAN]

D McLellan
Director

Consolidated cash flow statement for the year ended 31 December 2006

	2006 £m	2005 £m
Cash flows from operating activities		
Profit for the period	76.0	40.0
<i>Adjustments for:</i>		
Depreciation, amortisation and impairment charges	11.2	23.7
Finance income	(4.4)	(14.7)
Finance costs	14.8	69.4
Share of (profit)/loss of jointly controlled entities	(0.2)	3.7
Gain on disposal of discontinued operations	(98.2)	(130.0)
Profit/(loss) on sale of fixed assets	0.7	(2.2)
Tax (credit)/expense	(0.1)	1.6
	<hr/>	<hr/>
Operating loss before changes in working capital and provisions	(0.2)	(8.5)
Non cash items	3.2	(0.7)
Decrease in provision for pensions and similar obligations	(30.1)	(4.5)
(Decrease)/increase in other provisions	(7.2)	2.4
Increase in inventory	(6.4)	(2.7)
(Increase)/decrease in debtors	(2.7)	7.5
Increase /(decrease) in creditors	8.5	(5.8)
	<hr/>	<hr/>
Cash generated from operations	(34.9)	(12.3)
Taxation paid	-	(1.4)
Interest paid	(21.4)	(46.0)
Finance lease interest paid	-	(0.1)
	<hr/>	<hr/>
Net cash outflow from operating activities	(56.3)	(59.8)
	<hr/>	<hr/>
Cash flows from investing activities		
Dividends from jointly controlled entities	0.4	0.3
Interest received	2.3	1.6
Purchase of tangible fixed assets	(4.1)	(8.5)
Purchase of intangible fixed assets	-	-
Sale of tangible fixed assets	0.1	2.7
Net cash disposed with subsidiary	(0.7)	(4.8)
Acquisition of fixed asset investment	-	(1.5)
Proceeds from disposal of subsidiary undertaking	136.1	393.8
	<hr/>	<hr/>
Net cash inflow from investing activities	134.1	383.6
	<hr/>	<hr/>
Cash flows from financing activities		
Loan repayable in current year	-	6.0
Loan repayments	(96.0)	(302.7)
Own shares acquired	(1.2)	(0.4)
Finance lease capital repayments	-	(0.5)
	<hr/>	<hr/>
Net cash outflow from financing activities	(97.2)	(297.6)
	<hr/>	<hr/>
Net (decrease)/increase in cash and cash equivalents	(19.4)	26.2
Cash and cash equivalents at 1 January	49.1	22.7
Effect of exchange rate fluctuations on cash held	(0.3)	0.2
	<hr/>	<hr/>
Cash and cash equivalents at 31 December	29.4	49.1
	<hr/> <hr/>	<hr/> <hr/>

Consolidated statement of recognised income and expense
for the year ended 31 December 2006

	2006	2005
	£m	£m
Foreign exchange translation differences	(3.6)	(6.8)
Net gain on hedge of net investment in foreign subsidiary	0.2	6.1
Exchange loss recycled through income statement	0.2	5.6
Actuarial gain/(loss) relating to pension liability	7.0	(8.1)
Pension asset not recognised in the balance sheet	(9.7)	-
	<hr/>	<hr/>
Net expense recognised directly in equity	(5.9)	(3.2)
Profit for the year	76.0	40.0
	<hr/>	<hr/>
Total recognised income and expense for the period attributable to equity holders of the parent	70.1	36.8
	<hr/> <hr/>	<hr/> <hr/>

Notes

(forming part of the financial statements)

1 Significant accounting policies

Avecia Group Plc (the "company") is a company incorporated in Great Britain.

The group financial statements consolidate those of the company and its subsidiaries (together referred to as the "group") and equity account the group's interest in jointly controlled entities. The parent company financial statements present information about the company as a separate entity and not about its group (see note 31).

Statement of compliance

The group financial statements have been prepared and approved by the directors in accordance with International Financial Reporting Standards as adopted by the EU ("Adopted IFRSs"). The company has elected to prepare its parent company financial statements in accordance with UK GAAP; these are presented on pages 60 to 68.

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

Avecia's management considers the following to be the most important accounting policies in the context of the Group's operations.

In applying these accounting policies management makes certain judgements and estimations. Judgements include classification of transactions between the income statement and balance sheet, whilst estimations focus on areas such as carrying values and estimated lives.

The accounting policy descriptions set out the areas where judgement needs exercising, the most significant of which are revenue recognition, intangible assets, and post-retirement benefits.

Measurement convention

The financial statements are prepared on the historical cost basis except for derivative financial instruments which are stated at their fair value. Non-current assets and disposal groups held for sale are stated at the lower of previous carrying amount and fair value less costs to sell.

Functional and presentation currency

These consolidated financial statements are presented in sterling, which is the Company's functional currency. All financial information presented in sterling has been rounded to the nearest million.

Basis of consolidation

Subsidiaries are entities controlled by the group. Control exists when the group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Jointly controlled entities are those entities over whose activities the group has joint control, established by contractual agreement and requiring unanimous consent for strategic, financial and operating decisions. The consolidated financial statements include the group's share of the total recognised gains and losses of jointly controlled entities on an equity accounted basis, from the date that joint control commences until the date that joint control ceases.

Transactions eliminated on consolidation

Intra-group balances, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with equity accounted investees are eliminated against the investment to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

Notes (continued)

1. Significant accounting policies (continued)

Going Concern

The financial statements have been prepared on the assumption that the Group remains a going concern. The following paragraphs summarise the issues and basis on which the directors have reached their conclusion.

At 31 December 2006 the Group had \$30m of redeemable preference shares due for repayment in 2010, and cash reserves of £29.4m.

The directors have reviewed the group's budget for the current year and outline projections for the subsequent year, including cash flows and forecasts of liquidity available. Following this review, the directors have formed a judgement that, at the time of approval of the financial statements, the Group has sufficient resources to continue operating for the foreseeable future. For these reasons the directors continue to prepare the financial statements on a going concern basis.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. Where parts of an item of property, plant and equipment have different useful lives they are accounted for as separate property, plant and equipment. Assets in the course of construction are not depreciated.

Cost includes expenditures that are directly attributable to the acquisition of the asset. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment. The cost of each item of property, plant and equipment is written off evenly over its estimated remaining useful life. Reviews are made periodically of the estimated remaining lives of individual productive assets, taking account of commercial and technological obsolescence as well as normal wear and tear. Depreciation is charged to the income statement on a straight line basis over the estimated useful lives of each part of an item of property, plant and equipment. Land is not depreciated. The total asset lives approximate to 15 years for buildings and 10 years for plant and equipment.

Intangible assets and goodwill

All business combinations are accounted for by applying the purchase method. Goodwill represents the excess of the cost of the acquisition over the net fair value of the identifiable assets and liabilities arising on acquisition of subsidiaries and Jointly Controlled Entities. Identifiable intangibles are those which can be sold separately or which arise from legal rights regardless of whether those rights are separable.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is not amortised but is tested annually for impairment.

In respect of acquisitions prior to 1 January 2004, goodwill is included on the basis of its deemed cost, which represents the amount recorded under UK GAAP. Negative goodwill arising on an acquisition is recognised in the income statement.

Expenditure on research activities is recognised in the income statement as an expense as incurred.

Expenditure on internally generated goodwill and brands is recognised in the income statement as an expense as incurred.

Intangible assets acquired separately, including patents and intellectual property rights are capitalised and amortised on a straight line basis over their estimated useful lives. Intangible assets are stated net of amortisation and accumulated impairment losses. Internally developed intangible assets are not capitalised.

Notes (continued)

1 Significant accounting policies (continued)

Provisions

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event, that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and where appropriate the risks specific to the liability.

Restructuring

A provision for restructuring is recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring either has commenced or has been announced publicly. Future operating costs are not provided for.

Classification of financial instruments issued by the Group

Financial instruments issued by the Group are treated as equity (i.e. forming part of shareholders' funds) only to the extent that they meet the following two conditions:

- (a) they include no contractual obligations upon the group to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the group; and
- (b) where the instrument will or may be settled in the company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the company's own equity instruments or is a derivative that will be settled by the company's exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

To the extent that this definition is not met, the proceeds of issue are classified as a financial liability. Where the instrument so classified takes the legal form of the company's own shares, the amounts presented in these financial statements for called up share capital and share premium account exclude amounts in relation to those shares.

Finance payments associated with financial liabilities are dealt with as part of finance expenses. Finance payments associated with financial instruments that are classified in equity are dividends and are recorded directly in equity.

Derivative financial instruments

Derivative financial instruments

Derivative financial instruments are recognised at fair value. The gain or loss on remeasurement to fair value is recognised immediately in the income statement.

Loans and preference shares

Loans and preference shares in kind are stated at amortised cost less impairment.

Foreign currency

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated at foreign exchange rates ruling at the dates the fair value was determined.

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, are translated at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign operations are translated at an average rate for the period where this rate approximates to the foreign exchange rates ruling at the dates of the transactions. Foreign currency differences are recognised directly in equity. Such differences are recognised in the translation reserve. When a foreign operation is disposed of, in part or in full, the relevant amount from the translation reserve is transferred to profit or loss.

Notes (continued)

1 Significant accounting policies (continued)

Foreign currency (continued)

Foreign currency differences arising on the retranslation of a financial liability designated as a hedge of a net investment in a foreign operation are taken directly to equity (the hedging reserve) to the extent that the hedge is effective. To the extent that the hedge is ineffective, such differences are recognised in profit or loss. They are released into the income statement upon disposal.

Government grants

Government grants made as a contribution towards revenue expenditure, or for an objective with an associated revenue cost (such as job creation) are included on the balance sheet as deferred income when there is a reasonable assurance that they will be received and that the Group will comply with the conditions associated with the grant, and are released to the income statement in line with the costs being incurred.

Capital based government grants are included within accruals and deferred income in the balance sheet and credited to the income statement over the estimated useful economic lives of the assets to which they relate.

Where grants comprise both capital and revenue elements, these elements are split out on a reasonable basis and each element is treated as described above.

Lease payments

Rentals under operating leases are charged to the income statement on a straight-line basis over the lease term. Lease incentives received are recognised in the income statement as an integral part of the total lease expense.

Net financing costs

Net financing costs comprise interest payable, finance charges on shares classified as liabilities and finance leases, interest receivable on funds invested, dividend income, foreign exchange gains and losses and gains and losses on hedging instruments that are recognised in the income statement (see financial instruments accounting policy) and finance charges with respect to the group's defined benefit pension schemes.

Interest income and interest payable are recognised in the income statement as they accrue, using the effective interest method. Dividend income is recognised in the income statement on the date the entity's right to receive payments is established.

Post-retirement benefits

Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred.

Defined benefit plans

The Group's net obligation in respect of defined benefit pension plans is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value, and the fair value of any plan assets (at bid price) is deducted. The liability discount rate is the yield at the balance sheet date on AA credit rated bonds that have maturity dates approximating to the terms of the Group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

Actuarial gains and losses that arise are recognised in the period they occur directly into equity through the statement of recognised income and expense.

Current service costs and finance charges are recognised in the income statement.

Notes (continued)

1 Significant Accounting policies (continued)

Non-current assets held for sale and discontinued operations

A non-current asset (or disposal group containing assets and liabilities) is classified as held for sale if its carrying amount will be recovered principally through sale rather than through continuing use, it is available for immediate sale and sale is highly probable within one year.

On initial classification as held for sale, non-current assets and disposal groups are measured at the lower of previous carrying amount and fair value less costs to sell with any adjustments taken to the income statement. The same applies to gains and losses on subsequent remeasurement. Any impairment loss on a disposal group is first allocated to goodwill, and then to the remaining assets and liabilities on a pro rata basis. A discontinued operation is a component of the group's business that represents a separate major line of business or geographical area of operations or is a subsidiary acquired exclusively with a view to resale, that has been disposed of, has been abandoned or that meets the criteria to be classified as held for sale.

