Medical Solutions plc

Annual Report and Accounts 2004

Innovative Solutions in Medicine

Medical Solutions plc Corporate Overview

Services

UK Diagnostic Pathology
A histopathology business, focused on the UK private and public healthcare sectors. The division has laboratories in both Nottingham and Harley Street, London.

Dubai Diagnostic Pathology
Medical Solutions Dubai offers a broad range of diagnostic services to local hospitals and healthcare providers. In early 2005, we formally completed the acquisitions of Dubai Medical Laboratories and Specialised Clinical Laboratories.

Drug Development Services
The Drug Development Services business unit offers diagnostic and therapeutic testing services to support drug discovery and development for pharmaceutical and biotechnology companies.

Technology

SurePath™ Liquid Based Cytology
SurePath™ is an FDA-approved Liquid Based Cytology system distributed by the Group under licences and intended for use in the screening and detection of cervical cancer.

Virtual Microscopy
The Group provides telepathology workstations and has a suite of dedicated histopathology software for virtual microscopy which is made up of three programmes: PathSight, PathScope and PathScan.

Medical Solutions plc provides world leading services and technology for Cancer Diagnosis and Pathology, supporting the Healthcare, Pharmaceutical and Biotechnology sectors.

Financial Highlights 2004

- Turnover of £6.6 million (2003: £7.3 million)
- Operating loss before exceptional costs and amortisation of goodwill and development costs of £4.8 million (2003: £1.8 million), see Note 2
- Operating loss after exceptional costs and amortisation of goodwill and development costs of £9.5 million (2003: £2.2 million)

Operational and Financial Highlights – Early 2005

- Successful Placing and Open Offer raising £5.6 million (net of expenses)
- Initial cost reduction measures introduced, expected to generate annualised savings of approximately £0.6 million per annum; further initiatives planned
- Signing of further Liquid Based Cytology contract with Lancashire and Cumbria Strategic Health Authority
- Acquisitions of Dubai Medical Laboratories and Specialised Clinical Laboratories formally completed
- Strengthened Board through appointments of Dr Neil Johnston and Robin Slinger

"Whilst 2004 was undoubtedly a difficult year, the Board remains focused on becoming a profitable business through the achievement of its three strategic goals."

Recent Developments

2004 was a challenging year for Medical Solutions. Having made significant investment into our operational capabilities in 2003, the level of revenue growth we anticipated did not materialise as quickly as we had hoped. This led to a drain on the Group's cash resources. It is pleasing to report that, despite these challenges, the Group has delivered a number of important successes during the year culminating in a successful Placing and Open Offer, raising approximately £5.6 million (after expenses). The Placing and Open Offer was supported by both new and existing shareholders and the Board was advised by Nomura International plc.

In our Services Division, our profitable operations in Dubai were expanded through the recent acquisitions of Dubai Medical Laboratories ("DML") and Specialised Clinical Laboratories ("SCL"). We demonstrated our ability to capitalise on the market opportunity for liquid based cervical smear testing having been awarded five-year contracts to supply the whole of Wales, Birmingham Women's Hospital and Good Hope Hospital and the Cheshire and Merseyside region. Our UK Diagnostic Pathology and Drug Development Services businesses made slower progress than we expected.

In our Technology Division we sold the trade and assets of both Kinetic Imaging Inc and Kinetic Imaging Limited

Summary

- Lower than expected revenue growth led to a drain on the Group's cash resources
- Successful Placing and Open Offer in early 2005 raised approximately £5.6 million (after expenses)
- Expansion of profitable operations in Dubai through recent acquisitions of DML and SCL
- Board strengthened through recent appointments of Dr Neil Johnston and Robin Slinger
- Board focused on becoming a profitable business

to Andor Technology plc. We also completed the sale and leaseback of our Nottingham facility.

Board Changes

In early 2005, the Board was delighted to welcome Dr Neil Johnston as Chief Financial Officer and Company Secretary. Neil was previously Chief Financial Officer at Pharmagene plc and spent nine years at PricewaterhouseCoopers. We also welcomed Robin Slinger to the Board as a Non-Executive Director. Robin spent 34 years as a Director of Corporate Banking at the Royal Bank of Scotland plc.

In December, Professor Ian Ellis resigned from the Board as a result of his commitments to the University of Nottingham, but remains with the Group as Medical Director on a part-time basis. Andrew Longstaffe, previous Chief Financial Officer and Company Secretary left the Board and the Group to pursue other activities. We wish him well in his future career.

Corporate Governance

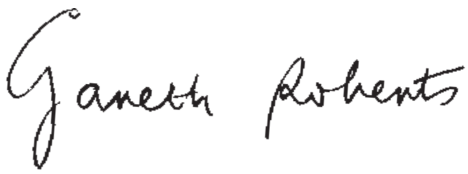
The Board is committed to improving its corporate governance policies and practices. Our policy and planned developments in this area are described more fully in our corporate governance statement on pages 17 to 19.

Prospects

Whilst 2004 was undoubtedly a difficult year, the Board remains focused on becoming a profitable business through the achievement of its three strategic goals:

- expanding the Group's research services business with pharmaceutical companies through both clinical trials support and biomarker contracts;
- growing the UK-based pathology services business, including through the SurePath™ Liquid Based Cytology system; and
- maximising returns from the Group's activities in the Middle East, both through its existing pathology services operations and through pursuing acquisition opportunities as they arise.

We look forward to updating shareholders on our progress during 2005.



Sir Gareth Roberts FRS, FREng
Non-Executive Chairman

"Medical Solutions is a UK-based healthcare company specialising in pathology products and services. The Board continued to implement its strategy of moving towards being a service focused business."

Overview

Medical Solutions is a UK-based healthcare company specialising in pathology products and services. Our business continues to be divided into two divisions.

The Services Division provides specialist pathology-based services, biomaterials resources and expertise to the Pharmaceutical and Biotechnology Industry as well as public and private healthcare providers based in the UK and Dubai. The Services Division has access to an established tissue bank and a network of over 60 specialist pathologists to provide reporting services to both the NHS and the private sector. We believe Medical Solutions remains well placed to fully exploit the increasing international demand for outsourced support services, particularly in cancer diagnostics and drug development.

The Technology Division has a range of products including specialist software in virtual microscopy, telepathology, image analysis and tissue quantification. Medical Solutions also distributes and supports the SurePath™ Liquid Based Cytology ("LBC") system for the preparation and analysis of cervical smear samples. SurePath™ is one of only two systems approved by the National Institute of Clinical Excellence ("NICE") for use in England and Wales.

The Board continued to implement its strategy of moving towards being a service focused business. During the early part of the year, we continued to invest in additional staff and facilities to provide the operating capacity to fulfil the level of revenue we had anticipated. Unfortunately, this revenue did not materialise as quickly as we had hoped. This placed a significant strain on our cash resources resulting in the need to raise additional finance.

Summary

- Turnover for the year was £6.6 million (2003: £7.3 million)
- Operating losses before exceptional items and amortisation of goodwill and development costs were £4.8 million (2003: £1.8 million)
- Operating losses including exceptional items and amortisation of goodwill and development costs were £9.5 million (2003: £2.2 million)
- Secured LBC contracts to supply the whole of Wales, Birmingham Women's and Good Hope Hospitals and the Merseyside and Cheshire region. Further supplemented in early 2005 by agreement to supply Lancashire and Cumbria
- Sold trade and assets of Kinetic Imaging Limited and Kinetic Imaging Inc in June for total consideration of £0.6 million
- Remain focused on creating a profitable and cash generative pathology-based services group

In December, we announced a Placing and Open Offer to raise approximately £5.6 million (after expenses). The fundraising was closed successfully in January 2005.

Turnover for the year was £6.6 million (2003: £7.3 million). For the year ended 31 December 2004, operating losses before exceptional items and amortisation of goodwill and development costs were £4.8 million (2003: £1.8 million), see Note 2. Operating losses including exceptional items and amortisation of goodwill and development costs were £9.5 million for the year ended 31 December 2004 (2003: £2.2 million).

Services Division

Our Services Division generated revenue of £5.5 million in 2004 compared to £5.1 million in 2003, an increase of 8%. Operating losses before common costs, exceptional items and amortisation of goodwill and development costs were £0.8 million in 2004 compared to an operating profit of £0.9 million in 2003.

UK Diagnostic Pathology

Revenue from our UK Diagnostic Pathology operation grew in 2004 compared with 2003. The UK operation is solely histopathology-based and generates revenue from our operations in London and Nottingham. In London, our specialist laboratory in Harley Street provides histopathology services to both private and public healthcare providers. In Nottingham, we provide outsourced histopathology consulting services to NHS Trusts and carry out a number of specialised laboratory tests. Our Reference Laboratory is the only private laboratory in the UK used by Roche to carry out its HER-2 test on tissue to establish whether a patient will respond to its drug Herceptin for breast cancer.

We have put in place a level of capacity based on our expectations of revenue during 2004. It was disappointing that our expectations were not met.

The market drivers for this business remain sound. The UK continues to experience a shortfall in the number of pathologists and the Government's focus on modernising UK pathology services is expected to generate significant long-term benefits. In December, our London laboratory had its Clinical Pathology Accreditation status renewed. In September, we appointed Carol Knott as Divisional Manager. Carol comes with a strong operational management background in both public and private healthcare, primarily in the UK and has already made a strong contribution.

Dubai Diagnostic Pathology

The Dubai Diagnostic Pathology business generated stable revenues of £2.8 million in both 2004 and 2003. The diagnostic pathology business in Dubai comprises the pathology laboratory of the Welcare Hospital together with a small, histopathology based business known as Histopathology and Speciality Laboratories ("HSL"). We put in place a new management team and additional resources to grow and integrate our businesses in Dubai. These costs have reduced the profitability of our Dubai business in the short-term, but have been planned as part of our long-term objectives in this region.

Following the completion of the Placing and Open Offer in January 2005, the Group also formally completed the acquisitions of majority shareholdings in Dubai Medical Laboratories and Specialised Clinical Laboratories, for a total consideration of £2.8 million.

The Group serves a number of international pharmaceutical and biotechnology clients. Our services and diagnostic tests provide support for research and development efforts as well as clinical trials.

Dubai Diagnostic Pathology cont...

These acquisitions have helped to consolidate Medical Solutions' position as the leading provider of pathology services in this geographic area and both are expected to generate further growth in this part of our business.

We are now focused on the efficient integration of our four businesses in Dubai, an emerging world centre for business and high quality healthcare provision.

Drug Development Services

Medical Solutions' Drug Development Services business unit offers diagnostic and therapeutic testing services to support drug discovery and development and assists pharmaceutical and biotechnology companies in identifying the markers most closely linked with response to therapy during clinical trials. We are mainly focused on cancer research particularly in the development of new surrogate markers.

In addition, the Group offers its clients rapid and flexible access to a range of ethically sourced human biomaterials with full donor consent and demographic and medical history.

The Drug Development Services business made encouraging progress in 2004. Our relationship with AstraZeneca continued to grow stronger as we successfully completed a number of cancer focused biomarker assessment contracts. During the second half of the year, we completed a significant agreement with Synexus Ltd to provide histopathology services for a Phase III study into the reduction of prostate cancer risk. We also completed a number of smaller studies with other pharmaceutical and biotechnology companies. Sales of processed human tissue and human tissue based products were disappointing and we continue to keep this aspect of our business under review.

We recruited Cliff Murray to the position of Senior Scientist, Drug Development Services in December. Cliff is a highly respected research scientist who was previously Reader in Oncology at Nottingham University and Head of the Cancer Research UK Tumour Cytokine Biology Group.

Technology Division

Within the Technology Division, turnover fell from £2.2 million in 2003 to £1.1 million in 2004 largely as a result of the disposal of Kinetic Inc and Kinetic Limited in June, which contributed turnover of £0.6 million in 2004 (2003: £1.1 million). Operating losses before common costs, exceptional items and amortisation of goodwill and development costs for the year ended 31 December 2004 were £2.1 million (2003: £1.4 million). Operating losses after exceptional items and amortisation of goodwill and development costs for the year ended 31 December 2004 were £5.4 million (2003: £1.6 million).

SurePath™ Liquid Based Cytology

There are currently more than four million smear tests performed each year in England and Wales. We believe that this new marketplace is worth in excess of £10 million annually. During 2004, Medical Solutions has demonstrated its ability to capitalise on this market opportunity by being awarded five year contracts to supply the whole of Wales, Birmingham Women's and Good Hope Hospitals, and the Merseyside and Cheshire region. This was supplemented in early 2005 by the announcement of a further agreement to supply Lancashire and Cumbria.

During the year, we observed a fundamental shift in the buying pattern of our customers in this area.

Where previously, we had expected to make outright sales of LBC machines and associated consumables, our customers ultimately chose a purchasing model in which the cost of machines was absorbed into a higher consumable unit price over the five year period. This led to a significantly lower level of revenue than we had expected during the year. In addition, this meant the Group has had to finance the cost of its investment in LBC machines (£1.3 million). As contracts were awarded, we were able to successfully finance around £0.6 million of this investment.

Virtual Microscopy

Whilst we have enjoyed significant past successes in this area of our business, we have recognised that Medical Solutions does not have sufficient resources to continue to research and develop new products in the area of virtual microscopy.

For this reason, we have been collaborating with companies such as Hamamatsu Photonics KK to develop new product lines such as the NanoZoomer, a fast scanning device used to scan and store microscope slide images.

We are looking to exit this area of our business over the medium-term but expect to retain a core software development team to assist other parts of our business, particularly the Drug Development Services area.

Other Key Transactions

We sold the trade and assets of Kinetic Imaging Limited and Kinetic Imaging Inc in June for a total consideration of £0.6 million. In February, we completed the sale and leaseback of our headquarters generating consideration of £4.6 million. The Group entered into a 25 year lease for the premises at an annual rent of £400,000.

Intellectual Property

Our intellectual property portfolio continued to be strengthened and we were granted a key patent in the area of microscopy imaging systems. We also filed a further two patent applications to support our operational activities in the drug development services area.

Summary

2004 was a difficult year for Medical Solutions and its shareholders. We remain focused on the key challenge of creating a profitable and cash generative pathology-based services group.

Charles Green
Chief Executive Officer

“2004 was a difficult year for Medical Solutions and its shareholders. We remain focused on the key challenge of creating a profitable and cash generative pathology-based services group.”

"Having raised the funds necessary to secure the immediate future of the Group, we have set about the task of reversing the Group's fortunes. Initially, our efforts have focused on reducing the Group's cost base and identifying those parts of our business capable of achieving scalable growth."

Results of Operations

Turnover for the year ended 31 December 2004 was £6.6 million, compared to £7.3 million in 2003, a reduction of 10%. Costs of sales (excluding exceptional costs of sales of £0.4 million, see Note 3) rose from £3.9 million in 2003 to £4.7 million in 2004 as the Group geared up its internal resources, particularly headcount, in anticipation of further revenue growth. Average direct headcount rose from 52 in 2003 to 77 in 2004. Revenue growth did not materialise as anticipated during 2004 and as a result gross profit, excluding exceptional cost of sales, fell to £1.9 million (see Note 3) compared to £3.4 million in 2003. Including exceptional cost of sales, gross profit in 2004 was £1.5 million (2003: £3.4 million). The exceptional cost of sales of £0.4 million relates to a change in accounting methodology for human tissue stock together with a write down of certain Technology stocks in recognition of the Group's plans to exit this area of its business over the medium-term.

Operating losses before exceptional costs and amortisation of goodwill and development costs were £4.8 million (2003: £1.8 million, see Note 2). Operating losses after exceptional costs and amortisation of goodwill and development costs were £9.5 million (2003: £2.2 million). Other operating expenses, excluding exceptional items and amortisation of goodwill and development costs, were £6.7 million in 2004 compared with £5.2 million

Summary

- Turnover within the Group's Services Division grew to £5.5 million (2003: £5.1 million); turnover in the Technology Division fell from £2.2 million to £1.1 million
- Services Division operating loss before exceptional costs, common costs, amortisation of goodwill and development costs of £0.8 million (2003: operating profit of £0.9 million); operating loss after exceptional costs and amortisation of goodwill and development costs (before common costs) of £2.3 million (2003: operating profit of £0.6 million)
- Technology Division operating loss before exceptional costs, common costs and amortisation of goodwill and development costs of £2.1 million (2003: £1.4 million); operating loss after exceptional costs and amortisation of goodwill and development costs (before common costs) of £5.4 million (2003: £1.6 million)
- Placing and Open Offer completed in January 2005 raised £5.6 million (net of expenses)
- Initial efforts to reverse Group's fortunes have focused on reducing the Group's cost base and identifying parts of business capable of scalable growth

in 2003 (see Note 3). Total other operating expenses in 2004 were £11.0 million compared to £5.7 million in 2003.

Selling and distribution costs of £0.9 million were broadly in line with 2003 (£0.8 million). Research and development costs were reduced to £0.2 million in 2004 from £1.1 million in 2003 as a result of a shift in business focus. Administrative expenses, excluding exceptional items and amortisation of goodwill and development costs, were £5.6 million compared with £3.3 million in 2003 (see Note 3). Increased administrative expenditure in the year was primarily due to the cost of the Group's Nottingham facility following the sale and leaseback in February 2004, increased depreciation charges following the investment in LBC and laboratory equipment and IT systems during 2003 and 2004 and full year costs in relation to MSL Dubai and MSL London, both acquired during 2003. As part of the continuing consolidation of the Group's facilities, the Group agreed to surrender a property lease in Nottingham at a cost of £0.1 million.

We have conducted a thorough review of the carrying value of the Group's goodwill and development costs in the consolidated balance sheet. The net impact of this review has resulted in a total charge to the profit and loss account of £2.9 million for the year ended 31 December 2004 (2003: £Nil). This has been shown as an exceptional administrative cost (see Note 3). Other exceptional administrative costs for the year ended 31 December 2004 include redundancy costs of £0.2 million and costs related to an aborted acquisition of £0.2 million.

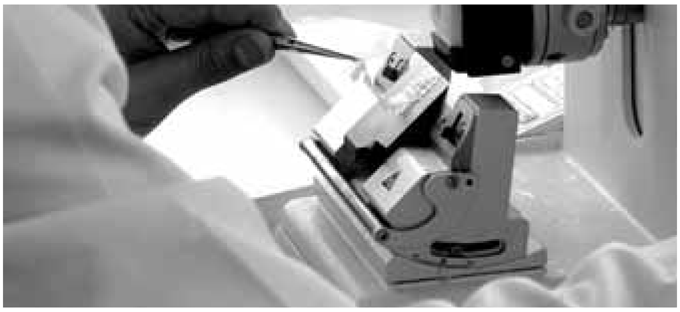
The Group generated a net profit of £0.6 million from the sale and leaseback of its main Nottingham facility and the cost of exiting alternative premises in Nottingham. During the year, the activities of Kinetic Limited and Kinetic Inc were sold, generating a loss of £0.5 million after taking account of transaction costs and goodwill written off.

After taking account of tax and interest charges, the loss for the financial year was £9.5 million compared to a loss of £0.1 million in 2003.

Group net assets fell from £18.1 million at 31 December 2003 to £11.6 million at 31 December 2004. As at 31 December 2004, the Group had a total of 116 employees (31 December 2003: 132).

Segmental Performance

Internally, the Group reports the performance of two primary business segments, Services and Technology. A significant proportion of the Group's costs in 2004 relate to shared activities and are shown as common costs.



Segmental Performance cont...

Services Division

Turnover within the Group's Services Division grew to £5.5 million in 2004 from £5.1 million in 2003, an increase of 8% mainly as a result of a full year's revenue from MSL Dubai and MSL London. As already noted, significant investments were made in human resources to meet anticipated demand which did not materialise at the level expected. Consequently, operating losses before exceptional costs, common costs and amortisation of goodwill and development costs were £0.8 million in 2004 (2003: operating profit of £0.9 million, see Note 2). After taking account of exceptional costs and amortisation of goodwill and development costs, but before common costs, the division generated an operating loss of £2.3 million compared to an operating profit of £0.6 million in 2003 (see Note 2).

Technology Division

Turnover fell from £2.2 million in 2003 to £1.1 million in 2004, a reduction of 52%. This was partly due to the sale, in June 2004, of the trade and assets of Kinetic Imaging Limited and Kinetic Imaging Inc, but also to disappointing sales from other parts of this business. The Technology business generated an operating loss before exceptional costs, common costs and amortisation of goodwill and development costs of £2.1 million in 2004 compared to an operating loss of £1.4 million in 2003. Before common costs, but after exceptional costs, amortisation of goodwill and development costs, operating losses were £5.4 million in 2004 compared to £1.6 million in 2003 (see Note 2).

Liquidity and Capital Resources

Net cash outflow from operating activities during the year ended 31 December 2004 was £2.8 million (2003: £2.1 million, see Note 8). The Group generated net proceeds of £4.6 million from the sale and leaseback of the Nottingham facility. Medical Solutions plc concluded an equity fundraising in July 2004, raising £3.0 million, of which £2.2 million was used to satisfy part of the acquisition consideration for Dubai Medical Laboratories and Specialised Clinical Laboratories and deferred consideration for the acquisition of the laboratory business of the Welcare hospital. The sale of Kinetic Imaging and Kinetic Inc raised £0.6 million. The Group invested £0.8 million in tangible fixed assets (see Note 9).

Post Balance Sheet Events

The Group's operational performance during 2004 placed a significant strain on its cash position during the latter part of the year. Through a successful Placing and Open Offer, completed in January 2005, the Group raised £5.6 million net of expenses. These proceeds have been and are being used to repay certain borrowings, pay outstanding creditors and fund ongoing losses within the Group.

In January 2005, the Group also completed the acquisition of an 80% shareholding in DML and a 100% shareholding in SCL for a total combined consideration of £2.8 million.

We continue to develop our strategy with a view to focusing on those parts of our business capable of achieving scalable growth.

Recent Progress

Having raised the funds necessary to secure the immediate future of the Group, we have set about the task of reversing the Group's fortunes. Initially, our efforts have focused on reducing the Group's cost base, particularly in the UK. The Board of Directors has taken a 10% reduction in salary/fees, we have made headcount reductions in our UK business and have consolidated our operations in Nottingham onto a single site.
We continue to develop our strategy and are reviewing the number of businesses the Group operates in with a view to focusing on those parts of our business capable of building value and of achieving scalable growth.

Dr Neil Johnston
Chief Financial Officer

Sir Gareth Gwyn Roberts (age 64)
Non-Executive Chairman

Sir Gareth was appointed Non-Executive Chairman in April 2000, having joined the Board as Non-Executive Director in August 1999. He has an international reputation for his research on semiconductors and molecular electronics and is the author of numerous publications and patents. He was elected a Fellow of the Royal Society in 1984 and, more recently, to the Fellowship of the Royal Academy of Engineering. He is President of the Science Council and chairs the Research Committee of the Higher Education Funding Council. He was elected President of Wolfson College, Oxford in January 2001 and serves on the Board of ISIS Ltd. He has also held two senior industrial posts, the first as Senior Research Scientist with Xerox Corporation in America and the second as Director of Research and Chief Scientist of Thorn EMI. He has also been a member of the Retained Organs Commission for the past three years.

Charles Alexander Green (age 51)
Chief Executive Officer

Mr Green has significant experience of corporate acquisitions. In 1993 he was involved in the acquisition of L. Gardener Group plc, which was subsequently floated on the London Stock Exchange in November 1995. He was also involved in the purchase of a controlling stake in the holding company of Sheffield United F.C. where he was Chief Executive until March 1998 and was involved in its flotation in January 1997. He was also involved in the flotation of Medical Solutions plc in 1999 and, subsequently, the flotation of Kingsbridge Holdings PLC and Proactive Sports Group plc.