Discontinued operations are presented on a single line in the income statement (including the comparative period).

Inventories

Inventories are measured at the lower of cost and net realisable value. The cost of inventories is based on the first-in first-out principle or an average method, and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. In determining cost, depreciation is included but selling expenses and certain overhead expenses (principally central administration costs) are excluded. In the case of manufactured inventories and work in progress, cost includes an appropriate share of production overheads based on normal operating capacity. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

Trade and other receivables

Trade and other receivables are recorded initially at fair value. Subsequent to this they are measured at amortised cost less any impairment losses.

Trade and other payables

Trade and other payables are recorded initially at fair value. Subsequent to this they are measured at amortised cost.

Taxation

Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for temporary differences arising from the following: the initial recognition of goodwill; the initial recognition of assets or liabilities that affect neither accounting nor taxable profit other than in a business combination, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

Notes (continued)

1 Significant Accounting policies (continued)

Revenue

The company generates revenue through raw material conversion and supply and development contracts. Revenue excludes inter-segment revenue and value added taxes.

Revenue from the sale of goods is measured at the fair value of the consideration received or receivable.

Revenue is recognised when services have been rendered and significant risks and rewards in respect of ownership of the products are passed to the customer. Where multiple-element sales arrangements exist, this entails the company recognizing revenue on individual contract elements for work performed or services rendered during the period.

Cash and cash equivalents

Cash and cash equivalents, for the purpose of the cash flow statement, comprises cash in hand and deposits repayable on demand, less overdrafts payable on demand.

Impairment

Non Financial Assets

The carrying amounts of the group's non-financial assets other than inventories and deferred tax assets are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. For goodwill, assets that have an indefinite useful life and intangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date.

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Impairment losses are recognised in the income statement.

Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to cash-generating units and then to reduce the carrying amount of the other assets in the unit on a pro rata basis.

The recoverable amount of an asset or cash generating unit is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

Financial Assets

An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in the income statement.

The recoverable amount of the group's investments in receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (i.e. the effective interest rate computed at initial recognition of these financial assets). Receivables with a short duration are not discounted.

Reversals of impairment

An impairment loss in respect of goodwill is not reversed.

In respect of other assets, an impairment loss is reversed when there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Notes (continued)

1 Significant Accounting policies (continued)

Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between the initial value and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

Adopted IFRS not yet applied

The following adopted IFRSs were available for early application but have not been applied by the group in these financial statements :

IFRS 7 *Financial Instruments: Disclosures* and the *Amendment to IAS 1 Presentation of Financial Statements: Capital Disclosures* require extensive disclosures about the significance of financial instruments for an entity's financial position and performance, and qualitative and quantitative disclosures on the nature and extent of risks. IFRS 7 and amended IAS 1, which become mandatory for the Group's 2007 financial statements, will require extensive additional disclosures with respect to Group's financial instruments and share capital. The adoption of IFRS 7 will have no impact upon the results or net assets of Avecia.

IFRS 8 'Operating Segments' was issued in November 2006. It requires the identification of operating segments based on internal reporting to the chief operating decision maker and extends the scope and disclosure requirements of IAS 14 'Segmental Reporting'. It is effective for annual periods beginning on or after 1 January 2009. The adoption of IFRS 8 will have no impact upon the net results or net assets of Avecia.

IFRIC 9 *Reassessment of Embedded Derivatives* requires that a reassessment of whether embedded derivative should be separated from the underlying host contract should be made only when there are changes to the contract. IFRIC 9, which becomes mandatory for the Group's 2007 financial statements, is not expected to have any impact on the consolidated financial statements.

Notes (continued)

2 Segmental information

Segment information is presented in respect of the Group's business and geographical segments. The primary format, business segments, is based on the Group's management and internal reporting structure.

Inter-segment pricing is determined on an arm's length basis.

Business segments

The group now operates solely in the Biotechnology segment. The group's businesses which were disposed of in 2005 or 2006 are described below under *Discontinued Operations*.

The following is a brief description of each business segment:

Biotechnology – manufacturing and process development services for advanced medicines. The group now operates through two main businesses within the Biotechnology segment, Biologics and DNA, which report to the central management team. Inter segment sales are minimal.

Discontinued Operations – comprises i. the NeoResins business (supplier of water-borne resins used as binders and additives in the paint, coating, adhesives and printing ink industries) having been sold in January 2005, ii. Chemicals, the Fine Chemicals and Pharmaceutical businesses having being sold in September and December 2005 respectively and iii. Electronic Materials, with the Displays and Organic Semiconductor business unit having been sold in February 2005, the Inkjet and Electrophotography businesses on 17 February 2006 and the Image Polymer business on 31 March 2006.

The following tables analyse certain income statement and net asset items by business segment. No segment allocation has been shown for interest and taxation as they have not been allocated to these businesses. The accounting policies for each segment are the same as those for the consolidated/combined business. Central costs and overheads are not allocated to individual segments. The group's policy is to transfer products internally at external market prices.

Geographical segments

The Biotechnology segment operates in two principal geographical areas, UK and America. In the UK, the manufacturing facilities are based in Billingham in the North of England. In America, the manufacturing facilities are based in Milford, Massachusetts.

In presenting information on the basis of geographical segments, segment revenue is based on the geographical location of customers. Segment assets are based on the geographical location of the assets.

Notes (continued)

2 Segmental information (continued)

Year ended 31 December 2006	Continuing Operations				Discontinued Operations				Total
	Bio- technology £m	Central and other £m	Cont- inuing £m	Electronic Materials £m	Chemicals £m	NeoResins £m	Specialty Products £m	Discont- inued £m	£m
Revenue									
Total revenue	63.3	7.3	70.6	9.9	-	-	-	-	80.5
Jointly controlled entities revenue	-	-	-	(1.8)	-	-	-	-	(1.8)
Revenue to third parties	63.3	7.3	70.6	8.1	-	-	-	-	78.7
Segment operating (loss)/ profit before:	-	(10.9)	(10.9)	(0.5)	(0.7)	-	-	(1.2)	(12.1)
Share of profit in jointly controlled entities	-	-	-	0.2	-	-	-	0.2	0.2
Profit on disposal of business	-	-	-	98.2	-	-	-	98.2	98.2
Segment profit/(loss) before interest and taxation	-	(10.9)	(10.9)	97.9	(0.7)	-	-	97.2	86.3
Total assets as at 31 December 2006	80.4	105.1	185.5	-	-	-	-	-	185.5
Total liabilities at 31 December 2006	31.8	22.1	53.9	-	-	-	-	-	53.9
Capital expenditure	3.6	0.5	4.1	0.2	-	-	-	0.2	4.3
Depreciation & amortisation	7.4	3.5	10.9	0.3	-	-	-	0.3	11.2
Government grant income	1.0	-	1.0	-	-	-	-	-	1.0
Revenue generated from									
Sale of goods	18.6	-	18.6	8.1	-	-	-	-	26.7
Rendering of services	44.7	7.3	52.0	-	-	-	-	-	52.0
Total	63.3	7.3	70.6	8.1	-	-	-	-	78.7

Notes (continued)

2 Segmental information (continued)

Year ended 31 December 2005	Continuing Operations				Discontinued Operations				Total
	Bio- technology £m	Central and other £m	Cont- inuing £m	Electronic Materials £m	Chemicals £m	NeoResins £m	Specialty Products £m	Discont- inued £m	£m
Revenue									
Total revenue	62.2	4.8	67.0	80.5	56.2	17.3	-	154.0	221.0
Jointly controlled entities revenue	-	-	-	(7.3)	-	-	-	(7.3)	(7.3)
Revenue to third parties	62.2	4.8	67.0	73.2	56.2	17.3	-	146.7	213.7
Segment operating (loss)/profit before:	(13.8)	(24.9)	(38.7)	12.7	(7.4)	3.4	-	8.7	(30.0)
Share of loss in jointly controlled entities	-	-	-	(3.7)	-	-	-	(3.7)	(3.7)
Profit on disposal of business	-	-	-	12.9	(7.5)	120.5	4.1	130.0	130.0
Segment profit/(loss) before interest and taxation	(13.8)	(24.9)	(38.7)	21.9	(14.9)	123.9	4.1	135.0	96.3
Total assets as at 31 December 2005	79.4	143.8	223.2	57.8	-	-	-	57.8	281.0
Total liabilities at 31 December 2005	16.7	196.5	213.2	5.1	-	-	-	5.1	218.3
Capital expenditure	2.3	1.1	3.4	3.7	0.6	0.4	-	4.7	8.1
Depreciation & amortisation	16.0	2.0	18.0	1.6	3.6	0.5	-	5.7	23.7
Government grant income	0.3	-	0.3	-	-	-	-	-	0.3

The fixed asset impairment charge in 2006 was £Nil (2005: £ Nil).

Notes (continued)

2 Segmental information (continued)

Year ended 31 December 2006	UK £m	Continental Europe £m	The Americas £m	Asia, Africa and Australia £m	Total £m
<i>Revenue by destination</i>					
Revenue to third parties	15.2	8.3	51.6	3.6	78.7
	=====	=====	=====	=====	=====
<i>Revenue by origin</i>					
Revenue to third parties	55.0	-	22.7	1.0	78.7
	=====	=====	=====	=====	=====
Total assets as at 31 December 2006	152.0	1.3	32.2	-	185.5
	=====	=====	=====	=====	=====
Capital expenditure	3.0	-	1.3	-	4.3
	=====	=====	=====	=====	=====
 Year ended 31 December 2005					
	UK £m	Continental Europe £m	The Americas £m	Asia, Africa and Australia £m	Total £m
<i>Revenue by destination</i>					
Revenue to third parties	33.3	44.4	90.1	45.9	213.7
	=====	=====	=====	=====	=====
<i>Revenue by origin</i>					
Revenue to third parties	110.4	14.4	75.2	13.7	213.7
	=====	=====	=====	=====	=====
Total assets as at 31 December 2005	232.1	-	47.1	1.8	281.0
	=====	=====	=====	=====	=====
Capital expenditure	6.7	0.4	1.0	-	8.1
	=====	=====	=====	=====	=====

Notes (continued)

3 Group operating loss

	2006	2006	2006	2005	2005	2005
	Continuing	Discontinued	Total	Continuing	Discontinued	Total
	operations	operations	£m	operations	operations	£m
	£m	£m		£m	£m	£m
Operating costs						
Cost of sales	(52.5)	(5.5)	(58.0)	(56.1)	(114.4)	(170.5)
Distribution costs	(0.9)	(0.1)	(1.0)	(0.7)	(1.5)	(2.2)
Research and development	(9.1)	(1.2)	(10.3)	(10.5)	(15.8)	(26.3)
Selling, general and administrative expenses	(19.3)	(2.5)	(21.8)	(40.9)	(8.8)	(49.7)
	<u>(81.8)</u>	<u>(9.3)</u>	<u>(91.1)</u>	<u>(108.2)</u>	<u>(140.5)</u>	<u>(248.7)</u>
	<u><u>(81.8)</u></u>	<u><u>(9.3)</u></u>	<u><u>(91.1)</u></u>	<u><u>(108.2)</u></u>	<u><u>(140.5)</u></u>	<u><u>(248.7)</u></u>
The following are included within selling, general and administrative expenses :						
Restructuring and site closure	(1.0)	-	(1.0)	(7.8)	-	(7.8)
	<u>(1.0)</u>	<u>-</u>	<u>(1.0)</u>	<u>(7.8)</u>	<u>-</u>	<u>(7.8)</u>
	<u><u>(1.0)</u></u>	<u><u>-</u></u>	<u><u>(1.0)</u></u>	<u><u>(7.8)</u></u>	<u><u>-</u></u>	<u><u>(7.8)</u></u>
Other operating income						
Licence income and profit on disposal of fixed assets	0.3	-	0.3	2.5	2.5	5.0
	<u>0.3</u>	<u>-</u>	<u>0.3</u>	<u>2.5</u>	<u>2.5</u>	<u>5.0</u>
	<u><u>0.3</u></u>	<u><u>-</u></u>	<u><u>0.3</u></u>	<u><u>2.5</u></u>	<u><u>2.5</u></u>	<u><u>5.0</u></u>
Total charge for depreciation and amortisation included above	(10.9)	(0.3)	(11.2)	(18.0)	(5.7)	(23.7)
	<u>(10.9)</u>	<u>(0.3)</u>	<u>(11.2)</u>	<u>(18.0)</u>	<u>(5.7)</u>	<u>(23.7)</u>
	<u><u>(10.9)</u></u>	<u><u>(0.3)</u></u>	<u><u>(11.2)</u></u>	<u><u>(18.0)</u></u>	<u><u>(5.7)</u></u>	<u><u>(23.7)</u></u>

Notes (continued)

4 Non-current assets held for sale and discontinued operations

On 17 February 2006 the Inkjet and Electrophotography businesses was sold to Fuji Photo Film Co. Ltd ("Fujifilm") for £143.0 million. The sale included all Avecia Inkjet and Electrophotography development and manufacturing assets in Manchester, England, Grangemouth, Scotland and New Castle, Delaware, USA. 340 employees transferred with the business on completion.