Dr Neil Gerard Johnston (age 38)
Chief Financial Officer and Company Secretary

Dr Johnston joined the Board as Chief Financial Officer and Company Secretary in January 2005. Dr Johnston was previously Chief Financial Officer of Pharmagene plc. At Pharmagene he played a key role in its admission to the Official List of the UKLA and flotation on the main market of the London Stock Exchange in July 2000. Prior to this he worked at PricewaterhouseCoopers for nine years, the last five of which were spent in the Corporate Finance practice where he specialised in the biotechnology sector, gaining extensive experience in public listings, private placements, acquisitions and disposals. Dr Johnston holds a Ph.D in molecular biology from Liverpool University and is a Chartered Accountant.

Professor Karol Sikora (age 54)

Scientific Director

Professor Sikora studied medical science and biochemistry at Cambridge. He became Clinical Director for Cancer Services at Hammersmith in London where, during the following 12 years, he established a major cancer research laboratory. Following a period as Deputy Director (Clinical Research) of the Imperial Cancer Research Fund, he became Chief of the WHO Cancer Programme. From 1999 to 2001 he was Vice President, Global Clinical Research (Oncology) at Pharmacia Corporation. He is currently a consultant to AstraZeneca and Special Adviser to HCA Healthcare, where his role is to create and develop the largest UK cancer network outside the NHS. He is also Visiting Professor of Cancer Medicine and honorary Consultant Oncologist at Imperial College School of Medicine, Hammersmith Hospital, London.

Dr Susan Foden (age 51)

Senior independent Non-Executive Director
and Chairman of the Remuneration Committee

Dr Foden read biochemistry at the University of Oxford and subsequently obtained a D.Phil there in 1978. After a period in research at AERE Harwell (now AEA Technology), she joined the Academic Liaison Group at Celltech Limited and ran this function from 1984-1987. From Celltech, she went on to establish the technology transfer company of one of the UK's leading cancer research charities, the Cancer Research Campaign (now Cancer Research UK). The success of this company, Cancer Research Campaign Technology Limited ("CRCT"), led to the establishment of a second venture, Cancer Research Ventures ("CRV") in 1998 which carried out technology transfer for cancer research organisations worldwide. Dr Foden was Chief Executive of CRCT for 12 years, and in the last three of these was also Chief Executive of CRV. In September 2000, she joined the biosciences venture capital company Merlin Biosciences Limited as Director of Technology, subsequently becoming an Investment Director in 2001. In October 2003, she moved away from her management responsibilities at Merlin and became a Consultant Investment Director. She is a member of the Welcome Trust Technology Transfer Strategy Panel and of the Board of Trustees of the Institute of Cancer Research in London.

Robin Slinger (age 50)

Non-Executive Director and Chairman of the Audit Committee

Mr Slinger joined the Board as a Non-Executive Director in January 2005. Until June 2004, Mr Slinger was a Director of Corporate Banking at the Royal Bank of Scotland plc, leaving after 34 years to pursue other activities. Over the last ten years he had specific responsibilities for corporate clients active within the London, New York and Amsterdam exchanges, gaining broad experience in public listings, placements and general corporate activity in acquisitions and disposals. Mr Slinger is an Associate of The Chartered Institute of Bankers, and also a Non-Executive Director of Community Broking Group plc, which is an insurance company quoted on the Alternative Investment Market of the London Stock Exchange.

The Directors present their annual report on the affairs of the Group, together with the financial statements and auditors' report for the year ended 31 December 2004.

Principal Activities

Medical Solutions is a healthcare company specialising in pathology products and services. The business has two core divisions – Services and Technology. The Services Division delivers specialist pathology-based services, biomaterials resources and expertise to the pharmaceutical and biotechnology industry, as well as public and private healthcare providers based in the UK and Dubai. The Technology Division has a range of products which includes specialist software in virtual microscopy, telepathology, image analysis and tissue quantification. Medical Solutions also distributes the SurePath™ liquid based cytology system and consumables in the UK and Middle East for cervical cancer screening.

Second Opinion Solutions AS holds the intellectual property for PathSight, a Fairfield Imaging product.

Medical Solutions FZ LLC is the Group's main operation in Dubai and includes the pathology laboratory currently in the Welcare Hospital and the Histopathology & Speciality Laboratory.

Medical Solutions (London) Limited is a histopathology laboratory in Harley Street, London.

Results and Dividends

Turnover for the year amounted to £6.6 million (2003: £7.3 million). The operating loss before exceptional costs and amortisation of goodwill and development costs for the year ended 31 December 2004 was £4.8 million compared to £1.8 million in 2003 (see Note 2). The operating loss after exceptional costs and amortisation of goodwill and development costs for the year ended 31 December 2004 was £9.5 million compared to £2.2 million in 2003. The loss for the year before taxation amounted to £9.4 million compared to a loss of £2.3 million in 2003. The Directors do not propose the payment of a dividend (2003: £Nil).

A review of operations and future prospects is contained in the Chairman's Statement, Chief Executive Officer's Review of Operations and the Chief Financial Officer's Report.

Research and Development

In order to further its business objectives, the Group engaged in certain research and development projects. These projects were primarily focused on the development of software products designed for both internal use and use by third parties. During the year, a total of £0.1 million (2003: £1.1 million) was charged to the profit and loss account in respect of such projects.

Post Balance Sheet Events

Placing and Open Offer

On 22 December 2004, the Group announced that it intended to raise approximately £6.4 million before expenses through a Placing and Open Offer. At an Extraordinary General Meeting of the Company held on 14 January 2005, all resolutions necessary to approve the Placing and Open Offer together with certain other matters were duly passed and dealings in the new shares issued commenced on 19 January 2005. As a result of the Placing and Open Offer, the Group raised net proceeds of approximately £5.6 million.

Acquisition of Subsidiary Undertakings

On 14 January 2005, the Group completed the acquisitions of an 80% shareholding in Dubai Medical Laboratories ("DML") and a 100% holding in Specialised Clinical Laboratories ("SCL") for a total combined consideration of approximately £2.8 million. Details of these acquisitions are given in Note 29 to the financial statements.

Directors and their Interests

The Directors of the Company during the year ended 31 December 2004 are listed below:

Sir Gareth G Roberts	(Non-Executive Chairman)
Mr C A Green	(Chief Executive Officer)
Mr A D Longstaffe	(Finance Director and Company Secretary, resigned 14 January 2005)
Prof I O Ellis	(Medical Director, resigned 21 December 2004)
Prof K Sikora	(Scientific Director)
Dr S Foden	(Senior Independent Non-Executive Director)

Dr N G Johnston and Mr R Slinger, both of whom were appointed on 14 January 2005, will offer themselves for re-appointment in accordance with the Company's Articles of Association and provision A.7.1 of the Combined Code which recommends the election of Directors by shareholders at the first Annual General Meeting after their appointment. Biographical details of the Directors are given on pages 12 to 13. Sir Gareth G Roberts and Prof K Sikora retire by rotation and being eligible will offer themselves for re-election at the next Annual General Meeting. Other than as disclosed in Note 30 to the accounts, no contract existed during the year or at the year end in which any Director of the Company was interested, other than service contracts.

None of the Directors have a service contract with the Company requiring more than 12 months' notice of termination to be given. The details of the Directors' contracts are given in the Directors' Remuneration Report.

The interests (including the interests of their immediate families and persons connected with the Directors) of the Directors who held office during the year (or have been appointed since 1 January 2005) in the ordinary shares of the Company at 30 April 2005, 31 December 2004 and at 1 January 2004 or the date of appointment were:

	Beneficial holding		
	30 April 2005 Number of shares	**31 December 2004 Number of shares**	January 2004 or date of appointment Number of shares
Sir Gareth G Roberts	**431,723**	**210,223**	210,223
Mr C A Green	**637,722**	**342,422**	288,422
Mr A D Longstaffe (resigned 14 January 2005)	**858,538**	**755,238**	755,238
Prof I O Ellis (resigned 21 December 2004)	**208,766**	**61,166**	61,166
Prof K Sikora	**624,600**	**255,500**	215,000
Dr S Foden	**110,700**	**—**	—
Dr N G Johnston	**110,700**	**—**	—
Mr R Slinger	**25,000**	**—**	—

Substantial Shareholders

On 30 April 2005 the Company had been notified, in accordance with sections 198 to 208 of the Companies Act 1985, of the following interests of 3% or more in the Company's ordinary share capital:

	Number	Percentage of ordinary share capital
Aberforth Partners Ltd	29,600,000	14.7%
Mr S Varkey	13,177,189	6.6%
FMR Corp and Fidelity International Limited	11,877,189	5.9%

Employees and Disabled Persons

The Group places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees. Participation of employees towards the growth of the Group is encouraged through regular meetings between management and all staff who are invited to discuss progress, plans, performance or any issues affecting them or the Group. The Group also operates a Management Forum through which issues can be raised and addressed.

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. In the event of members of staff becoming disabled every effort is made to ensure that their employment with the Group continues and that appropriate training is arranged. It is the policy of the Group that the training, career development and promotion of disabled persons should be, as far as possible, identical with that of other employees.

Charitable and Political Donations

The Group made no charitable or political donations during the year (2003: £Nil).

Supplier Payment Policy

The Group is committed to obtaining the best terms for all types of business. Consequently, there is no single policy as to the terms used. During the year, the Group encountered certain financial difficulties and was unavoidably forced to seek the agreement of many suppliers to delay payment. The number of days purchases represented by Group trade creditors at 31 December 2004 was 137 days (2003: 78 days).

Impact of IFRS

The Group is in the process of adopting International Financial Reporting Standards as the basis of its financial statements for the year ending 31 December 2005 and for its interim results for the six months ending 30 June 2005. The Group expects to disclose the impact of any significant adjustments to its balance sheets as at 31 December 2003 and 2004 and on the reported loss for the year ended 31 December 2004 within its 2005 interim results and its financial statements for the year ending 31 December 2005.

Auditors

The auditors, Deloitte & Touche LLP, have indicated their willingness to continue in office and a resolution that they be re-appointed will be proposed at the forthcoming Annual General Meeting.

By order of the Board

Dr N G Johnston
Company Secretary
1 Orchard Place
Nottingham Business Park
Nottingham NG8 6PX
24 May 2005

The Combined Code – Statement of Compliance

The Directors have set out below how the principles of the July 2003 FRC Combined Code on Corporate Governance have been applied and the extent to which the Group has complied with the best practice provisions as set out in the Combined Code on Corporate Governance.

The Group is committed to high standards of corporate governance and the Board believes that the Group has been in compliance with Section 1 of the July 2003 FRC Combined Code on Corporate Governance with the exception of the following:

- the Group did not formalise written evidence of the roles of the Chairman and Chief Executive until April 2005 (A.2.1);
- the Group did not formalise written terms of reference for its Audit and Remuneration Committees until February 2005 (B.2.1; C.3.2; C.3.3);
- prior to the appointment of Mr R Slinger in January 2005, the Company did not have two independent, Non-Executive Directors (A.3.2). As a result, neither the Audit Committee nor the Remuneration Committee included at least two independent, Non-Executive Directors (C.3.1; B.2.1) during the period. Professor Roberts was Chairman of both the Audit and Remuneration Committees until February 2005;
- the Group does not have a Nomination Committee as senior appointments are currently considered by the Board as a whole (A.4.1–A.4.3). The Board expects to consider the requirement for a Nomination Committee on an annual basis;
- Dr S Foden was appointed the Senior Independent Director in early 2005 (A.3.3; D.1.1);
- Non-executive letters of appointment do not currently specify fixed terms (A.7.2); the Board expects to address the issue during 2005 but remains confident of the effectiveness and commitment of each of its Non-Executive Directors;
- the performance of the Board, its Committees and individual Directors including the Chairman were not formally evaluated during 2004 (A.6.1; A.7.2). Such evaluations will be carried out during 2005; and
- staff of the Company may, in confidence, raise concerns about financial reporting or other matters through the Company's grievance procedures (C.3.4). The Audit Committee expects to review such arrangements again during 2005.

The Board of Directors

The Board of Directors currently consists of three Executive Directors and three Non-Executive Directors. Biographical details of the Board of Directors are set out on pages 12 and 13. The roles of Chairman and Chief Executive are separate and written evidence of this was formalised in April 2005. Sir Gareth G Roberts is Chairman of the Board. His other significant commitments include being President of the Science Council and Wolfson College, Oxford. Professor Roberts also chairs the Research Committee of the Higher Education Funding Council. C A Green is the Chief Executive Officer and Dr S Foden is the Senior Independent Non-Executive Director. Dr N G Johnston and Mr R Slinger were appointed to the Board on 14 January 2005. Mr Slinger was appointed in order to complement the existing skills and expertise amongst the Non-Executive Directors. Manntex Limited, a company in which Mr Slinger is an employee, provided advice on the renewal of the Company's banking facilities during 2004. His financial expertise and experience was in line with that which the Board had been seeking and as a result Mr Slinger was appointed without open advertising or the use of an external search consultancy. Between them, the Directors have a considerable breadth of experience and a range of complementary skills. Each brings an independent judgement to bear on matters of strategy, performance, resources and standards of conduct. Appropriate training is made available to assist the Directors in the discharge of their duties and each has access to the advice and services of the Company Secretary. All Directors have access to independent professional advice, at the expense of the Company, where they judge it necessary to discharge their responsibilities as Directors. Each Director receives a full, tailored induction on joining the Board.

Board papers contain sufficient information to enable the Directors to form a balanced overview of all significant matters to be considered. Such papers are prepared and distributed in advance of the meetings at which these matters are to be discussed.

During 2004, the Board met 28 times. Professor Roberts, Dr Foden and Mr Longstaffe attended on 27 occasions, Professor Sikora on 25 occasions, Mr Green on 23 occasions and Professor Ellis on 21 occasions. The Board is responsible for providing entrepreneurial leadership with a framework of controls for managing risk and considers key issues relating to the performance, prospects and business opportunities of the Group as well as matters specifically reserved for Board consideration. These include Group strategy, consideration of all significant business transactions (including acquisitions, disposals and fundraisings), major capital expenditure programmes, approval of Group budgets and the approval of annual and interim financial statements. Certain Board responsibilities may be delegated to Committees of the Board.

The Board of Directors cont...

The performance of the Board, its Committees and individual Directors including the Chairman were not formally evaluated during 2004. It is currently reviewing various approaches to this issue and expects to carry out comprehensive evaluations during 2005. The Non-Executive Directors including the Chairman meet from time to time in the absence of Executive Directors to consider the operations of the Company and the running of the Board.

Following the appointment of two new Directors in January 2005, the Board has reorganised its Committees and introduced the terms of reference for both the Audit and Remuneration Committees. Details of the membership of each of these Committees are set out below. The Group does not currently have a Nomination Committee as all senior appointments are considered by the Board as a whole as part of a process led by the Chairman or the Senior Independent Director. The Board believes that these procedures are formal, rigorous and transparent. The Board expects to consider the requirement for a Nomination Committee each year.

Committees of the Board

The Terms of Reference of the Remuneration and Audit Committees and the Terms and Conditions for each Non-Executive Director appointment are made available upon request.

Remuneration Committee

During 2004, the Remuneration Committee met three times and was chaired by Sir Gareth G Roberts and also included Dr S Foden. Each member of the Committee was present on each occasion. In February 2005, Dr Foden became Chairman of the Remuneration Committee, and Mr Slinger was appointed to the Committee. In line with the July 2003 FRC Combined Code on Corporate Governance, Sir Gareth Roberts stepped down from the Committee but continues to attend such meetings by invitation. The key functions of the Remuneration Committee and its policy on remuneration are described on pages 20 to 23.

Audit Committee

During 2004, the Audit Committee met twice and was also chaired by Sir Gareth G Roberts and included Mr C A Green, Chief Executive Officer, and Dr Foden. Each of the Committee's members was present at each meeting. In February 2005, Mr Slinger was appointed as Chairman of the Audit Committee and Sir Gareth Roberts and Mr Green stepped down in line with the July 2003 FRC Combined Code on Corporate Governance. Dr Foden remained on the Committee. Sir Gareth Roberts and certain Executive Directors may attend meetings of the Audit Committee by invitation.

At least once a year the Audit Committee meets with the auditors with no Executive Directors present.

The Audit Committee meets at least twice a year to review the scope and results of the audit and the Group's accounting policies and financial reporting. The Audit Committee also provides a forum through which the auditors may report to the Board. The Group's auditors, Deloitte & Touche LLP have provided non-audit services during the year, principally in respect of taxation and in connection with the Placing and Open Offer and an aborted acquisition. The Audit Committee has taken steps to ensure the independence of the Group's auditors. Prior to commissioning non-audit services from Deloitte & Touche LLP, the Audit Committee considers whether such an appointment may impact upon their objectivity and independence as auditors. If appropriate, the Board may also seek proposals from other professional firms for such work.

The Audit Committee and the Board have considered the need for an internal audit function and concluded that such a function is not required, given the current size and complexity of the Group's operations.

Executive Committee

Operational decision making is delegated to the Executive Committee which comprises the Executive Directors together with the heads of each of the Group's divisions. The Executive Committee meets every two weeks to discuss the performance of the Group's business units and other issues as they arise in the course of the Group's activities.

Nomination Committee

Given the small size of the Group, the Directors consider it unnecessary to create a specific Nomination Committee. All Directors are involved in the appointment of new Directors.

Independence

The Board of Medical Solutions plc considers that each of its current Non-Executive Directors (excluding the Chairman) are independent for the purposes of the Combined Code. Notwithstanding the advice provided to the Board by Manntex Limited (of whom Mr Slinger is an employee) during 2004, the Board believes that Mr Slinger remains independent in character and judgement and, along with Dr S Foden continues to make a significant and challenging contribution to the Company. On this basis the Board does not believe Mr Slinger's independence or objectivity is compromised.

Dialogue with Key Shareholders

The Directors seek to build on a mutual understanding of objectives between the Group and its key shareholders, in particular by communicating regularly throughout the year (by holding regular meetings) and encouraging them to participate in the Annual General Meeting.

Feedback is provided by the Executive Directors following meetings with key shareholders. Each Non-Executive Director is available to meet with shareholders should this be desired.

Internal Control

In applying Principle C.2 of the Combined Code that the Board should maintain a sound system of internal control to safeguard shareholders' investment and the Company's assets, the Directors recognise that they have overall responsibility for ensuring that the Group maintains a system of internal control to provide them with reasonable assurance regarding effective and efficient operations, internal financial control and compliance with laws and regulations. The system of internal control is designed to manage rather than eliminate the risk of failure to observe business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss.

The following sets out the ongoing process for identifying, evaluating and managing significant risks found by the Company. This process has been in place for the year under review and up until the date of approving these statements and is reviewed regularly by the Board.

The Board meets regularly to review all aspects of the Group's performance, concentrating mainly on financial performance, business risks and development. A number of matters are reserved for the Board's specific approval as set out above.

There is a clearly defined organisational structure. The Group operates a comprehensive annual planning and budgeting process. Individual objectives are set out at the start of each year and cascaded throughout the organisation. The performance of each part of the business is reviewed by the Executive Committee and the Board. Corrective actions are taken where performance does not meet internal expectations.

The internal control system is continuously evaluated, regularly reviewed by the Board and accords with the Turnbull guidance.

The Board's monitoring covers all controls, including financial, operational and compliance controls and risk management. It is based principally on reviewing reports from management to consider whether significant risks are identified, evaluated, managed and controlled and whether any significant weaknesses are promptly remedied and indicate a need for more extensive monitoring. During the year the Directors have undertaken a review of the effectiveness of the Group's system of internal controls.

Going Concern

In accordance with the guidance for Directors of listed companies "Going Concern and Financial Reporting", and after making appropriate enquiries, the Directors have concluded, at the time of approving the financial statements, that it is appropriate to continue to adopt the going concern basis in preparing these financial statements. This is based on the Directors' opinion that the Group has adequate financial resources to continue in operational existence for the foreseeable future.

Approved by the Board of Directors and signed on behalf of the Board

Gareth Roberts

Sir Gareth G Roberts
Non-Executive Chairman
24 May 2005

Introduction
The Directors’ Remuneration Report Regulations require the Company’s auditors to report to the Company’s members on the “auditable part” of the Directors’ Remuneration Report and to state whether in their opinion that part of the report has been properly prepared in accordance with the Companies Act 1985 (as amended by the Regulations). The report has therefore been divided into separate sections for audited and unaudited information.

Unaudited Information
Remuneration Committee
During 2004, the Remuneration Committee was chaired by Sir Gareth G Roberts and also included Dr S Foden. In February 2005, Dr Foden became Chairman of the Remuneration Committee and Mr R Slinger was appointed to the Committee. In line with the new Combined Code, Sir Gareth Roberts stepped down from the Committee but continues to attend such meetings by invitation. None of the Committee has any personal financial interest (other than as shareholders), conflicts of interests arising from cross-directorships or day-to-day involvement in running the business. The Remuneration Committee is responsible for setting Group policy on remuneration for Executive Directors and other members of senior management in the UK and Dubai whose total remuneration package exceeds £60,000 per annum. Fees paid to Non-Executive Directors are determined by the Board as a whole. No Director is involved in discussions about his or her own remuneration. In determining the Directors’ remuneration for the year, the Committee consulted Mr C A Green about its proposals, except those concerning his own remuneration. The Remuneration Committee seeks to give full consideration to the Combined Code including the provisions set out in Schedule A to the Code.

Remuneration Policy
Executive remuneration packages are prudently designed to attract, motivate and retain Directors of the high calibre needed to improve the Group’s position and to reward them for enhancing value to shareholders. There are four main elements of the remuneration package for Executive Directors and senior management:

- basic annual salary;
- annual discretionary bonus payments;
- other customary benefits such as pension contributions, private health insurance, life assurance and, in certain situations, company car benefits; and
- long-term incentive arrangements in the form of share options.

The Company’s policy is that a substantial proportion of the remuneration of the Executive Directors should be performance related. Executive Directors may earn annual incentive payments at the discretion of the Remuneration Committee together with the benefits of participation in share option schemes.

Executive Directors are entitled to accept appointments outside the Company providing that the Chairman’s permission is sought.

Basic Salary
An Executive Director’s basic salary is determined by the Committee at the beginning of each year and when an individual changes position or responsibility. In deciding appropriate levels, the Committee considers performance and aims to ensure that remuneration remains competitive with similar companies in terms of size and complexity.

Annual Bonus Payments
Each Executive Director is eligible for a discretionary annual bonus in recognition of their personal and collective contribution to the success of the Group and the achievement of specified performance targets. As a matter of current policy, the maximum cash bonus for Executive Directors is 50% of basic salary. In addition, the Company operates a matching bonus scheme whereby cash bonuses invested in the Company’s shares are matched by the issue of the Company’s shares to the Director.

Share Options
Share options are granted to Executive Directors and senior employees (and other staff) to encourage them to identify with shareholder interests. Share options are granted and exercised under the rules of the Inland Revenue approved executive share option scheme and the unapproved executive share option scheme.

The Company’s policy is to grant options at the discretion of the Committee taking into account individual performance up to a maximum of four times salary over a three year period. It is the Company’s policy to phase the granting of share options rather than to award them in a single large block to any individual, except where specific circumstances exist.

Remuneration Policy cont...

Share Options cont...