On 31 March 2006 the group sold its interest in the Image Polymer business, a jointly controlled entity, to Mitsui for \$8.7m.

The assets and liabilities of these businesses were classified as held for sale at 31 December 2005.

The principal effects on the reported results are as follows:

	Electronic Materials £m	Other £m	Total £m
Cash flow			
Cash disposed	(0.7)	-	(0.7)
Sale of business	140.7	2.0	142.7
Net cash inflow	<u>140.0</u>	<u>2.0</u>	<u>142.0</u>
Profit on disposal			
Goodwill written off on disposal	(17.7)	-	(17.7)
Net assets disposed excluding cash :			
Fixed assets	(33.1)	(0.2)	(33.3)
Current assets	(32.0)		(32.0)
Current liabilities	19.8		19.8
Pension fund curtailment gain	25.8	-	25.8
Disposal costs	(5.5)	(0.9)	(6.4)
Profit on disposal	97.3	0.9	98.2
Consideration: Cash	148.0		
Working capital settlement	(7.3)		
Impact on cashflows during the period:			
Cash generated from operations	0.6		
Cashflows from investing activities	(0.4)		
Cashflows from financing activities	0.4		

Other above includes contingent consideration in respect of the Biocides (2004) disposal of £1.2m and in respect of the NeoResins (2005) disposal £1.7m; offset by the working capital and pensions settlements in respect of Pharmaceuticals (2005) disposal £0.9m. The costs shown under other mainly relate to IT disengagements. The group has tax losses which can be used to offset the gain from discontinued operations.

Notes *(continued)*

4 Non-current assets held for sale and discontinued operations *(continued)*

Assets classified as held for sale	2006	2005
	£m	£m
Disposal group held for sale		
Goodwill	-	17.7
Property, plant and equipment	-	26.8
Inventory	-	15.9
Trade and other receivables	-	6.9
Investment in jointly controlled entities	-	4.4
	<hr/>	<hr/>
	-	71.7
	<hr/> <hr/>	<hr/> <hr/>
 Liabilities classified as held for sale	 2006	 2005
	£m	£m
Disposal group held for sale		
Trade and other creditors	-	7.0
Provisions	-	0.2
Other creditors	-	-
Deferred taxation	-	-
Pension liabilities	-	5.7
	<hr/>	<hr/>
	-	12.9
	<hr/> <hr/>	<hr/> <hr/>

Notes (continued)

5 Expenses and auditors remuneration

	2006	2005
	£m	£m
<i>Profit for the year (excluding interest and taxation) is stated after charging:</i>		
Auditors' remuneration (see below)	0.2	0.7
Depreciation and other amounts written off tangible fixed assets		
Owned	10.9	23.4
Leased	-	-
Impairment of tangible and intangible fixed assets	-	-
Impairment of investment in joint controlled entities	-	3.6
Amortisation of intellectual property rights	0.3	0.3
Operating leases		
Land and buildings	0.4	0.5
Research and development expenditure	10.3	26.3
 <i>after crediting:</i>		
Government grants	1.0	0.3
 <hr style="border-top: 3px double #000;"/>		
<i>Auditors' remuneration:</i>		
	2006	2005
	£000	£000
Audit of these financial statements	95	246
Amounts receivable by auditors and their associates in respect of:		
Audit of financial statements of subsidiaries pursuant to legislation	29	34
Other services pursuant to such legislation	14	8
Other services relating to taxation	69	295
All other services	-	64
Amounts receivable by auditors and their associates in respect of the Avecia Limited pension scheme		
Audit	21	13

Amounts paid to the company's auditor in respect of services to the company, other than the audit of the company's financial statements, have not been disclosed as the information is required instead to be disclosed on a consolidated basis.

Notes *(continued)*

6 Remuneration of directors

	2006	2005
	£000	£000
Directors' emoluments	1,825	1,435
	<u> </u>	<u> </u>

The aggregate emoluments of the highest paid director were £495,211 for the year ended 31 December 2006 (2005: £551,182) and company pension contributions of £13,534 (2005: £12,672) were made to a money purchase scheme on his behalf.

	Number of directors	
	2006	2005
Retirement benefits are accruing to the following number of directors under:		
Money purchase schemes	-	2
Defined benefit schemes	2	3
	<u> </u>	<u> </u>
	2006	2005
	£000	£000
Compensation to directors for loss of office	-	1,980
	<u> </u>	<u> </u>

7 Staff numbers and costs

The average number of persons employed by the company (including directors) during the year, analysed by business segment, was as follows:

	Number of employees	
	2006	2005
Biotechnology	622	525
Discontinued	-	335
Other	20	36
	<u> </u>	<u> </u>
	642	896
	<u> </u>	<u> </u>

The aggregate payroll costs of these persons were as follows:

	2006	2005
	£m	£m
Wages and salaries	25.7	52.2
Social security costs	5.1	4.1
Other pension costs	4.4	7.7
	<u> </u>	<u> </u>
	35.2	64.0
Other employment costs		
Severance costs	0.3	10.4
Post retirement costs	0.1	0.6
	<u> </u>	<u> </u>
	0.4	11.0
	<u> </u>	<u> </u>
	35.6	75.0
	<u> </u>	<u> </u>

Notes (continued)

8 Finance income

	2006 £m	2005 £m
Exchange gains	-	0.3
Interest income on bank deposits	2.1	1.8
Income from parent company	1.2	0.6
Expected return on pension fund assets	1.1	12.0
	4.4	14.7
	4.4	14.7

9 Finance costs

	2006 £m	2005 £m
Exchange losses	0.9	12.6
Interest expense on bank loans and overdrafts	1.7	0.6
Interest expense on all other loans	4.1	26.7
Amortisation of finance fees	1.7	9.1
Interest on unwinding discount on pension liabilities	0.1	13.0
Unwinding of discount on provisions	-	0.5
Finance charges payable in respect of finance leases and hire purchase contracts	-	0.1
Dividends on redeemable preference shares	6.3	6.8
	14.8	69.4
	14.8	69.4

Notes (continued)

10 Taxation

Analysis of (credit)/charge in year

	2006	2005
	£m	£m
<i>UK corporation tax</i>		
Current tax on income for the year	-	-
Adjustments in respect of prior years	-	-
	<hr/>	<hr/>
Overseas taxation	(0.1)	2.9
	<hr/>	<hr/>
Total current tax (credit)/charge	(0.1)	2.9
Deferred taxation	-	(1.3)
	<hr/>	<hr/>
Tax on profit on ordinary activities	(0.1)	1.6
	<hr/> <hr/>	<hr/> <hr/>

The total tax expense differs from the amount computed by applying the UK rate of 30% to income before tax as a result of the following:

	2006	2005
	£m	£m
<i>Current tax reconciliation</i>		
Profit on ordinary activities before tax (including £97.2m of discontinued profit) (2005: £135m)	75.9	41.6
	<hr/>	<hr/>
Taxation charge at United Kingdom corporation tax rate of 30%	22.8	12.5
Overseas tax rates	(0.2)	0.3
Other	(22.7)	(11.2)
	<hr/>	<hr/>
Taxes on income from ordinary activities	(0.1)	1.6
	<hr/> <hr/>	<hr/> <hr/>

At 31 December 2006 there were £87.5 million of UK tax losses to be carried forward with no expiration date (2005: £133.3 million). In addition, at that date, the group had US\$ 35.0 million of US federal tax net operating losses which expire in years 2019 to 2022 (2005: \$28.0 million). No deferred tax asset was recognised in respect of these losses which results in the lower effective tax rate for the group.

Notes (continued)

10 Taxation (continued)

Factors affecting the tax charge for the current year

The current tax charge for the period is lower (2005: lower) than the standard rate of corporation tax in the UK 30%. The differences are explained below.

	2006 £m	2005 £m
<i>Current tax reconciliation</i>		
Profit before tax	75.9	41.6
	<hr/>	<hr/>
Current tax at 30%	22.8	12.5
<i>Effects of:</i>		
Expenses not deductible for tax:		
Depreciation for the period in excess of capital allowances	3.8	2.3
Disallowable items	1.9	4.6
Non taxable income	(11.5)	-
Generation of additional tax losses in the year	-	0.2
Higher rates on overseas earnings	(0.2)	0.3
Tax losses utilised	(17.2)	(19.9)
State taxes	0.1	0.1
Profit in inventory	0.2	0.4
Prior period taxation relating to Stahl Iberica, see note 24	-	2.5
R&D tax credits	-	(0.1)
	<hr/>	<hr/>
Total current tax charge (see above)	(0.1)	2.9
Deferred tax (credit)/charge for the period	-	(1.3)
	<hr/>	<hr/>
Deferred taxation		
Profit in inventory	-	(0.2)
Unremitted earnings	-	(0.6)
Other timing differences	-	(0.5)
	<hr/>	<hr/>
Total deferred taxes	-	(1.3)
	<hr/>	<hr/>
Taxes on income from ordinary activities	(0.1)	1.6
	<hr/>	<hr/>

All current and deferred income tax expense for the year is attributable to foreign operations.

Analysis of profit before taxation:

	2006 £m	2005 £m
UK activities	71.6	37.0
Non UK activities	4.3	4.6
	<hr/>	<hr/>
	75.9	41.6
	<hr/>	<hr/>

Notes (continued)

11 Intangible fixed assets

Group

	Goodwill	Intellectual	Total
	£m	Property rights	£m
		£m	
<i>Cost</i>			
Balance at 1 January 2005	70.5	3.3	73.8
Additions	-	-	-
Disposals	(12.8)	(2.1)	(14.9)
Transfers to assets held for sale	(28.7)	-	(28.7)
Translation adjustments	(0.6)	0.2	(0.4)
Balance at 31 December 2005	28.4	1.4	29.8
Balance at 1 January 2006	28.4	1.4	29.8
Additions	-	-	-
Disposals	-	-	-
Transfers to assets held for sale	-	-	-
Translation adjustments	(0.5)	-	(0.5)
Balance at 31 December 2006	27.9	1.4	29.3
<i>Amortisation</i>			
Balance at 1 January 2005	30.3	2.8	33.1
Charge for year	-	0.3	0.3
Transfers to assets held for sale	(11.0)	-	(11.0)
Disposals	(12.8)	(2.0)	(14.8)
Translation adjustments	1.3	-	1.3
Balance at 31 December 2005	7.8	1.1	8.9
Balance at 1 January 2006	7.8	1.1	8.9
Charge for year	-	0.3	0.3
Transfers to assets held for sale	-	-	-
Disposals	-	-	-
Translation adjustments	(0.5)	-	(0.5)
Balance at 31 December 2006	7.3	1.4	8.7
<i>Carrying amounts</i>			
At 1 January 2005	40.2	0.5	40.7
At 31 December 2005	20.6	0.3	20.9
At 1 January 2006	20.6	0.3	20.9
At 31 December 2006	20.6	-	20.6

Notes *(continued)*

11 Intangible fixed assets *(continued)*

The following units have significant carrying amounts of goodwill :

	31 December 2006 £m	31 December 2005 £m
Biotechnology	20.6	20.6
	<u> </u>	<u> </u>

The following goodwill amounts are included in "Assets held for Sale"

	31 December 2006 £m	31 December 2005 £m
Inkjet	-	17.7
	<u> </u>	<u> </u>

The goodwill has been tested for impairment by comparing carrying values to the recoverable amounts. In 2006 the recoverable amounts of the units were determined using value in use calculations. The calculations used cashflow projections based upon actual operating results and five year business plans. Cashflows were discounted at a rate of 9%. The recoverable amounts exceeded the carrying value of the units. In 2005 the sales prices for the units were used as a basis for determining the recoverable amounts. The recoverable amounts exceeded the carrying value of the units.