The exercise of options granted may be subject to performance conditions, at the discretion of the Remuneration Committee. Historic and recent share option grants have been made in order to motivate staff and as such there are no performance criteria applicable to grants made to date. The Remuneration Committee expects to review the issue at the time of any future share option grants and is mindful of ABI guidelines in this area.

The exercise price of the options granted under the above schemes is equal to the closing mid-market value of the Company's ordinary shares on the day prior to grant and vest with the individual after three years.

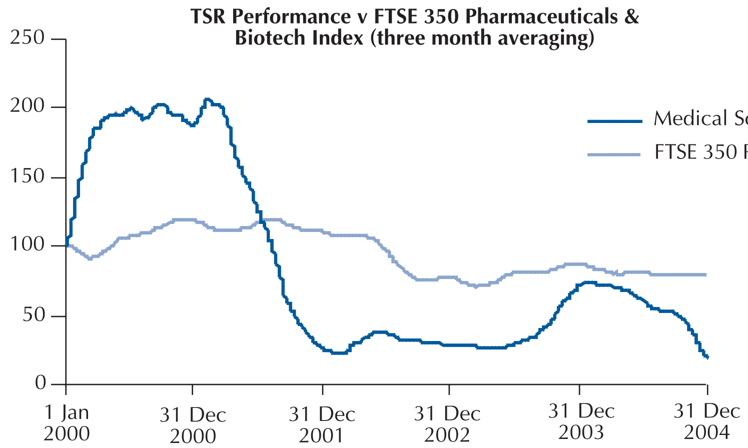
The Company also operates an Inland Revenue approved savings related scheme which is open to all employees and full-time Directors of the Company and its subsidiaries and who are UK income tax resident and ordinary resident.

Pension and Other Benefits

Executive Directors along with all employees are eligible to be members of the Company's defined contribution pension scheme. The Group contributes a sum equal to a fixed percentage of basic salary, currently between 3% and 12%. Members' dependents are eligible for dependents' pensions and the payment of a lump sum in the event of death in service. Members of the pension fund are also covered by Permanent Health Insurance, providing 50% of salary after six months' absence from work due to a permanent disability. The Group funds the provision of private medical insurance cover for Executive Directors and their immediate families and life assurance cover. Certain Executive Directors are provided with a company car or car allowance and are provided with a mobile phone for business and personal use.

Performance Graph

The following graph shows the Company's performance, measured by total shareholder return, compared with the performance of the FTSE 350 Pharmaceuticals and Biotech Index also measured by total shareholder return. The Directors are of the opinion that the FTSE 350 Pharmaceuticals and Biotech Index provides the most appropriate comparative, based on the Group's operations.



Directors' Contracts

It is the Company's policy that Executive Directors should have contracts with an indefinite term providing for a maximum of one year's notice.

All Non-Executive Directors have specific terms of engagement and their remuneration is determined by the Board within the limits set by the Articles of Association and based on independent surveys of fees paid to Non-Executive Directors of similar companies. Non-Executive Directors cannot now participate in any of the Company's share option schemes and are not eligible to join the Company's pension scheme.

Directors' Contracts cont...

The details of the service contracts or letters of appointment for all Directors who served during the year are shown in the table below:

	Date of contract/ letter of appointment	Notice period
Sir Gareth G Roberts	27 July 1999	6 months rolling
Dr S Foden	2 December 2004	6 months rolling
Mr C A Green	1 April 2005	12 months rolling
Prof I O Ellis (resigned 21 December 2004)	28 June 2001	12 months rolling
Prof K Sikora	1 September 2003	12 months rolling
Mr A D Longstaffe (resigned 14 January 2005)	28 March 1997	12 months rolling

Audited Information

Directors' Emoluments and Compensation

	Fees/basic salary £'000	Bonus £'000	Taxable benefits in kind £'000	**Total 2004 £'000**	Total 2003 £'000	**Pension 2004 £'000**	Pension 2003 £'000
Executive Directors							
Mr C A Green	185	25	—	**210**	147	**—**	—
Mr A D Longstaffe (resigned 14 January 2005)	103	—	9	**112**	115	**6**	5
Prof I O Ellis (resigned 21 December 2004)	120	—	—	**120**	124	**1**	1
Prof K Sikora	80	—	—	**80**	42	**—**	—
Non-Executive Directors							
Sir Gareth G Roberts	55	—	17	**72**	58	**—**	—
Dr S Foden	30	—	—	**30**	7	**—**	—
				624	493	**7**	6
Money purchase pension contributions				**7**	6		
Aggregate remuneration				**631**	499		

Of the amounts disclosed above, £210,000 (2003: £147,500) was paid to a third party, HFG Limited, on behalf of Mr C A Green. Subsequent to the production of the Group accounts for the year ended 31 December 2003, the Remuneration Committee approved the payment of a bonus of £25,000 to Mr Green in respect of his contribution to the Group's performance for that year.

Subsequent to the year end, Mr A D Longstaffe resigned from the Group and consequently his contract was terminated. Mr Longstaffe was paid £117,000 in respect of his contractual notice period and his company car and computer were transferred to him at nil cost. Prof I O Ellis stepped down from the Board in December, but he remained as part time Medical Director.

Audited Information cont...

Directors' Emoluments and Compensation cont...

The Directors who held office during the year hold options under the Company's share option schemes as follows:

Notes	Director	1 January 2004	Granted	Lapsed	**31 December 2004**	Option price	First exercisable date	Last exercisable date
1	Mr C A Green	416,667	—	—	**416,667**	48p	28 Sept 2002	28 Sept 2009
1	Prof I O Ellis	2,535,824	—	—	**2,535,824**	22p	13 Jan 2006	13 Jan 2013
2	Sir Gareth G Roberts	706,000	—	—	**706,000**	22p	13 Jan 2006	13 Jan 2013
2	Mr A D Longstaffe	250,000	—	—	**250,000**	22p	13 Jan 2006	13 Jan 2013
2	Prof I O Ellis	373,267	—	—	**373,267**	22p	13 Jan 2006	13 Jan 2013
2	Mr C A Green	500,000	—	—	**500,000**	32.5p	22 Sept 2006	22 Sept 2013
2	Prof K Sikora	250,000	—	—	**250,000**	32.5p	22 Sept 2006	22 Sept 2013
2	Mr A D Longstaffe	150,000	—	—	**150,000**	32.5p	22 Sept 2006	22 Sept 2013
3	Prof K Sikora	—	52,189	—	**52,189**	34.25p	16 Oct 2011	16 Apr 2012

Note 1: granted under the unapproved share option scheme.
Note 2: granted under the 2001 approved share option scheme.
Note 3: granted under the Inland Revenue approved savings related scheme.

No Directors exercised share options during the year. Subsequent to the year end, Dr N G Johnston was granted 4,000,000 share options under the Group unapproved share option scheme at an exercise price of 6.75p. Each Executive Director was granted a further 25,000 share options at 6.25p on 3 May 2005.

There have been no variations to the terms and conditions or performance criteria for share options during the financial year. As described in this Remuneration Report there are no performance criteria attached to the options granted to date.

The market price of the Company's ordinary shares at 31 December 2004 was 7.25p and the range during the year was 53.71p to 5.44p.

On behalf of the Board

Dr S Foden
Chairman of Remuneration Committee
24 May 2005

Statement of Directors' Responsibilities

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements.

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

To the Members of Medical Solutions plc

We have audited the financial statements of Medical Solutions plc for the year ended 31 December 2004 which comprise the consolidated profit and loss account, the balance sheets, the consolidated cash flow statement, the statement of total recognised gains and losses and the related notes numbered 1 to 30. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the part of the Directors' Remuneration Report that is described as having been audited.

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

Respective Responsibilities of Directors and Auditors

As described in the statement of Directors' responsibilities, the Company's Directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. They are also responsible for the preparation of the other information contained in the annual report including the Directors' Remuneration Report. Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report described as having been audited in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

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

We review whether the corporate governance statement reflects the Company's compliance with the nine provisions of the July 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the Directors' Report and the other information contained in the annual report for the above year as described in the contents section including the unaudited part of the Directors' Remuneration Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of Audit Opinion

We conducted our audit in accordance with United Kingdom auditing standards 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 and the part of the Directors' Remuneration Report described as having been audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, 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 and the part of the Directors' Remuneration Report described as having been audited 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 and the part of the Directors' Remuneration Report described as having been audited.

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2004 and of the loss of the Group for the year then ended; and
- the financial statements and part of the Directors' Remuneration Report described as having been audited have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
Nottingham
24 May 2005

Consolidated Profit and Loss Account

For the year ended 31 December 2004

	Notes	2004 £'000	2003 £'000
Turnover			
Continuing operations	2	**6,026**	6,197
Discontinued operations	2	**560**	1,103
	2	**6,586**	7,300
Cost of sales			
– Normal	3	**(4,721)**	(3,870)
– Exceptional	3	**(412)**	—
		(5,133)	(3,870)
Gross profit		**1,453**	3,430
Other operating expenses			
Selling and distribution costs	3	**(923)**	(832)
Research and development costs	3	**(148)**	(1,070)
Administrative expenses			
– Normal (including amortisation of goodwill and development costs of £940,000, 2003: £435,000)	3	**(6,526)**	(3,761)
– Exceptional (including impairment of goodwill and development costs of £2,938,000, 2003: £Nil)	3	**(3,359)**	—
Total administrative expenses	3	**(9,885)**	(3,761)
Total other operating expenses	3	**(10,956)**	(5,663)
Operating loss			
Continuing operations	2	**(9,336)**	(1,803)
Discontinued operations	2	**(167)**	(430)
		(9,503)	(2,233)
Profit/(loss) on disposal of fixed assets – continuing operations	4	**607**	—
Loss on disposal of discontinued operations	5	**(469)**	(91)
Loss on ordinary activities before finance charges		**(9,365)**	(2,324)
Finance charges (net)		**(20)**	63
Loss on ordinary activities before taxation		**(9,385)**	(2,261)
Tax on loss on ordinary activities		**(90)**	2,126
Loss for the financial year		**(9,475)**	(135)
Loss per ordinary share – basic and diluted	11	**(10.2)p**	(0.16)p

The accompanying notes are an integral part of this consolidated profit and loss account.

Consolidated Statement of Total Recognised Gains and Losses

For the year ended 31 December 2004

	2004 £'000	2003 £'000
Loss for the financial year	**(9,475)**	(135)
Currency translation difference on foreign currency net investments	**(54)**	(136)
Total losses recognised since the last report and financial statements	**(9,529)**	(271)

At 31 December 2004

	Notes	Group 2004 £'000	Group 2003 £'000	Company 2004 £'000	Company 2003 £'000
Fixed assets					
Development costs and know-how	12	**339**	1,698	**—**	—
Goodwill	13	**11,005**	13,934	**—**	—
Intangible assets		**11,344**	15,632	**—**	—
Tangible assets	14	**2,679**	6,594	**760**	4,220
Investments	15	**—**	2	**22,929**	23,073
		14,023	22,228	**23,689**	27,293
Current assets					
Stocks	16	**878**	1,461	**—**	—
Debtors (including £2.2 million prepaid consideration for acquisitions completed in 2005)	17, 29	**4,348**	2,783	**2,490**	7,298
Cash at bank and in hand		**1,990**	3,250	**1,888**	3,007
		7,216	7,494	**4,378**	10,305
Creditors: Amounts falling due within one year	18	**(8,086)**	(5,565)	**(18,003)**	(14,676)
Net current (liabilities)/assets		**(870)**	1,929	**(13,625)**	(4,371)
Total assets less current liabilities		**13,153**	24,157	**10,064**	22,922
Creditors: Amounts falling due after more than one year	19	**(1,540)**	(6,045)	**(1,000)**	(5,271)
Net assets		**11,613**	18,112	**9,064**	17,651
Capital and reserves					
Called-up share capital	21, 22	**1,960**	1,788	**1,960**	1,788
Share premium account	22	**27,912**	25,059	**27,912**	25,059
Shares in Employee Benefit Trust	22	**—**	(45)	**—**	(45)
Merger reserve	22	**3,467**	3,467	**3,467**	3,467
Capital redemption reserve	22	**5**	—	**5**	—
Other reserve	22	**1,136**	1,136	**1,136**	1,136
Translation reserve	22	**(190)**	(136)	**—**	—
Profit and loss account	22	**(22,677)**	(13,157)	**(25,416)**	(13,754)
Equity shareholders' funds		**11,613**	18,112	**9,064**	17,651

The accompanying notes are an integral part of these balance sheets.