Notes (continued)

12 Property, plant and equipment

	Land and buildings	Plant and equipment	Assets in the course of construction	Total
	£m	£m	£m	£m
<i>Cost</i>				
At 1 January 2005	18.8	277.7	7.2	303.7
Additions	-	0.3	7.4	7.7
Disposals	(12.5)	(101.3)	(0.3)	(114.1)
Transfers	0.2	6.5	(6.7)	-
Transfers to assets held for sale	(2.6)	(25.4)	(4.7)	(32.7)
Translation adjustments	2.2	5.3	0.1	7.6
At 31 December 2005	6.1	163.1	3.0	172.2
At 1 January 2006	6.1	163.1	3.0	172.2
Additions	-	1.8	2.4	4.2
Disposals	-	(0.9)	-	(0.9)
Transfers	-	2.5	(2.5)	-
Transfers to assets held for sale	-	-	-	-
Translation adjustments	(0.4)	(2.4)	-	(2.8)
At 31 December 2006	5.7	164.1	2.9	172.7
<i>Depreciation and impairment losses</i>				
At 1 January 2005	0.2	157.4	-	157.6
Charge for year	0.3	23.1	-	23.4
Disposals	-	(78.0)	-	(78.0)
Transfers to assets held for sale	-	(6.0)	-	(6.0)
Translation adjustments	0.1	3.3	-	3.4
At 31 December 2005	0.6	99.8	-	100.4
At 1 January 2006	0.6	99.8	-	100.4
Charge for year	0.6	10.3	-	10.9
Disposals	-	(0.5)	-	(0.5)
Transfers to assets held for sale	-	-	-	-
Translation adjustments	(0.2)	(1.3)	-	(1.5)
At 31 December 2006	1.0	108.3	-	109.3
<i>Carrying amounts</i>				
At 1 January 2005	18.6	120.3	7.2	146.1
At 31 December 2005	5.5	63.3	3.0	71.8
At 1 January 2006	5.5	63.3	3.0	71.8
At 31 December 2006	4.7	55.8	2.9	63.4

Notes *(continued)*

12 Property, plant and equipment *(continued)*

The carrying amounts of land and buildings comprises:

	2006 £m	2005 £m
Freehold	4.7	4.0
Long leasehold	-	1.5
	<hr/> 4.7 <hr/>	<hr/> 5.5 <hr/>

The cost of land and buildings include £5.5 million of depreciable assets at 31 December 2006 (2005: £5.9 million).

Depreciation was not charged on land with a cost of £0.2 million included in land and buildings during the year ended 31 December 2006 (2005: £0.2 million).

Notes (continued)

13 Investment in jointly controlled entities

Group

	2006 £m	2005 £m
<i>Cost</i>		
At beginning of year		
Goodwill	-	12.9
Share of net assets	-	9.1
Translation adjustments	-	0.3
Capital contributions	-	(0.1)
Transfer to assets held for sale	-	(22.2)
	-	-
At end of year	-	-
<i>Share of post acquisition reserves</i>		
At beginning of year	-	(1.2)
Retained profit less losses	-	(0.1)
Dividends received	-	(0.1)
Transfer to assets held for sale	-	1.4
	-	-
At end of year	-	-
<i>Amortisation</i>		
At beginning of year	-	(12.9)
Charged for year	-	-
Impairment	-	(3.6)
Transfer to assets held for sale	-	16.5
	-	-
At end of year	-	-
<i>Net book value</i>		
At 31 December	-	-

In 2005 the sales prices for the investment was used as a basis for determining the recoverable amount. An impairment of £3.6m was taken in 2005.

Image Polymers Europe and Image Polymers Company were partnerships with the Mitsui Chemicals group and the group held a 50% interest in each of these partnerships. On 31 March 2006, the group sold these partnership interests to the Mitsui Chemicals group and thereby ceased to have any further interest in the partnerships.

The following information is relevant to an undertaking of the investments in joint controlled entities.

The amounts included in respect of joint controlled entities comprise the following:

	Assets £m	Liabilities £m	Equity £m	Revenues £m	(Loss)/Profit £m
2005					
Image Polymers Europe	5.5	(0.5)	5.0	2.7	(0.1)
Image Polymers Company	4.1	(1.1)	3.0	4.6	0.0
	9.6	(1.6)	8.0	7.3	(0.1)
	9.6	(1.6)	8.0	7.3	(0.1)

There were no amounts in respect of jointly controlled entities in 2006.

Notes (continued)

14 Inventories

	2006	2005
	£m	£m
Raw materials and consumables	5.3	4.0
Work in progress	1.1	1.2
Finished goods and goods for resale	5.3	2.0
	<hr style="border-top: 1px solid black;"/>	<hr style="border-top: 1px solid black;"/>
	11.7	7.2
	<hr style="border-top: 3px double black;"/>	<hr style="border-top: 3px double black;"/>
Inventories stated at fair values less costs to sell	0.9	1.9
	<hr style="border-top: 3px double black;"/>	<hr style="border-top: 3px double black;"/>

Inventory costs of £7.3m, and impairment provisions of £0.7m, were charged during the year.

15 Trade and other receivables

	2006	2005
	£m	£m
Trade receivables	13.9	10.1
Other receivables	1.0	5.6
Prepayments and accrued income	1.7	1.8
Amounts receivable from joint ventures	-	0.1
	<hr style="border-top: 1px solid black;"/>	<hr style="border-top: 1px solid black;"/>
	16.6	17.6
	<hr style="border-top: 3px double black;"/>	<hr style="border-top: 3px double black;"/>

Notes (continued)

16 Trade and other payables

	2006	2005
	£m	£m
Trade payables	9.2	20.6
Other taxation and social security	0.9	0.9
Other payables	3.3	1.9
Accruals and deferred income	20.0	11.5
	<hr/>	<hr/>
	33.4	34.9
	<hr/> <hr/>	<hr/> <hr/>

17 Other payables due in more than one year

	2006	2005
	£m	£m
Non current liabilities		
Other payables	2.8	0.2
Accruals and deferred income	-	-
	<hr/>	<hr/>
	2.8	0.2
	<hr/> <hr/>	<hr/> <hr/>

Included in other payables is deferred government grant income of £3.3m (of which £0.5m is due within one year). The grant income received in the year relates to two Regional Selective Assistance Grants that have been awarded to the company. The remaining grant is being amortised over the useful life of the assets to which it relates.

18 Financial liabilities

	2006	2005
	£m	£m
Current liabilities :		
Redeemable preference share dividend	1.2	3.5
	<hr/>	<hr/>
Non-current liabilities :		
High yield bonds	-	70.3
Redeemable preference shares (see note 22)	15.2	39.0
	<hr/>	<hr/>
	15.2	109.3
	<hr/>	<hr/>
Total financial liabilities (see note 19)	16.4	112.8
	<hr/> <hr/>	<hr/> <hr/>

Notes *(continued)*

18 Financial liabilities *(continued)*

The above figures include preference shares, the redemption of which is mandatory on 1 July 2010. They may, however, be redeemed at the option of the company on or after 1 January, 2006 or earlier on certain public equity offerings at a redemption value equal to the liquidation preference value (\$25 per share) plus all accumulated and unpaid dividends to the date of redemption. On 5 July 2006 the company redeemed 1,822,489 of the preference shares at a total cost of US\$ 48,056,048, leaving 1,200,000 of the preference shares in issue.

High yield bond

In 1999, the company had issued high yield bonds repayable in 2009 and with interest fixed at 11%. The difference between net and gross repayable is unamortised fees. The high yield bond was guaranteed by Avecia Corporation Limited. Payments under the guarantee were subordinated to the guarantor's payment of its obligations under the term loan agreements. Under the terms of the bond, the company and certain of its subsidiaries were subject to restrictions over the sale of assets unless certain, specified conditions are met.

All of the outstanding high yield bonds were repaid by the company on 23 March 2006.

Bank loans and overdrafts

The group repaid its outstanding term loans during the course of the year 2005. Under the conditions of the term loans entered into by the group, Avecia Corporation Limited, a wholly owned subsidiary of the company, and certain of its subsidiaries had guaranteed the obligations of each other. In addition, the various obligations under the credit agreement were secured by security interests created over certain of the assets of Avecia Corporation Limited and its subsidiaries. These obligations ceased on repayment of the outstanding term loans.

Finance lease liabilities

The finance leases held by the group were disposed of as part of the sale of the Fine Chemicals business during 2005.

Borrowing facilities

The group had no committed borrowing facilities available to it at 31 December 2006 or at 31 December 2005.

Notes (continued)

19 Borrowings, financial instruments and risk management

The group's finance department manages the group's funding, liquidity and exposure to interest rates and foreign exchange rate risks.

The group holds or issues financial instruments for two main purposes:

- i. to finance its operations;
- ii. to manage the interest rate and currency risks arising from its operations and from its sources of finances.

In addition, various financial instruments – for example, trade debtors, trade creditors, accruals and prepayments – arise directly from the group's operations.

The group financed its operations by a mixture of bank borrowings, high yield bonds and redeemable preference shares. The group's long term loans were raised centrally by group finance companies which funded operating subsidiaries, on commercial terms, all of which are included in the consolidated financial statements. During 2005 and the first three months of 2006 the group has repaid all bank borrowings and the high yield bonds from proceeds arising on the disposal of businesses.

The group now finances its operations by a combination of redeemable preference shares and cash retained from proceeds arising on the disposal of businesses.

All derivatives previously used for interest rate management have matured.

The main risks arising from the group's financial instruments are interest rate risk, liquidity risk, foreign currency risk and market price risk. The board reviews and agrees policies for managing each of these risks and they are summarised below. These policies have remained unchanged since incorporation.

Liquidity risk

Group policy is to match currency cash expenditure with currency cash income subject to the existence of a free market for that currency's debt and differences in funding costs between markets. Group borrowings were £15.2m at 31 December 2006 comprising Redeemable Preference shares due in 2010. Group borrowings at 31 December 2005 comprised a High Yield Bond of £70.3 million due in 2009, net of unamortised fees, and Redeemable Preference shares of £42.5m due in 2010. In March 2006 the group repaid all the outstanding High Yield Bonds.

At 31 December 2006 and at 31 December 2005, the group had no undrawn committed borrowing facilities.

Finance and interest rate risk

Having repaid all variable rate debt, the group is no longer exposed to interest rate fluctuations on borrowings.

Notes (continued)

19 Borrowings, financial instruments and risk management (continued)

Effective interest rate and repricing analysis

In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates at the balance sheet date and periods in which they reprice.