The financial statements were approved by the Board of Directors on 24 May 2005 and signed on its behalf by:

C A Green
Chief Executive Officer
24 May 2005

Consolidated Cash Flow Statement

For the year ended 31 December 2004

	Notes	2004 £'000	2003 £'000
Net outflow from operating activities	23	**(2,836)**	(2,057)
Returns on investments and servicing of finance	24	**(20)**	63
Taxation	24	**(61)**	—
Capital expenditure and financial investment	24	**3,563**	(6,074)
Acquisitions and disposals	24	**(1,675)**	(7,263)
Cash outflow before management of liquid resources and financing		**(1,029)**	(15,331)
Financing	24	**832**	2,068
Decrease in cash in the year		**(197)**	(13,263)

The accompanying notes are an integral part of this consolidated cash flow statement.

1 Statement of Accounting Policies

The principal accounting policies are summarised below. They have all been applied consistently throughout the year and the preceding year.

a) Accounting Convention

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

b) Basis of Consolidation

The consolidated financial statements include the Company and all its subsidiary undertakings drawn up to 31 December each year. The results of subsidiaries and business undertakings acquired or sold are included in the consolidated profit and loss account for the periods from or to the date on which the transaction became unconditional. Acquisitions are accounted for under the acquisition method and intra-group transactions, profits and balances are eliminated in full on consolidation.

c) Intangible Assets – Goodwill

Goodwill arising on the acquisition of subsidiary undertakings and businesses, representing any excess of the fair value of the consideration paid over the fair value of the identifiable assets and liabilities acquired, is capitalised and written off on a straight-line basis over its useful economic life, usually 20 years. Provision is made for any permanent impairment in the carrying value of goodwill as assessed by the Directors.

d) Intangible Assets – Development Costs

Development costs are written off, except where the Directors are satisfied as to the technical, commercial and financial viability of individual projects. In such cases, the identifiable expenditure is deferred and amortised from the point of sale of the product over the period during which the Group is expected to benefit. This is estimated to be four years for current projects. Development costs on projects in progress are not amortised. Provision is made for any impairment in the carrying value of such development costs.

e) Tangible Assets

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. Depreciation is provided on all tangible fixed assets, other than freehold land, at rates calculated to write off the cost, less estimated residual value, of each asset evenly over its expected useful life as follows:

Leasehold improvements	– lower of 10 years and remaining lease term
Plant and machinery	– 5 – 15 years
Fixtures, fittings and computer software	– 3 – 10 years
Motor vehicles	– 4 years

f) Government Grants

Government grants of a revenue nature are credited to the profit and loss account in the same period as the related expenditure. Government grants of a capital nature are released to the profit and loss account by equal annual instalments over the expected useful lives of the relevant assets.

g) Leasing and Hire Purchase Commitments

Assets obtained under finance leases and hire purchase contracts that transfer substantially all the risks and rewards of ownership to the Group are capitalised in the balance sheet and depreciated over the shorter of the lease term and their useful lives. The interest element of the rental obligation is charged to the profit and loss account over the period of the lease and represents a constant proportion of the balance of capital repayments outstanding.

Costs in respect of operating leases are charged to the profit and loss account on a straight-line basis over the period of the lease.

h) Stocks and Work in Progress

Stocks and work in progress are stated at the lower of cost and net realisable value. Cost is determined on a first-in first-out basis and includes transport and handling costs. In the case of manufactured products, cost includes all direct expenditure and production overheads based on the normal level of activity. Net realisable value is the price at which stock can be sold in the normal course of business after allowing for the cost of realisation and, where appropriate, the cost of conversion from their existing state to a finished condition. The Group capitalises certain external costs related to processed human tissue. Such costs are averaged over the number of samples acquired and written off to the profit and loss account as the samples are utilised within the business or after a period of three years from acquisition if not used during that period. Provision is made where necessary for obsolete, slow-moving and defective stock.

1 Statement of Accounting Policies cont...

i) Taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the Company's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

j) Turnover

Turnover (excluding VAT) comprises the value of sales of contract pathology services, processed human tissue, the sale of telepathology hardware systems and associated software, support services and the sales of liquid based cytology systems and consumables. Amounts received or receivable for services provided under contract pathology services are recognised as revenue when obligations are fulfilled. Revenue from sales of processed human tissue, liquid based cytology systems and consumables and telepathology hardware systems is recognised when goods are delivered and revenue for post contract support is recognised on a straight-line basis over the period for which support and maintenance is provided to the customer.

k) Foreign Currency

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange ruling at the balance sheet date. All differences are taken to the profit and loss account.

The results of overseas operations are translated at the closing rate of exchange at the end of the period and their balance sheets at the rate ruling at the balance sheet date. Exchange differences arising on the translation of opening net assets and the results of overseas operations are reported in the statement of total recognised gains and losses. All other exchange differences are included in the profit and loss account.

l) Investments

Fixed asset investments are shown at cost less provision for impairment.

m) Pensions

The Group operates defined contribution pension schemes for the benefit of the Directors and employees of the Group. The assets of the schemes are administered by trustees in funds independent from those of the Group.

The amount charged to the profit and loss account in respect of pension costs and other post-retirement benefits is the contribution payable in the year. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

2 Turnover and Segmental Analysis

	Continuing operations		Discontinued operations		Total	
	2004 £'000	2003 £'000	**2004 £'000**	2003 £'000	**2004 £'000**	2003 £'000
Turnover	**6,026**	6,197	**560**	1,103	**6,586**	7,300
Cost of sales						
– normal	**(4,298)**	(3,358)	**(423)**	(512)	**(4,721)**	(3,870)
– exceptional	**(412)**	—	**—**	—	**(412)**	—
	(4,710)	(3,358)	**(423)**	(512)	**(5,133)**	(3,870)
Gross profit	**1,316**	2,839	**137**	591	**1,453**	3,430
Other operating expenses						
Selling and distribution costs	**(866)**	(593)	**(57)**	(239)	**(923)**	(832)
Research and development costs	**(103)**	(830)	**(45)**	(240)	**(148)**	(1,070)
Administrative expenses						
– normal	**(6,324)**	(3,219)	**(202)**	(542)	**(6,526)**	(3,761)
– exceptional	**(3,359)**	—	**—**	—	**(3,359)**	—
Total administrative expenses	**(9,683)**	(3,219)	**(202)**	(542)	**(9,885)**	(3,761)
Total other operating expenses	**(10,652)**	(4,642)	**(304)**	(1,021)	**(10,956)**	(5,663)
Operating loss	**(9,336)**	(1,803)	**(167)**	(430)	**(9,503)**	(2,233)
Profit on sale of fixed assets	**607**	—	**—**	—	**607**	—
Loss on sale of discontinued operations	**—**	(91)	**(469)**	—	**(469)**	(91)
Loss on ordinary activities before finance charges and taxation	**(8,729)**	(1,894)	**(636)**	(430)	**(9,365)**	(2,324)
Finance charges (net)	**(20)**	63	**—**	—	**(20)**	63
Loss on ordinary activities before taxation	**(8,749)**	(1,831)	**(636)**	(430)	**(9,385)**	(2,261)

An analysis of exceptional costs is shown in Note 3.

2 Turnover and Segmental Analysis cont...

	Technology		Services		Total	
	2004 £'000	2003 £'000	**2004 £'000**	2003 £'000	**2004 £'000**	2003 £'000
Turnover	**1,056**	2,199	**5,530**	5,101	**6,586**	7,300
Operating (loss)/profit before exceptional costs, amortisation of goodwill and development costs and common costs	**(2,110)**	(1,448)	**(834)**	949	**(2,944)**	(499)
Exceptional cost of sales	**(202)**	—	**(210)**	—	**(412)**	—
Exceptional administrative expenses (including impairment of goodwill and development costs)	**(2,784)**	—	**(575)**	—	**(3,359)**	—
Amortisation of goodwill and development costs	**(255)**	(133)	**(685)**	(302)	**(940)**	(435)
Operating (loss)/profit before common costs	**(5,351)**	(1,581)	**(2,304)**	647	**(7,655)**	(934)
Common costs					**(1,848)**	(1,299)
Operating loss					**(9,503)**	(2,233)
Profit on sale of fixed assets					**607**	—
Loss on sale of discontinued operations	**(469)**	—	**—**	(91)	**(469)**	(91)
Loss on ordinary activities before finance charges and taxation					**(9,365)**	(2,324)
Net assets, excluding unallocated net assets	**955**	4,263	**13,023**	13,418	**13,978**	17,681
Unallocated net assets					**(2,365)**	431
Net assets					**11,613**	18,112

Within the Chief Financial Officer's Report, reference is made to the Operating loss before exceptional costs and amortisation of goodwill and development costs (£4.8 million; 2003: £1.8 million). This figure represents the sum of the operating loss before exceptional costs, amortisation of goodwill and development costs and common costs of £2.9 million (2003: £0.5 million) as shown above together with common costs of £1.8 million (2003: £1.3 million) also shown above. A reconciliation to the statutory operating loss of £9.5 million (2003: £2.2 million) is shown above. An analysis of exceptional costs is given in Note 3.

2 Turnover and Segmental Analysis cont...

	Total 2004 £'000	Total 2003 £'000
Turnover by destination		
United Kingdom and Republic of Ireland	**3,193**	3,536
Other European Union	**241**	122
Rest of Europe	**17**	44
The Americas	**247**	315
Africa	**—**	—
Asia	**2,887**	3,281
Other	**1**	2
	6,586	7,300

All turnover originated in the United Kingdom, Dubai, or USA.

Geographical Analysis by Origin

	United Kingdom operations		Dubai operations		USA operations		Total	
	2004 £'000	2003 £'000	**2004 £'000**	2003 £'000	**2004 £'000**	2003 £'000	**2004 £'000**	2003 £'000
Turnover	**3,509**	3,896	**2,832**	3,149	**245**	255	**6,586**	7,300
Operating profit/(loss) before exceptional costs and amortisation of goodwill and development costs	**(5,717)**	(3,019)	**527**	1,223	**(14)**	(2)	**(5,204)**	(1,798)
Exceptional costs (including impairment of goodwill and development costs)	**(3,359)**	—	**—**	—	**—**	—	**(3,359)**	—
Amortisation of goodwill and development costs	**(370)**	(144)	**(570)**	(291)	**—**	—	**(940)**	(435)
Operating (loss)/profit	**(9,446)**	(3,163)	**(43)**	932	**(14)**	(2)	**(9,503)**	(2,233)
Profit on sale of fixed assets	**607**	—	**—**	—		—	**607**	—
Loss on sale of discontinued operations	**(420)**	(91)	**—**	—	**(49)**	—	**(469)**	(91)
Loss on ordinary activities before finance charges and taxation	**(9,259)**	(3,254)	**(43)**	932	**(63)**	(2)	**(9,365)**	(2,324)
Net assets	**10,045**	16,953	**1,644**	1,172	**(76)**	(13)	**11,613**	18,112

An analysis of exceptional costs is shown in Note 3.

3 Cost of Sales and Other Operating Expenses (Net)

	Continuing operations		Discontinued operations		Total	
	2004 £'000	2003 £'000	**2004 £'000**	2003 £'000	**2004 £'000**	2003 £'000
Cost of sales – normal	**4,298**	3,358	**423**	512	**4,721**	3,870
Cost of sales – exceptional						
– Write down of technology stocks	**202**	—	**—**	—	**202**	—
– Write down of tissue stocks	**210**	—	**—**	—	**210**	—
	412	—	**—**	—	**412**	—
Total cost of sales	**4,710**	3,358	**423**	512	**5,133**	3,870
Selling and distribution costs	**866**	593	**57**	239	**923**	832
Research and development costs	**103**	830	**45**	240	**148**	1,070
Administrative expenses						
– Amortisation of goodwill and development costs	**940**	416	**—**	19	**940**	435
– Other normal administrative expenses	**5,384**	2,784	**202**	542	**5,586**	3,326
Normal administrative expenses	**6,324**	3,200	**202**	561	**6,526**	3,761
Exceptional items						
– Redundancy	**181**	—	**—**	—	**181**	—
– Costs of aborted acquisition	**240**	—	**—**	—	**240**	—
– Impairment of goodwill	**1,712**	—	**—**	—	**1,712**	—
– Impairment of development costs	**1,226**	—	**—**	—	**1,226**	—
Exceptional administrative expenses	**3,359**	—	**—**	—	**3,359**	—
Total administrative expenses	**9,683**	3,200	**202**	561	**9,885**	3,761
Total other operating expenses	**10,652**	4,623	**304**	1,040	**10,956**	5,663

Exceptional costs of sales of £412,000 (2003: £Nil) includes the write down of technology stock (£202,000; 2003: £Nil) and tissue stock (£210,000; 2003: £Nil). The Group expects to exit part of its Technology business over the short to medium-term and as such has recognised a one-off charge to the carrying value of related stock items. During the year the Group changed the methodology on which it has accounted for tissue stock and no longer includes certain overheads in the valuation of such items. Accordingly, the Group's results for the year ended 31 December 2004 reflect a charge of £210,000 (2003: £Nil). Gross profit before exceptional items of £1,865,000 represents the sum of exceptional costs of sales as described above (£412,000) and the statutory gross profit figure of £1,453,000 for the year ended 31 December 2004.

Exceptional administrative expenses for the year ended 31 December 2004 were £3,359,000 (2003: £Nil). This includes redundancy costs (2004: £181,000; 2003: £Nil), costs associated with an aborted acquisition (2004: £240,000; 2003: £Nil) and costs associated with the impairment of the carrying values of development costs (2004: £1,226,000; 2003: £Nil) and goodwill (2004: £1,712,000; 2003: £Nil), based on a review carried out by the Directors, which included the potential commercial prospects of each identified project or business stream.

Other operating expenses, excluding exceptional expenses and amortisation of goodwill and development costs of £6,657,000 (2003: £5,228,000) comprises selling and distribution costs (£923,000; 2003: £832,000), research and development costs (£148,000; 2003: £1,070,000) and other normal administrative expenses (£5,586,000; 2003: £3,326,000) as shown above.

4 Profit on Disposal of Fixed Assets

On 28 February 2004, the Group completed the sale and leaseback of its headquarters in Nottingham for a consideration of £4.6 million generating a profit on disposal of fixed assets of £986,000. During 2004, the Group also agreed to surrender its lease at Malville Works, Nottingham and completed its move to new premises in Harley Street, London, recognising a charge of £379,000 relating to fixed asset disposals. Overall, the Group recognised a net profit on disposal of fixed assets of £607,000 (2003: £Nil).

This exceptional item has had no effect on the tax charge in the year.

5 Loss on Disposal of Discontinued Operations

The trade and assets of Kinetic Imaging Inc and Kinetic Imaging Limited were sold in June 2004, generating a loss on disposal of £469,000 after accounting for unamortised goodwill and certain transaction related legal and professional costs.

This exceptional item has had no effect on the tax charge in the year.

6 Finance Charges (Net)

	2004 £'000	2003 £'000
Interest receivable and similar income	—	134
Bank loans and overdrafts	(4)	(23)
Finance leases and hire purchase contracts	(16)	(48)
Total interest payable	(20)	(71)
Finance charges (net)	(20)	63

7 Loss on Ordinary Activities Before Taxation

Loss on ordinary activities before taxation is stated after charging/(crediting):

	2004 £'000	2003 £'000
Depreciation of tangible fixed assets		
– owned	615	270
– held under finance leases and hire purchase contracts	280	103
Amortisation of development costs	225	316
Impairment of development costs	1,226	—
Amortisation of goodwill	715	435
Impairment of goodwill	1,712	—
Loss on sale of businesses	469	91
Profit on sale of fixed assets	(607)	—
Operating lease rentals – other	493	162
Auditors' remuneration		
– audit services – statutory audit	59	39
– further assurance services	150	
– tax services – compliance	44	21
– advisory	38	
– other services	10	—
Research and development costs expensed	148	1,070
Exchange gains		
– realised	53	9
– unrealised	38	24

7 Loss on Ordinary Activities Before Taxation cont…

The audit fee for the Company was £5,000 (2003: £5,000). During the year, the Company's auditors undertook a due diligence exercise in respect of a potential acquisition which was subsequently aborted. Fees for this exercise were £150,000. In addition to the fees disclosed above, the Group's auditors carried out work related to the Placing and Open Offer which was completed in January 2005 (see Note 29). Fees for the work totalled £35,000 and were included in prepayments as at 31 December 2004. In 2003, other auditor services of £153,000 were included within acquisition costs related to transactions completed in that year.

8 Staff Costs

The average monthly number of employees (including Executive Directors) during the year was:

	2004	2003
Management	11	8
Administration and finance	23	25
Production, development and technical	77	52
Sales and marketing	14	17
	125	102

Their aggregate remuneration comprised:

	2004 £'000	2003 £'000
Wages and salaries	3,543	2,514
Social security costs	329	241
Other pension costs	76	51
	3,948	2,806
Less amounts capitalised	(248)	(329)
	3,700	2,477

Details of the Directors' remuneration are given in the Directors' Remuneration Report on page 22.

9 Tax on Loss on Ordinary Activities

The tax (credit)/charge comprises:

	2004 £'000	2003 £'000
UK corporation tax	—	—
Adjustments in respect of previous period		
– UK corporation tax	90	(2,126)
Total current tax	90	(2,126)
Deferred tax		
Origination and reversal of timing differences	—	—
Total tax on loss on ordinary activities	90	(2,126)

The tax credit in 2003 relates to the release of the provision made in 2002 for tax on the disposal of the trade and assets of Adams Healthcare. During 2003 tax losses became available to cover the whole of the gain made on that disposal.

9 Tax on Loss on Ordinary Activities cont...

The difference between the total current tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the loss before tax is as follows:

	2004 £'000	2003 £'000
Group loss on ordinary activities before tax	**(9,385)**	(2,261)
Tax on Group loss on ordinary activities at standard UK corporation tax rate of 30% (2003: 30%)	**(2,815)**	(678)
Effects of:		
Expenses not deductible for tax purposes	**91**	27
Short term timing differences	**(3)**	—
Utilisation of brought forward losses	**(145)**	—
Goodwill and development costs amortisation not deductible for tax purposes	**214**	—
Crystalisation of gain previously rolled over	**582**	—
Impairment of development costs	**255**	27
Capital allowances in excess of depreciation	**140**	(76)
Losses carried back	**—**	847
R&D tax relief	**(18)**	(44)
(Profit)/loss on disposal of non-qualifying assets	**(75)**	—
Consolidation adjustment on intercompany balances	**452**	(76)
Tax losses not recognised	**1,322**	—
Adjustments in respect of previous periods	**90**	(2,126)
Group current tax (credit)/charge for the year	**90**	(2,126)

Losses within the Parent Company and certain subsidiaries which are available for relief against future profits of the same trade are approximately £5.2 million (2003: £520,000).

Deferred Tax

Not provided deferred tax is as follows:

	2004 £'000	2003 £'000
Group		
Accelerated capital allowances	**59**	131
Tax losses available	**(1,568)**	(155)
Potential deferred tax asset	**(1,509)**	(24)
Company		
Accelerated capital allowances	**13**	(1)
Tax losses available	**(73)**	—
Potential deferred tax asset	**(60)**	(1)

The deferred tax asset is not recognised as the Group does not anticipate taxable profits arising within the immediate future.

10 Loss Attributable to Members of the Parent Company

In accordance with the exemption allowed by section 230 of the Companies Act 1985 the Company has not presented its own profit and loss account. The loss after taxation dealt with in the financial statements of the Parent Company amounted to £11,617,000 (2003: £732,000).

11 (Loss)/Earnings per Ordinary Share

The calculations of loss per share are based on the following profits and numbers of shares:

	Basic and diluted	
	2004 £'000	2003 £'000
Loss for the financial year	**(9,475)**	(135)

	2004 Number of shares	2003 Number of shares
Weighted average number of shares:		
For basic earnings per share and diluted earnings per share	**92,597,733**	84,303,925

FRS 14 requires presentation of diluted earnings per share ('EPS') when a Company could be called upon to issue shares that would decrease net profit or increase net loss per share. For a loss making Company with outstanding share options, net loss per share would only be increased by the exercise of out-of-the-money options. Since it seems inappropriate to assume that option holders would act irrationally and there are no other diluting future share issues, diluted EPS equals basic EPS.

12 Intangible Fixed Asset – Development Costs

	Total £'000
Cost	
At 1 January 2004	2,730
Additions	248
Disposals	(836)
At 31 December 2004	**2,142**
Amortisation	
At 1 January 2004	1,032
Charge for the year	225
Disposals	(680)
Impairment	1,226
At 31 December 2004	**1,803**
Net book value:	
At 31 December 2004	**339**
At 1 January 2004	1,698

The carrying value of development costs was reviewed at 31 December 2003 and, in the opinion of the Directors, no impairment was required at that time. During the year ended 31 December 2004, a further impairment review was conducted. The net impact of the review was a charge to the profit and loss account of £1.2 million.

13 Intangible Fixed Assets – Goodwill

Group	Total £'000
Cost	
At 1 January 2004	14,740
Adjustment in respect of prior period acquisitions	(184)
Disposals	(384)
At 31 December 2004	**14,172**
Amortisation	
At 1 January 2004	806
Charge for the year	715
Disposals	(66)
Impairment	1,712
At 31 December 2004	**3,167**
Net book value:	
At 31 December 2004	**11,005**
At 1 January 2004	13,934

On 16 September 2003, Medical Solutions FZ LLC acquired the business of Histopathology & Speciality Laboratories ("HSL"), Dubai for £100,000 cash and £175,000 by the issue of ordinary shares in the Company at the mid price at the close of business on 10 September 2003. A further cash payment of up to £75,000 is payable on the achievement of agreed financial targets for the first year following acquisition. The share element was not fixed until 1 February 2005. Given the lower share price, the actual initial consideration paid was £31,000 rather than the £175,000 as stated in the 2003 financial statements. This, together with a small adjustment to the opening balance sheet, resulted in an adjustment in respect of prior period requisitions of £184,000 in 2004.

The carrying value of goodwill was reviewed at 31 December 2003 and, in the opinion of the Directors, no impairment was required at that time. During the year ended 31 December 2004, a further impairment review was conducted. The net impact of the review was a charge to the profit and loss account of £1.7 million.

14 Tangible Fixed Assets

Group	Freehold land and buildings £'000	Leasehold improvements £'000	Plant and machinery £'000	Computer software, fixtures and fittings £'000	Motor vehicles £'000	Total £'000
Cost						
At 1 January 2004	4,059	—	701	2,282	175	7,217
Additions	—	151	344	454	13	962
Disposals	(3,418)	(44)	—	(788)	(85)	(4,335)
Translation	—	—	—	(9)	—	(9)
Transfers	(641)	641	—	—	—	—
At 31 December 2004	**—**	**748**	**1,045**	**1,939**	**103**	**3,835**
Depreciation						
At 1 January 2004	—	—	—	559	64	623
Charge for the year	—	73	183	617	22	895
Disposals	—	(1)	—	(318)	(43)	(362)
At 31 December 2004	**—**	**72**	**183**	**858**	**43**	**1,156**
Net book value:						
At 31 December 2004	**—**	**676**	**862**	**1,081**	**60**	**2,679**
At 1 January 2004	4,059	—	701	1,723	111	6,594

The total net book value of fixed assets includes £716,000 (2003: £57,000) of assets held under finance leases and hire purchase contracts. During the year, the Group revised the useful economic life of certain tangible fixed assets based on its operational expenses. The effect of this revision is an increase in the depreciation charge for the year of £255,000.