		2006						
		Effective Interest Rate	Total	6 months or less	6-12 months	1-2 years	2-5 years	More than 5 years
Cash and cash equivalents	5.9%	29.4	29.4	-	-	-	-	-
Redeemable preference shares	16%	(15.2)	-	-	-	(15.2)	-	-
		14.2	29.4	-	-	(15.2)	-	-

		2005						
		Effective Interest Rate	Total	6 months or less	6-12 months	1-2 years	2-5 years	More than 5 years
Cash and cash equivalents	4.3%	49.1	49.1	-	-	-	-	-
High yield bonds	11%	(70.3)	-	-	-	-	(70.3)	-
Redeemable preference shares	16%	(42.5)	-	-	-	-	(42.5)	-
		(63.7)	49.1	-	-	-	(112.8)	-

Currency risk

The group publishes its financial statements in pounds sterling and conducts some businesses in foreign currencies. As a result, it is subject to foreign currency exchange risk due to exchange rate movements which will affect the group's transaction costs and revenues, and the translation of the results and underlying net assets of its subsidiaries. By holding borrowings in foreign currencies and a proportion of its cash in foreign currencies, the group hedges a substantial portion of its exposure to fluctuations on the translation into pounds sterling of its foreign currency net assets.

All outstanding foreign exchange contracts at the end of 2005 matured during 2006. No further foreign exchange contracts have been entered into. At 31 December 2005 the group had £3.3 million of outstanding gross foreign exchange contracts; all were to sell Japanese Yen.

Notes (continued)

19 Borrowings, financial instruments and risk management (continued)

Currency exposures

At 31 December 2006 the net monetary assets and liabilities denominated in currencies other than the functional currencies of the group companies (other than certain non sterling borrowings treated as hedges of net investments in overseas operations) were as follows:

Functional currency of group operation	Sterling	US dollar	Euro	Japanese yen	Total
	£m	£m	£m	£m	£m
Sterling	-	21.4	(1.3)	-	20.1
US dollar	-	-	-	-	-
Euro	-	-	-	-	-
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
	-	21.4	(1.3)	-	20.1
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

At 31 December 2005 the net monetary assets and liabilities denominated in currencies other than the functional currencies of the group companies (other than certain non sterling borrowings treated as hedges of net investments in overseas operations) were as follows:

Functional currency of group operation	Sterling	US dollar	Euro	Japanese yen	Total
	£m	£m	£m	£m	£m
Sterling	-	(30.3)	-	1.0	(29.3)
US dollar	71.1	-	-	-	71.1
Euro	-	-	-	-	-
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
	71.1	(30.3)	-	1.0	41.8
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

Credit risk and market risk

The above financial instruments are subject to credit and market risk. Avecia contains credit risk by ongoing review procedures. All financial instruments are transacted with commercial banks. The notional principal values of balance sheet financial instruments do not represent amounts exchanged by the parties and are not a measure of the credit risk to the group of these instruments. The credit risk of these instruments is limited to the positive fair values of such contracts. At the reporting date there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the balance sheet.

Market risk is the sensitivity of the value of financial instruments to changes in related currency and interest rates. The group is not exposed to material market risk because gains and losses on the derivative financial instruments are largely offset by gains and losses on the underlying assets, liabilities and transactions subject to hedge.

Notes *(continued)*

19 Borrowings, financial instruments and risk management *(continued)*

Fair values of financial assets and financial liabilities

Set out below is a comparison by category of book values and fair values of all the group's financial assets and financial liabilities as at 31 December 2006:

	2006	2006	2005	2005
	Carrying	Fair value	Carrying	Fair value
	amount		amount	
	£m	£m	£m	£m
High yield bonds	-	-	(70.3)	(74.5)
Redeemable preference shares	(15.2)	(20.9)	(42.5)	(47.2)
Preference share dividend	(1.2)	(1.2)	(3.5)	(3.5)
Other financial assets	-	-	0.2	0.2
Trade receivables	13.9	13.9	10.1	10.1
Cash and cash equivalents	29.4	29.4	49.1	49.1
Trade payables	(9.2)	(9.2)	(20.6)	(20.6)
Forward foreign currency contracts – assets	-	-	0.2	0.2
	<hr/>	<hr/>	<hr/>	<hr/>
	17.7	12.0	(77.3)	(86.2)
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

Market values have been used to determine the fair value of forward foreign currency contracts and all listed debt issued. The fair values of all other items have been calculated by discounting expected future cash flows at 31 December 2006 LIBOR interest rates.

Fair value judgements and changes in market conditions and assumptions could significantly affect these estimates. The disclosed values of those which are representative of fair values at the dates indicated. No financial instruments were held for the purpose of dealing or other financial instrument trading activities.

Notes (continued)

20 Provisions for liabilities and charges

	Reorganisation and other provisions £m
1 January 2006	8.8
(Credit) / Charge for the year	(0.4)
Utilised during year	(7.2)
Disposals	-
Exchange	-
	<hr/>
At 31 December 2006	1.2
	<hr/> <hr/>
Non-current	-
Current	1.2
	<hr/>
	1.2
	<hr/> <hr/>

The reorganisation and other provisions primarily relate to severance costs which are expected to be fully paid out by the end of 2007.

Notes (continued)

21 Deferred taxation

Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	Assets		Liabilities		Net	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Property, plant and equipment	-	-	-	-	-	-
Intangible assets	-	-	-	0.3	-	0.3
Inventories	-	-	-	-	-	-
Interest-bearing loans and borrowings	-	-	-	-	-	-
Employee benefits	-	(0.1)	-	-	-	(0.1)
Impairment of investments	-	-	-	-	-	-
Other items	-	(0.1)	-	-	-	(0.1)
Tax value of loss carry-forwards recognised	-	-	-	-	-	-
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Tax(assets)/liabilities	-	(0.2)	-	0.3	-	0.1
Set off of tax	-	0.2	-	(0.2)	-	-
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Net tax liabilities	-	-	-	0.1	-	0.1
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

Unrecognised deferred tax assets

Deferred tax assets have not been recognised in respect of the following items:

	2006 £m	2005 £m
Depreciation in excess of capital allowances	9.2	7.8
Short term timing differences	0.7	2.7
Long term timing differences	7.4	10.6
Tax losses	42.4	44.9
	<hr/>	<hr/>
	59.7	66.0
	<hr/> <hr/>	<hr/> <hr/>

Movement in temporary differences during the year

	Balance 1 Jan 06 £m	Recognised in income £m	Recognised in equity £m	Balance 31 Dec 06 £m
Property, plant and equipment				
Intangible assets	0.3	(0.3)	-	-
Inventories				
Employee benefits	(0.1)	0.1	-	-
Impairment of investments				
Other items	(0.1)	0.1	-	-
	<hr/>	<hr/>	<hr/>	<hr/>
	0.1	(0.1)	-	-
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

Notes (continued)

21 Deferred taxation (continued)

Movement in temporary differences during the year

	Balance 1 Jan 05 £m	Recognised in income £m	Recognised in equity £m	Balance 31 Dec 05 £m
Property, plant and equipment	1.1	1.1	-	-
Intangible assets	0.6	0.4	-	0.2
Inventories	0.2	0.2	-	-
Employee benefits	2.2	2.3	-	(0.1)
Impairment of investments	1.0	1.0	-	-
Other items	0.5	0.5	-	-
	5.6	5.5	-	0.1
	5.6	5.5	-	0.1

22 Called up share capital

	2006 Number of shares	2006 Nominal value of shares £'000	2005 Number of shares	2005 Nominal value of shares £'000
<i>Authorised</i>				
Equity: ordinary shares of £1 each	400,000,000	400,000	400,000,000	400,000
Non equity – Pay-in-Kind (PIK) 16% cumulative redeemable preference shares of \$1 each	3,500,000	2,222	3,500,000	2,222
	403,500,000	402,222	403,500,000	402,222
	403,500,000	402,222	403,500,000	402,222
<i>Allotted, called up and fully paid</i>				
Equity: ordinary shares of £1 each	179,100,001	179,100	329,100,001	329,100
Non equity – Pay-in-Kind (PIK) 16% cumulative redeemable preference shares of \$1 each	1,200,000	517	3,022,489	1,751
	180,300,001	179,617	332,122,490	330,851
	180,300,001	179,617	332,122,490	330,851

Following a successful petition to the Courts on 17 May 2006, Avecia Group plc reduced its issued share capital from £329,100,001 to £179,100,001 by means of cancellation of 150,000,000 ordinary shares of £1 each. The resulting reserve was credited to the Company's retained earnings.

Redeemable preference shares

The redemption of preference shares is mandatory on 1 July 2010 but they may be redeemed at the option of the company on or after 1 January 2005 or earlier on certain public equity offerings at a redemption value equal to the issue price of \$25 per share plus all accumulated and unpaid dividends to the date of redemption. In addition, on redemption prior to 1 January 2008, a redemption premium is payable in accordance with the Company's articles of association. On winding up the preference shares rank in priority to ordinary shares. Up to 1 July 2004 the company was able to issue further preference shares instead of a cash dividend (based on the issue price of \$25 per share). After 1 July 2004 this option was no longer available and subsequent dividends became payable in cash. Subject to certain exceptions contained in the articles of association, the preference shares have no voting rights at meetings of the ordinary shareholders. They attract a dividend rate of 16% but, during any period where dividends due are unpaid, a further 2% default rate is also payable. The carrying value of the preferred shares is being increased from the date of issue to the mandatory redemption date, by the effective interest method, such that the carrying value at the mandatory redemption date will equal the redemption value of \$25 per share. The accretion for 2006 was £0.9 million (2005: £0.1 million).

Notes (continued)

23 Share capital and reserves

Group

	Share capital	Capital redemption reserve	Share premium account	Translation reserve	Hedging Reserve	Reserve for own shares	Retained earnings	Total
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2005	329.1	-	-	(0.1)	(19.5)	(0.3)	(309.9)	(0.7)
Total recognised income and expense	-	-	-	(1.2)	6.1	-	31.9	36.8
Capital contribution from parent	-	-	-	-	-	-	27.0	27.0
Own shares acquired	-	-	-	-	-	(0.4)	-	(0.4)
At 31 December 2005	329.1	-	-	(1.3)	(13.4)	(0.7)	(251.0)	62.7
At 1 January 2006	329.1	-	-	(1.3)	(13.4)	(0.7)	(251.0)	62.7
Total recognised income and expense	-	-	-	(3.6)	0.4	-	73.3	70.1
Own shares acquired	-	-	-	-	-	(1.2)	-	(1.2)
Redemption of preference shares	-	1.1	23.8	-	-	-	(24.9)	-
Share capital reduction	(150.0)	-	-	-	-	-	150.0	-
At 31 December 2006	179.1	1.1	23.8	(4.9)	(13.0)	(1.9)	(52.6)	131.6

Capital redemption reserve and share premium account

On 5 July 2006 the company redeemed 1,822,489 of the preference shares at a total cost of US\$ 48,056,048, leaving 1,200,000 of the preference shares in issue. The capital redemption reserve and share premium were credited with the appropriate amounts arising from this redemption.

Translation reserve

The translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations that are not integral to the operations of the company.

Hedging reserve

The hedging reserve comprised the effective portion of the net investment hedge between borrowings and foreign currency net assets. This hedge is no longer in place so there will be no further movement on this reserve, unless the investment to which it relates is disposed of.

Reserve for own shares

The reserve for the company's own shares comprises the cost of the company's shares held by the group.

24 Contingent liabilities and contingent assets

Environmental

On the acquisition by the group of the speciality chemicals business of the AstraZeneca group in 1999, the group acquired all the sites of that business which were then in operation or use. Sites which were formerly part of the speciality chemicals business but which were not in operation at the date of its acquisition by the group were not transferred to the group. Since the acquisition of the speciality chemicals business in 1999, the group has disposed of its interest in most of its major operational sites, including the group's former sites at St. Clair du Rhone (France), Mount Pleasant (Tennessee), Grangemouth (UK), Huddersfield (UK), Waalwijk (The Netherlands), Newcastle (Delaware) and Parets (Spain). The group now retains only operational sites at Billingham (UK), Blackley (UK) and Milford (Massachusetts). The group has actual or potential environmental liabilities in respect of its current or

Notes *(continued)*

24 Contingent liabilities and contingent assets *(continued)*

former sites and is subject to contingencies pursuant to laws and regulations which in the future may require it to take action to correct the effects on the environment of the prior disposal, release or escape of chemical substances.

An Environmental Deed of Covenant entered into by companies in the AstraZeneca group, notably Zeneca Limited (as a principal seller of the business to the group) and AstraZeneca plc (as guarantor), on the group's acquisition of AstraZeneca's specialty chemicals business, provides certain indemnities to and by group companies for environmental liabilities and costs arising from events or circumstances existing prior to the acquisition. These include liabilities relating to or arising out of pre-acquisition contamination at sites which were transferred to group companies in 1999 but which have subsequently been disposed of. These also include historic liabilities arising on any sites previously owned by companies acquired by the group in the course of the acquisition transaction but where the sites in question were not themselves part of the acquisition transaction. The liability of the AstraZeneca group to indemnify group companies in respect of these matters is, subject to certain exceptions, subject to maximum caps of liability, de minimis levels of liability, time limits for claims to be made and/or contributions by group companies. Where time limits or caps on liability apply, on the expiry of the relevant time limit or if the environmental liabilities and costs exceed the relevant cap, the environmental liabilities and costs, or excess thereof, would be the responsibility of group companies. On the disposal of relevant businesses out of the group, where purchasers have assumed liabilities which may be subject to indemnity from the AstraZeneca group under the Environmental Deed or which may otherwise be the responsibility of group companies under the deed, the benefits and obligations under the Environmental Deed have, insofar as they relate to the sold businesses or sites, been assigned to the purchasers subject to appropriate limitations on the maximum amounts which the purchasers may claim under the Environmental Deed.

While the outcome of some of these matters cannot be readily foreseen, the directors believe that they will be disposed of without material effect on the financial position as shown in these consolidated financial statements.

The ultimate requirement for remediation work and its cost are difficult to estimate. However, where such costs are not within the scope of the indemnities provided by the deed of covenant referred to above, and where such costs are deemed probable and identifiable, provision has been made in the financial statements.

Litigation and other claims

Companies in the group are from time to time parties to legal actions and claims by third parties, regulatory and fiscal authorities. While the outcome of some of these matters cannot be readily foreseen, the directors believe that they will be disposed of without material effect on the financial position as shown in these consolidated financial statements.

Notes (continued)

24 Contingent liabilities and contingent assets (continued)

Corporate Tax Audit, Stahl Iberica, Spain

Stahl Iberica SL was owned by the group in 1999 at the time it undertook a similar merger transaction as that for Avecia Spain referred to above. The Spanish tax authority carried out a parallel tax audit at Stahl Iberica, but the tax inspector delayed his conclusions until a decision was made in the case of Avecia Spain.

During 2003 and 2004 the Spanish tax authority carried out a corporate tax audit at Stahl Iberica. The tax inspector decided that the merger transaction undertaken by the company in 1999 did not have sufficient economic reasons to qualify for the beneficial tax regime for restructuring processes.

On 4 July 2005, the tax inspector issued a final tax assessment arising from the tax audit in an amount €2,474,047 plus delay interest of €648,912.

On 7 July 2005, the current owners of Stahl Iberica made a claim to the group in respect of that assessment.

At the group's request, an appeal against the assessment was submitted in July 2005. As a condition to submitting the appeal, it has been necessary for the group to pay the disputed tax and delay interest totalling €3,122,959; this was paid on 17 August 2005. This means that group will have no further liability arising from the audit.

The appeal is being pursued with a final appeal document submitted in March 2006. No decisions have been reached by the Tax Court.

Notes (*continued*)

25 Commitments

(a) Capital commitments of the group at the end of the financial period, for which no provision has been made are as follows:

	2006	2005
	£m	£m
Contracted capital commitments	0.2	0.4
	<u> </u>	<u> </u>

Capital commitments are expected to be settled within one year.

(b) Total commitments under non cancellable operating leases are as follows:

	2006	2005
	Land and buildings	Land and buildings
	£m	£m
Operating leases which expire:		
In the second to fifth years inclusive	1.8	0.3
After five years	-	2.7
	<u> </u>	<u> </u>
	1.8	3.0
	<u> </u>	<u> </u>

The future minimal lease payments under operating and finance leases, including finance charges, were as follows:

	2006	2006	2005	2005
	Operating leases	Finance leases	Operating leases	Finance leases
	£m	£m	£m	£m
Due in one year or less	0.4	-	0.5	-
Due between one and two years	0.4	-	0.5	-
Due between two and three years	0.4	-	0.5	-
Due between three and four years	0.4	-	0.5	-
Due between four and five years	0.2	-	0.5	-
Due in five years or more	-	-	0.5	-
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
	1.8	-	3.0	-
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

There were no commitments (*2005: £nil*) under finance leases at the balance sheet date that were due to commence thereafter.

Notes (continued)

26 Employee benefits

The Avecia group participates in retirement plans, which cover the majority of its employees. These plans are either defined contribution, where the level of company contribution is fixed at a set level or percentage of employees pay, or defined benefit, where benefits are based on employees' years of service and average final remunerations. In general all plans are funded through separate trustee-administered funds. The pension cost for the main defined benefit plans is established in accordance with the advice of independent qualified actuaries based on valuations undertaken on varying dates. There are material plans in the UK and the US but the group no longer has employees or pension plans in The Netherlands.

UK

An actuarial valuation was carried out as at 31 March 2006. The assets are taken at market value with the liabilities valued using financial assumptions derived from market yields on AA rated Corporate bonds at the valuation date. The significant assumptions used in this valuation were UK price inflation of 3% pa, investment returns of 5.9% pa, salary increases of 4% pa and pension increases of 2.9% pa. The market value of the fund's assets was £88.1 million and represented 108% of the accrued liabilities at that date allowing for projected future salary increases. The next valuation will be as at March 2009.

The contribution rate currently payable by the employer is 14.0% of pensionable salaries. Employees pay varying levels of contribution in accordance with the rules and the current average is 4.3% of pensionable salaries.

Avecia's investment policy for the UK pension scheme is to consider a full range of asset classes, the risks and rewards of alternative asset allocation strategies, the suitability of each asset class in the planned asset allocation strategy, and the need for appropriate diversification. It is the trustee's policy to delegate all day-to-day decisions about the investments that fall within each investment option to the fund manager.

The cost of defined contribution schemes in 2006 was £0.6m.

US

Avecia LLC terminated its Qualified Pension Plan with effect from 30 April 2006. Following receipt of a favourable distribution letter from the IRS, Avecia LLC made final funding payments into the Plan and distributed funds in accordance with the instructions of members of the Plan in December 2006.

The cost of defined contribution schemes in 2006 was \$0.4m.

Netherlands

Following the disposal of the NeoResins business in February 2005 the group no longer has employees or pension plans in the Netherlands.

Notes (continued)

26 Employee benefits (continued)

Major assumptions

	2006 UK %	2006 US %	2005 UK %	2005 US %
Rate of general increase in salaries	4.10	4.25	3.90	4.25
Rate of increase to pensions in payment	3.10	-	2.80	-
Discount rate at 31 December	5.10	5.5	4.70	5.50
Medical cost trend rate	-	5.0	-	5.00
Inflation	3.10	3.25	2.90	3.25

Demographic Assumptions

	2006 PMA92/PFA92 2013 2023 Short cohort	2005 PMA92/PFA92 2010 2020 Short cohort
Post-retirement mortality		
- projection year, current pensioners		
- projection year, future pensioners		
Future improvements		

	2006 UK £m	2006 USA £m	2006 Other £m	2005 UK £m	2005 USA £m	2005 Other £m	2004 UK £m	2004 USA £m	2004 Other £m
Present value of unfunded obligations	-	-	-	(45.2)	(4.3)	(4.5)	(72.9)	(9.2)	(23.6)
Present value of funded obligations	(81.7)	-	-	(124.0)	(12.7)	-	(175.3)	(12.9)	(32.7)
Fair value of plan assets	91.4	-	-	124.0	12.7	-	175.3	12.9	32.7
Present value of net assets/(obligations)	9.7	-	-	(45.2)	(4.3)	(4.5)	(72.9)	(9.2)	(23.6)
Recognised liability for defined benefit obligations	-	-	-	(45.2)	(4.3)	(4.5)	(72.9)	(9.2)	(23.6)
Total employee benefits	9.7	-	-	(45.2)	(4.3)	(4.5)	(72.9)	(9.2)	(23.6)

History of experience gains and losses

	2006 £m	2005 £m	2004 £m
Difference between expected and actual return on scheme assets			
Amount	1.6	21.9	6.5
Percentage of scheme assets	2%	16%	3%
Experience gains/(losses) on scheme liabilities			
Amount	3.0	6.3	(2.2)
Percentage of scheme assets	4%	3%	(1%)

Notes (continued)

26 Employee benefits (continued)

Movements in net asset/(liability) for defined benefit obligations recognised in the balance sheet

	2006	2006	2006	2005	2005	2005
	UK	USA	Other	UK	USA	Other
	£m	£m	£m	£m	£m	£m
Net liability for defined benefit obligations at 1 January	(45.2)	(1.3)	(1.9)	(72.9)	(6.1)	(5.8)
Contributions received	30.0	2.7	1.2	16.5	2.6	0.2
Actuarial gain / (loss)	5.7	0.5	0.6	(7.9)	0.5	(0.7)
Gain / (loss) due to exchange	-	0.4	-	-	(0.8)	(0.4)
Expense recognised in the income statement	19.2	(2.3)	(0.3)	19.1	(0.5)	2.1
Transfer to liabilities classified as held for sale	-	-	-	-	3.0	2.7
Pension asset not recognised in the balance sheet	(9.7)	-	-	-	-	-
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Net liability for defined benefit obligations at 31 December	-	-	-	(45.2)	(1.3)	(1.9)
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

The Directors have assessed the recoverability of the net asset relating to the UK Defined Benefit scheme and concluded that it would not be appropriate to recognise this asset in the Balance Sheet of the Group because the Group will not receive a refund from the Pension Scheme, nor is it likely that any benefit will arise in the future from reduced contributions to the scheme.

Movement in fair value of plan assets

	UK	USA	Other
	£m	£m	£m
Assets at 1 January 2006	124.0	9.2	-
Company contributions	30.0	2.7	1.2
Expected return on assets	5.6	(0.3)	-
Actuarial gain/(loss)	0.6	1.0	-
Member contributions	0.7	-	-
Benefits Paid	(13.7)	(0.5)	-
Gain/(loss) due to settlement/curtailment	(55.8)	(11.4)	(1.2)
Gain/(loss) due to exchange	-	(0.7)	-
	<hr/>	<hr/>	<hr/>
Assets at 31 December 2006	91.4	-	-
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

Plan assets are comprised of equities £44.3m, government bonds £35.6m, corporate bonds £10.0m, other £1.5m.

Avecia employs a building block approach in determining the long term rate of return on pension plan assets. Historical markets are studied and assets with higher volatility are assumed to generate higher returns consistent with widely accepted capital market principals. The overall expected rate of return on assets is then derived by aggregating the expected return for each asset class over the actual asset allocation for the Fund at the accounting date.

The Actual return on plan assets was £6.2m for the UK scheme and £0.7m for the US (2005 : £36.2m UK, £1.3m US).

Notes *(continued)*

26 Employee benefits *(continued)*

Movement in defined benefit obligations

	UK £m	USA £m	Other £m
Liabilities at 1 January 2006	(169.2)	(10.5)	(1.9)
Current service cost	(3.1)	(0.1)	-
Past service cost	(1.2)	-	-
Interest cost	(4.5)	(0.2)	(0.1)
Actuarial gain/(loss)	5.1	-	0.6
Member contributions	(0.7)	-	-
Benefits Paid	13.7	0.5	-
Gain/(loss) due to settlement/curtailment	78.2	9.2	1.0
Gain/(loss) due to exchange	-	1.1	0.4
Liabilities at 31 December 2006	(81.7)	-	-

Notes (continued)

26 Employee benefits (continued)

Expense recognised in the income statement

	Year ended 31 December 2006				Year ended 31 December 2005			
	UK	USA	Netherlands	Other PRB's	UK	USA	Netherlands	Other PRB's
	£m	£m	£m	£m	£m	£m	£m	£m
Current service cost	(3.1)	(0.1)	-	-	(7.1)	(0.3)	-	(0.2)
Past service cost	(1.2)	-	-	-	(2.8)	-	-	-
Interest cost	(4.5)	(0.2)	-	(0.1)	(11.4)	(1.4)	-	(0.2)
Expected return on assets	5.6	0.2	-	-	10.8	1.2	-	-
Gain due to curtailments/settlements	22.4	(2.2)	-	(0.2)	29.6	3.1	14.7	5.2
	<u>19.2</u>	<u>(2.3)</u>	<u>-</u>	<u>(0.3)</u>	<u>19.1</u>	<u>2.6</u>	<u>14.7</u>	<u>4.8</u>

The expense is recognised in the following lines in the income statement:

	2006 £m	2005 £m
Operating costs	(4.4)	(10.4)
Interest costs	1.0	(1.0)
Gain on disposal of discontinued business operations	20.0	52.6
	<u>16.6</u>	<u>41.2</u>

Contributions totalling £2.9m are expected to be made during 2007.

Notes (continued)

27 Post balance sheet events

On 15 February 2007, the Group disposed of surplus land at its site at Blackley, UK to a property development company. £3.9m of proceeds were received on completion, with a further instalment of £4.0m due to be received twelve months after completion. This latter amount is underwritten by a bill of exchange. £0.5m of proceeds are being held in escrow subject to satisfactory completion of some land remediation, while costs to complete the transaction will amount to some £0.5m.

28 Related party disclosures

In June 1999, Cinven and Investcorp S.A. jointly directed the formation of Avecia, and its acquisition of the Zeneca Specialties business. Cinven and Investcorp S.A. continue to provide consulting services to the group, for which they may receive payments of up to £400,000 per annum. In January 2002 Avecia completed the sale of its Stahl business to Luxembourg 101 S.A. and its affiliates. The purchase of Stahl from Avecia was managed by Investcorp S.A. on behalf of Luxembourg 101 SA and its affiliates, which under the terms of the Bond Indenture means that Luxembourg 101 SA is considered a related party. The sale of the Stahl business was therefore conducted under the terms of the bond indenture relating to related party transactions.

At December 31, 2006 debtors include £43.8m (2005: £42.7 m) owed by the parent companies of Avecia Group plc, Avecia Holdings plc and Avecia Finance plc, of which £15 million relates to acquisition fees (this amount is interest free) and £27 million relates to a capital contribution, on which interest is charged at 4.59%. Interest of £1.1m was charged during the year and is included in the £43.8m debtor at period end.

Related parties include key management personnel who are the directors. Amounts paid to key management personnel were £1.8m in respect of short term employee benefits and £0.1m in respect of post retirement benefits.

The principal undertakings of Avecia Group plc as at 31 December 2006 were as follows:

Subsidiary undertakings	Country of incorporation	Principal activity	Percentage of equity owned %
Avecia Corporation Limited	UK	Holding company	100*
Avecia Investments Limited	UK	Holding company	100*
Avecia UK Holdings Limited	UK	Holding company	100*
Avecia Limited	UK	Chemical manufacture	100*
Avecia Holdings Inc.	USA	Holding company	100*
Avecia Biotechnology Inc.	USA	Chemical manufacture	100*
Avecia Biologics Limited	UK	Chemical manufacture	100*
Hexagon Tower Limited	UK	Property holding	100*

Notes *(continued)*

29 Difference between IFRS and US accounting principles

These consolidated financial statements are prepared in accordance with IFRSs. Significant differences between IFRSs and US GAAP which affect the net income and net assets of Avecia Group plc are set out below.

Reclassification of parent company debtors

Since the acquisition of the Specialty Chemicals business of AstraZeneca in 1999, certain amounts have been due from Avecia Holdings plc and Avecia Finance plc, the parent companies of Avecia Group plc on a long term basis (see note 28). Under US GAAP, such amounts are reflected as a reduction of shareholders' funds. Net assets in accordance with US GAAP have been reduced by £15.0 million to reflect this reclassification at December 31, 2006 (*December 31, 2005: £15.0 million*).

Capitalization of interest

There is no mandatory IFRS accounting standard regarding the capitalization of interest and, accordingly, the business does not capitalize interest as part of the cost of fixed assets in financial statements prepared under IFRS. US GAAP requires interest incurred and associated with the cost of constructing fixed assets to be capitalized and amortized over the life of the asset.

Revenue recognition

Under US GAAP specific guidance is given regarding allocating revenue to separate elements of multiple element arrangements. Under this guidance a fair value cannot be readily ascertained for the separate elements of certain contracts and consequently revenue is recognised on a straight line basis over the term of the contract. Under IFRS there is no equivalent guidance and revenue has been recognised on separate elements of certain arrangements based upon the rendering of the associated service.

At the end of 2005, a total of £4.8m of contract revenue which was recognized under UK GAAP was deferred as contingent revenue under US GAAP as a liability was deemed to exist under the terms of the contract. Under IFRS transition rules the liability derecognition criteria under IAS 39 are not applied retrospectively therefore this revenue was not deferred under Adopted IFRS. In 2006, this deferred revenue held in the balance sheet under US GAAP has all been written off against profit on disposals, as the businesses to which it applied have all been disposed.

Deferred taxation

This represents the deferred taxation in respect of the US GAAP adjustments.

Pension Expense

There are various differences between IFRS and US GAAP in accounting for pension costs.

Under IFRS, actuarial gains and losses are permitted to be recognised immediately in the statement of recognised income and expense. Under US GAAP, such actuarial gains and losses are permitted to be amortised on a straight-line basis over the average remaining service period of the employees.

Under US GAAP, a minimum pension liability is recognized through other comprehensive income in certain circumstances when there is a deficit of plan assets relative to the accumulated benefits obligation. Under IFRS, there is no such requirement.

Under IFRS, prior service costs are recognised immediately in the income statement. Under US GAAP prior service costs are deferred and amortised over the average remaining life of the employees.

Notes (continued)

29 Difference between IFRS and US accounting principles (continued)

Goodwill Amortisation

Under US GAAP, goodwill is not amortised but is tested annually for impairment in accordance with SFAS 142. Similar principles apply under IFRS, however this applies only from the effective date of transition (1st January 2004). Prior to this goodwill was amortised according to UK GAAP. This leads to different carrying values of goodwill.

Onerous Contracts

Under IFRS, when a contract is recognised as onerous a provision must be made for unavoidable future losses. This is generally not permitted under US GAAP.

Purchase accounting adjustments (goodwill and intangibles)

In the consolidated financial statements, goodwill arising on acquisitions made prior to January 1998 accounted for under the purchase method has been eliminated against shareholders' equity, in accordance with UK GAAP. Under the requirements of UK Financial Reporting Standard 10 'Goodwill and intangible assets', goodwill on acquisitions made after January 1, 1998 is capitalized and amortized over its estimated useful life, which is generally presumed not to exceed 20 years.

In respect of acquisitions prior to 1 January 2004, goodwill is included at 1 January 2004 on the basis of its deemed cost, which represents the amount recorded under UK GAAP. On transition to IFRS amortisation of goodwill has ceased as required by IFRS 1.

Under IFRSs goodwill created outside the Avecia Group plc group of companies is not reported in the financial statements of Avecia Group plc. Under US GAAP an element of this goodwill is pushed down into the net assets of the group as it is deemed to be attached to assets held by the Avecia Group plc group of companies.

Impairment of Assets and Goodwill

Under US GAAP impairments are calculated in accordance with SFAS 142 (for goodwill and intangible assets) and SFAS 144 (for other long-lived assets).

Groups of long-lived assets (including finite-lived intangible assets) are tested for impairment by comparing the recoverable amount of the asset group (determined using undiscounted cash flows) to its carrying amount to determine whether an impairment exists. If the asset group is impaired, an impairment charge is determined by comparing the carrying amount of the asset group with its fair value. Goodwill is tested for impairment by comparing the fair value of each reporting unit with its carrying amount to determine whether the related goodwill is potentially impaired. Any impairment of goodwill is measured by comparing the implied fair value of goodwill to its carrying amount. The implied fair value of goodwill is determined by deducting the fair value of identifiable assets and liabilities within a reporting unit from the total fair value of that reporting unit. Indefinite-lived intangibles are tested for impairment under US GAAP by comparing the fair value of the asset with its carrying amount.

Under IFRS, the carrying value of cash generating units is compared with its recoverable amount and any deficit is written off initially to goodwill, then intangible assets, then other long-lived assets on a pro-rata basis.

Notes (continued)

29 Difference between IFRS and US accounting principles

The following is a summary of the material adjustments to retained profit and net assets which would have been required if US GAAP had been applied instead of IFRS.

	Avecia Group plc	
	Consolidated	
	For the year	For the year
	ended December	ended December
	31, 2006	31, 2005
	£ million	£ million
Retained profit for the financial period under IFRS	76.0	40.0
	<hr/>	<hr/>
Adjustments to conform to US GAAP		
Capitalization of interest, less disposals and amortization	(0.2)	(2.9)
Income recognition deferral	-	(0.9)
Pension (credit)/expense	1.1	(4.8)
Post-retirement benefits	-	(0.1)
Differences on profit on disposal of business	(24.9)	(35.0)
Goodwill additional impairment under US GAAP	-	-
Fixed asset additional impairment under US GAAP	-	-
Onerous contract provision not recognized under US GAAP	(0.5)	0.5
Deferred taxation on adjustments to conform to US GAAP	-	0.3
	<hr/>	<hr/>
Net profit/(loss) in accordance with US GAAP	51.5	(2.9)
	<hr/>	<hr/>
Net profit/(loss) available to common shareholders in accordance with US GAAP	51.5	(2.9)
	<hr/>	<hr/>
Profit/(loss) before taxation in accordance with US GAAP from:		
continuing operations	(20.8)	(94.6)
discontinued operations	72.3	93.0
Taxation in accordance with US GAAP on:		
continuing operations	-	(1.3)
discontinued operations	0.1	-
Net (loss)/profit in accordance with US GAAP from:		
continuing operations	(20.8)	(95.9)
discontinued operations	72.4	93.0

Notes (continued)

29 Difference between IFRS and US accounting principles (continued)

	Avecia Group plc Consolidated	
	As at December 31,2006 £ million	As at December 31,2005 £ million
IFRS		
Total shareholders funds	131.6	62.7
Adjustments to conform to US GAAP		
Reclassification of parent company debtors	(15.0)	(15.0)
Capitalization, less disposals and amortization of interest	1.1	8.3
Income recognition deferral	-	(7.5)
Pension liability	10.4	17.8
Post-retirement benefits/plan amendment	-	1.7
Additional minimum liability	-	(4.4)
Pensions intangible assets	-	0.1
Purchase accounting adjustments	11.0	22.0
Additional goodwill impairment under US GAAP	-	(4.2)
Difference in historical basis of goodwill	4.5	9.6
Additional fixed asset impairment	-	-
Onerous contract provision not recognized under US GAAP	-	0.5
Tax on adjustments to conform to US GAAP	-	-
Shareholders equity in accordance with US GAAP	143.6	91.6

30 Ultimate parent company

The company is a subsidiary undertaking of Avecia Finance plc which is incorporated in Great Britain. The ultimate parent company is Avecia (Jersey) Limited, a company registered and incorporated in Jersey. The registered number is 74318. The external address of the ultimate parent company is:

Avecia (Jersey) Limited
Mourant du Feu & Jeune
22 Grenville Street
St. Helier
Jersey
JE4 8PX

Notes (*continued*)

31 Company balance sheet under UK GAAP at 31 December 2006

	<i>Note</i>	2006 £m	2006 £m	2005 £m	2005 £m
Fixed assets					
Investments	35		278.7		294.5
Current assets					
Debtors: amounts due within one year	36	5.4		41.7	
Debtors: amounts due after one year	36	-		78.4	
		<u>5.4</u>		<u>120.1</u>	
Creditors: amounts falling due within one year	37	(1.2)		(7.4)	
Net current assets			4.2		112.7
Total assets less current liabilities			282.9		407.2
Creditors: amounts falling due after more than one year	38		(15.2)		(115.2)
Net assets			267.7		292.0
Capital and reserves					
Called up share capital	39		179.1		329.1
Capital redemption reserve	39		1.1		
Share premium account	39		23.8		
Profit and loss account	39		63.7		(37.1)
Shareholders' funds			267.7		292.0

These financial statements were approved by the board of directors on 6 June 2007 and were signed on its behalf by:

[D MCLELLAN]

D Mclellan
Director

Notes *(continued)*

32 Company reconciliation of movements in shareholders' funds

	2006	2005
	£000	£000
Loss for the period	(24.3)	(47.8)
Other recognised gains and losses relating to the period (net)	-	-
Capital contribution	-	27.0
	<hr/>	<hr/>
Net reduction to shareholders' funds	(24.3)	(20.8)
Opening shareholders' funds (as previously stated)	292.0	350.4
On adoption of FRS25	-	(37.6)
	<hr/>	<hr/>
Opening shareholders' funds (as restated)	292.0	312.8
	<hr/>	<hr/>
Closing shareholders' funds	267.7	292.0
	<hr/> <hr/>	<hr/> <hr/>

Notes (continued)

33 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the financial statements, except as noted below.

The corresponding amounts in these financial statements are restated where relevant in accordance with the new policies.

Basis of preparation

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

Under Financial Reporting Standard 1 (Revised 1996) the company is exempt from the requirement to prepare a cash flow statement on the grounds that a parent undertaking includes the company in its own published consolidated financial statements.

As the Company is a wholly owned subsidiary of Avecia Finance Limited, the company has taken advantage of the exemption contained in FRS 8 and has therefore not disclosed transactions or balances with entities which form part of the group (or investees of the group qualifying as related parties).

The consolidated financial statements of Avecia Group plc, within which this company is included, can be obtained from Avecia Group plc, PO Box 42, Hexagon Tower, Blackley, Manchester M9 8ZS.

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the contracted rate or the rate of exchange ruling at the balance sheet date and the gains or losses on translation are included in the profit and loss account.

Fixed asset investments

Fixed asset investments are stated at cost less provision for any permanent impairment.

Classification of financial instruments issued by the Company

Following the adoption of FRS 25, financial instruments issued by the Company are treated as equity (i.e. forming part of shareholders' funds) only to the extent that they meet the following two conditions:

- a) they include no contractual obligations upon the Company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Company; and
- b) where the instrument will or may be settled in the Company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Company's own equity instruments or is a derivative that will be settled by the Company's exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

To the extent that this definition is not met, the proceeds of issue are classified as a financial liability. Where the instrument so classified takes the legal form of the Company's own shares, the amounts presented in these financial statements for called up share capital and share premium account exclude amounts in relation to those shares.

Finance payments associated with financial liabilities are dealt with as part of interest payable and similar charges. Finance payments associated with financial instruments that are classified as part of shareholders' funds (see dividends policy), are dealt with as appropriations in the reconciliation of movements in shareholders' funds.

Notes (continued)

33 Accounting policies (continued)

Dividends on shares presented within shareholders' funds

Dividends unpaid at the balance sheet date are only recognised as a liability at that date to the extent that they are appropriately authorised and are no longer at the discretion of the Company. Unpaid dividends that do not meet these criteria are disclosed in the notes to the financial statements.

Taxation

The charge for taxation is based on the loss for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19.

Classification of financial instruments issued by the company

Following the adoption of FRS 25, financial instruments issued by the company are treated as equity (i.e. forming part of shareholders' funds) only to the extent that they meet the following two conditions:

- c) they include no contractual obligations upon the company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the company; and
- d) where the instrument will or may be settled in the company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the company's own equity instruments or is a derivative that will be settled by the company's exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

To the extent that this definition is not met, the proceeds of issue are classified as a financial liability. Where the instrument so classified takes the legal form of the company's own shares, the amounts presented in these financial statements for called up share capital and share premium account exclude amounts in relation to those shares.

Finance payments associated with financial liabilities are dealt with as part of interest payable and similar charges. Finance payments associated with financial instruments that are classified as part of shareholders' funds, are dealt with as appropriations in the reconciliation of movements in shareholders' funds.

34 Profit for the year

As permitted by section 230 of the Companies Act 1985 the company has elected not to present its own profit and loss account for the year. Avecia Group plc reported a loss for the financial year of £24.3m (2005: £47.8m).

Audit services for the company totalled £3000 (2005: £3000). The company is exempt from the requirement to disclose remuneration for other services as the group accounts include this disclosure on a group-wide basis.

The company had no employees for the year ended 31 December 2006 (2005: nil).

For information on the remuneration of directors, please see note 6.

Notes (continued)

35 Fixed asset investments

Company

	Shares in group undertakings £m
<i>Cost</i>	
At beginning and end of year	328.6

<i>Amortisation</i>	
At beginning of year	34.1
Impairment	15.8

At end of year	49.9

<i>Net book value</i>	
At 31 December 2006	278.7
	=====
At 31 December 2005	294.5
	=====

The carrying value of the company's investment in the group was reviewed and compared to the estimated recoverable amount. An impairment loss of £15.8m was recognised accordingly.

The directly held company in which the company's interest at the year end is more than 20% is as follows:

	Country of incorporation	Principal activity	Class and Percentage of shares held
<i>Subsidiary undertaking</i>			
Avecia Corporation Limited	UK	Intermediate holding	Ordinary – 100

The principal indirectly owned subsidiary undertakings at the year end are:

	Country of incorporation	Principal activity	Class and percentage of shares held
<i>Subsidiary undertakings</i>			
Avecia UK Holdings Limited	UK	Intermediate holding	Ordinary - 100
Avecia Limited	UK	Chemical manufacture	Ordinary - 100
Avecia Holdings Inc.	USA	Intermediate holding	Ordinary - 100
Avecia Inc.	USA	Chemical manufacture	Ordinary - 100
Avecia Biologics Limited	UK	Chemical manufacture	Ordinary – 100
Hexagon Tower Limited	UK	Property holding	Ordinary - 100

Notes *(continued)*

36 Debtors

	Company 2006 £m	Company 2005 £m
Debtors due within one year		
Amounts owed by group undertakings	5.4	41.7
	<hr style="width: 100%;"/>	<hr style="width: 100%;"/>
	5.4	41.7
	<hr style="width: 100%;"/>	<hr style="width: 100%;"/>
	£m	
Debtors due after one year		
Amounts owed by parent undertakings	-	78.4
	<hr style="width: 100%;"/>	<hr style="width: 100%;"/>
	-	120.1
	<hr style="width: 100%;"/>	<hr style="width: 100%;"/>

£Nil (2005: £78.4m) of amounts owed by group undertakings are due after more than one year. £Nil (2005: £76.1m) of the amounts owed by group undertakings is denominated in US dollars.

Notes *(continued)*

37 Creditors: amounts falling due within one year

	Company 2006 £m	Company 2005 £m
Accruals and deferred income	1.2	7.4
	<u>1.2</u>	<u>7.4</u>

38 Creditors: amounts falling due after more than one year

	Company 2006 £m	Company 2005 £m
Redeemable preference shares	15.2	39.0
Other loans	-	73.1
Amounts owed to group undertakings	-	3.1
	<u>15.2</u>	<u>115.2</u>
	<u>15.2</u>	<u>115.2</u>

Company

Analysis of debt:

	2006 £m	2005 £m
Debt can be analysed as falling due:		
Between one and two years	-	3.1
Between three and four years	15.2	-
Between four and five years	-	42.4
In five years or more	-	69.7
	<u>15.2</u>	<u>115.2</u>
	<u>15.2</u>	<u>115.2</u>

Notes (continued)

39 Called up share capital

	2006	2006	2005	2005
	Number of shares	Nominal value of shares £'000	Number of shares	Nominal value of shares £'000
<i>Authorised</i>				
Equity: ordinary shares of £1 each	400,000,000	400,000	400,000,000	400,000
Non equity – Pay-in-Kind (PIK) 16% cumulative redeemable preference shares of \$1 each	3,500,000	2,222	3,500,000	2,222
	<u>403,500,000</u>	<u>402,222</u>	<u>403,500,000</u>	<u>402,222</u>
<i>Allotted, called up and fully paid</i>				
Equity: ordinary shares of £1 each	179,100,001	179,100	329,100,001	329,100
Non equity – Pay-in-Kind (PIK) 16% cumulative redeemable preference shares of \$1 each	1,200,000	517	3,022,489	1,751
	<u>180,300,001</u>	<u>179,617</u>	<u>332,122,490</u>	<u>330,851</u>

Following a successful petition to the Courts on 17 May 2006, Avecia Group plc reduced its issued share capital from £329,100,001 to £179,100,001 by means of cancellation of 150,000,000 ordinary shares of £1 each. The resulting reserve was credited to the Company's retained earnings.

Redeemable preference shares

The redemption of preference shares is mandatory on 1 July 2010 but may be redeemed at the option of the company on or after 1 January 2006 or earlier on certain public equity offerings at a redemption value equal to the liquidation preference value plus all accumulated and unpaid dividends to the date of redemption. On a winding up they would rank in priority to ordinary shares. Up to 1 July 2004 the company was able to issue further PIK preference shares instead of a cash dividend (based on the liquidated preference amount of \$25 per share). Subsequent to 1 July 2004 this option was no longer available and subsequent dividends became payable in cash. Subject to certain exceptions contained in the articles of association, the preference shares have no voting rights at meetings of the ordinary shareholders. They attract a dividend rate of 16% but, during any period where dividends due are unpaid, a further 2% default rate is also payable. The carrying value of the preferred shares is being increased from the date of issue to the mandatory redemption date, by the effective interest method, such that the carrying value at the mandatory redemption date will equal the redemption value of \$25 per share. The accretion for 2006 was £0.9 million (2005: £0.1 million).

Notes *(continued)*

39 Called up share capital *(continued)*

Company

	Equity share capital £m	Capital redemption reserve	Share premium account	Profit and loss account £m	Total £m
At 1 January 2006	329.1	-	-	(37.1)	292.0
Loss for year	-	-	-	(24.3)	(24.3)
Redemption of preference shares	-	1.1	23.8	(24.9)	-
Share capital reduction	(150.0)	-	-	150.0	-
	<u>179.1</u>	<u>1.1</u>	<u>23.8</u>	<u>88.6</u>	<u>267.7</u>
At 31 December 2006	<u>179.1</u>	<u>1.1</u>	<u>23.8</u>	<u>88.6</u>	<u>267.7</u>

Capital redemption reserve and share premium account

On 5 July 2006 the company redeemed 1,822,489 of the preference shares at a total cost of US\$ 48,056,048, leaving 1,200,000 of the preference shares in issue. The capital redemption reserve and share premium were credited with the appropriate amounts arising from this redemption.