Company	Freehold land and buildings £'000	Leasehold improvements £'000	Fixtures and fittings £'000	Motor vehicles £'000	Total £'000
Cost					
At 1 January 2004	4,059	—	93	118	4,270
Additions	—	151	—	—	151
Disposals	(3,418)	(44)	—	(60)	(3,522)
Transfers	(641)	641	—	—	—
At 31 December 2004	**—**	**748**	**93**	**58**	**899**
Depreciation					
At 1 January 2004	—	—	11	39	50
Charge for year	—	73	27	16	116
Disposals	—	(1)	—	(26)	(27)
At 31 December 2004	**—**	**72**	**38**	**29**	**139**
Net book value:					
At 31 December 2004	**—**	**676**	**55**	**29**	**760**
At 1 January 2004	4,059	—	82	79	4,220

15 Fixed Assets Investments

Group	£'000
Investment in associates	
Cost and net book value	
At 1 January 2004	2
Disposals	(2)
At 31 December 2004	**—**

Company	£'000
Unlisted investments in subsidiary undertakings	
Cost	
At 1 January 2004	34,036
Adjustment in respect of prior period acquisitions (see Note 13)	(144)
At 31 December 2004	**33,892**
Provisions	
At 1 January 2004	10,963
Impairment	—
At 31 December 2004	**10,963**
Net book value:	
At 31 December 2004	**22,929**
At 1 January 2004	23,073

The subsidiary undertakings of Medical Solutions plc and their respective activities were as follows at 31 December 2004:

	Country of incorporation	Principal activity	Percentage held
Fairfield Imaging Limited	England	Dormant	100%
Fairfield Research Limited	England	Dormant	100%*
Fairfield Telepathology Limited	England	Dormant	100%*
Adams Healthcare Limited	England	Dormant	100%
Kinetic Imaging Limited	England	Dormant	100%
Quinoderm Limited	England	Dormant	100%
Second Opinion Solutions AS	Norway	Holds intellectual property	75.3%
PathLore Limited	England	Provision of pathology services	100%
Histological Solutions Limited	England	Dormant	100%
Medical Solutions FZ LLC	U.A.E.	Pathology laboratory and intermediate holding company	100%
Dubai Medical Laboratory FZ LLC	U.A.E.	Intermediate holding company	100%
Specialised Clinical Laboratory FZ LLC	U.A.E.	Intermediate holding company	100%
Medical Solutions (London) Limited	England	Histopathology services	100%

* held indirectly

16 Stocks

	Group	
	2004 £'000	2003 £'000
Raw materials and consumables	**766**	1,083
Work in progress	**36**	1
Finished goods and goods for resale	**76**	377
	878	1,461

The Directors consider that the difference between the amounts shown and the replacement cost is not significant.

17 Debtors: Amounts Falling Due Within One Year

	Group		Company	
	2004 £'000	2003 £'000	**2004 £'000**	2003 £'000
Trade debtors	**1,190**	2,343	**—**	45
Amounts owed by Group undertakings	**—**	—	**46**	7,000
VAT	**99**	308	**48**	225
Other debtors	**135**	—	**135**	—
Prepayments and accrued income	**2,924**	132	**2,261**	28
	4,348	2,783	**2,490**	7,298

Prepayments totalling £2.9 million include prepaid consideration (including associated legal and professional costs) of £2.2 million in respect of the acquisitions of DML and SCL. These acquisitions were formally completed in January 2005 (see Note 29).

18 Creditors: Amounts Falling Due Within One Year

	Group		Company	
	2004 £'000	2003 £'000	**2004 £'000**	2003 £'000
Bank loans	**2,298**	914	**1,986**	656
Overdraft	**678**	1,741	**—**	—
Finance leases and hire purchase contracts	**63**	23	**27**	14
Trade creditors	**2,338**	1,757	**576**	320
Amounts owed to Group undertakings	**—**	—	**13,350**	13,006
Corporation tax	**29**	—	**29**	—
Other taxes and social security	**133**	201	**—**	—
Other creditors	**—**	—	**—**	—
Accruals and deferred income	**1,290**	329	**778**	80
Deferred consideration	**1,257**	600	**1,257**	600
	8,086	5,565	**18,003**	14,676

19 Creditors: Amounts Falling Due After One Year

	Group		Company	
	2004 £'000	2003 £'000	**2004 £'000**	2003 £'000
Bank loans	**451**	4,007	**—**	3,244
Finance leases and hire purchase contracts	**89**	38	**—**	27
Deferred consideration	**1,000**	2,000	**1,000**	2,000
	1,540	6,045	**1,000**	5,271
Bank loans repayable				
Within one year or less or on demand	**2,298**	914	**1,986**	656
More than one year but not more than two years	**276**	931	**—**	656
More than two years but not more than five years	**175**	3,076	**—**	2,588
	2,749	4,921	**1,986**	3,900

A cash deposit of £2,000,000 together with mortgage debentures incorporating fixed and floating charges over certain current and future assets of Medical Solutions plc, PathLore Limited and Fairfield Imaging Limited are provided as security against bank loans of £1,986,000 and the overdraft of £678,000. Bank loans of £763,000 represent chattel mortgages secured over certain assets of PathLore Limited.

	Group		Company	
	2004 £'000	2003 £'000	**2004 £'000**	2003 £'000
Finance leases and hire purchase contracts repayable				
Within one year or less or on demand	**63**	32	**27**	27
More than one year but not more than two years	**35**	6	**—**	—
More than two years but not more than five years	**54**	—	**—**	—
	152	38	**27**	27
Less finance charges allocated to future periods	**—**	—	**—**	—
	152	38	**27**	27

Deferred consideration totalling £2.2 million (2003: £2.6 million) is expected to fall due for payment as follows: within one year £1.2 million (2003: £0.6 million); more than one year but not more than two years £1.0 million (2003: £1.0 million) and more than two years but not more than five years £Nil (2003: £1.0 million).

20 Derivatives and Other Financial Instruments

The numerical disclosures in this note deal with financial assets and financial liabilities as defined in FRS 13 "Derivatives and Other Financial Instruments: Disclosures". Certain financial assets such as investments in subsidiary and associated companies are excluded from the scope of these disclosures.

As permitted by FRS 13, short-term debtors and creditors have been excluded from the disclosures, other than the currency disclosures.

Liquidity

The Group's overall objective is to ensure that it is, at all times, able to meet its financial commitments as and when they fall due by ensuring that adequate facilities are in place.

Interest Rate Profile

The Group's exposure to interest rate fluctuations is managed by fixing interest rates in the short to medium-term on borrowings. The interest rate profiles on cash and borrowings are shown below.

The fair value of financial assets and liabilities is not materially different from their carrying values.

20 Derivatives and Other Financial Instruments cont...

Cash

There were no balances on short-term deposit at the year end (2003: £Nil). Cash balances at the year end were completely offset by associated bank borrowings.

Borrowings and Deferred Consideration

There was an overdraft of £678,000 at the year end (2003: £1,741,000). The overdraft is repayable on demand.

The maturity profile of the Group's financial liabilities as at 31 December 2004 is given in Notes 19 and 20.

The interest rates on bank borrowings are at 1.6% above The Royal Bank of Scotland base rate. The interest rate on chattel mortgages of £763,000 secured on certain fixed assets is fixed at 3.25% over a five year period. The interest rate on finance leases and hire purchase contracts ranges between 4.1% and 8.1%.

The deferred consideration due after more than one year is interest free, has a weighted average life of 1.4 years and is denominated in Sterling.

There are no un-drawn committed borrowing facilities available to the Group as at 31 December 2004. All interest rates relate to Sterling based borrowings.

Currency Exposure

Where possible the Group invoices in sterling to mitigate currency exposure. In situations where invoices are raised in other currencies, the Group seeks to minimise its risk through its pricing policy.

The table below shows the Group's currency exposure which gives rise to the currency gains and losses recognised in the profit and loss account. Such exposures comprise the monetary assets and liabilities of the Group that are not denominated in sterling. As at 31 December 2004 the net foreign currency monetary liabilities were as follows:

	Group	
	2004 £'000	2003 £'000
US dollar	**360**	178
Euro	**1**	240
	361	418

No hedging is used for either interest rate or currency exposures.

21 Share Capital

Group and Company

	2004		2003	
	Number	**£'000**	Number	£'000
Authorised				
Ordinary shares of 2p	**130,000,000**	**2,600**	100,000,000	2,000
Authorised, called-up and fully paid				
Ordinary shares of 2p	**97,994,108**	**1,960**	89,403,240	1,788

During the year, a total of 8,840,868 ordinary shares of 2p each were issued for a total consideration of £3,139,000. On 26 July 2004, the Company cancelled 250,000 ordinary shares representing £5,000 in aggregate of the nominal value of issued share capital.

21 Share Capital cont...

Group and Company cont...

Details of the share options outstanding at 31 December 2004 are as follows:

Note	Ordinary shares at 31 December 2003	Granted during the year	Lapsed during the year	**Ordinary shares at 31 December 2004**	Exercise price	Earliest date exercisable	Expiry date
1	416,667	—	—	**416,667**	48p	28.09.2002	28.09.2009
1	—	—	—	**—**	132p	04.04.2003	04.04.2010
1	2,500	—	—	**2,500**	124p	09.05.2003	09.05.2010
1	25,000	—	—	**25,000**	27.75p	25.03.2005	25.03.2012
1	3,335,824	—	—	**3,335,824**	22p	13.01.2006	13.01.2013
2	2,529,267	—	—	**2,529,267**	22p	13.01.2006	13.01.2013
2	1,480,000	—	—	**1,480,000**	32.5p	22.09.2006	22.09.2013
2	40,000	—	—	**40,000**	46p	27.10.2006	27.10.2013
3	—	181,532	—	**181,532**	34.25p	16.10.2007	15.10.2014

Note 1: granted under the unapproved share option scheme.
Note 2: granted under the 2001 approved share option scheme.
Note 3: granted under the Inland Revenue approved savings related scheme.

22 Reconciliation of Movement in Shareholders' Funds and Reserves

Group	Share capital £'000	Share premium account £'000	Shares in EBT £'000	Merger reserve £'000	Capital redemption reserve £'000	Other reserve £'000	Translation reserve £'000	Profit and loss account £'000	Total £'000
At 1 January 2004	1,788	25,059	(45)	3,467		1,136	(136)	(13,157)	18,112
Shares issued	177	2,853	—	—	—	—	—	—	3,030
Loss for the year	—	—	—	—	—	—	—	(9,475)	(9,475)
Shares in EBT	(5)	—	45	—	5	—	—	(45)	—
Translation adjustment	—	—	—	—	—	—	(54)	—	(54)
At 31 December 2004	**1,960**	**27,912**	**—**	**3,467**	**5**	**1,136**	**(190)**	**(22,677)**	**11,613**

Company	Share capital £'000	Share premium account £'000	Shares in EBT £'000	Merger reserve £'000	Capital redemption reserve £'000	Other reserve £'000	Translation reserve £'000	Profit and loss account £'000	Total £'000
At 1 January 2004	1,788	25,059	(45)	3,467	—	1,136	—	(13,754)	17,651
Shares issued	177	2,853	—	—	—	—	—	—	3,030
Loss for the year	—	—	—	—	—	—	—	(11,617)	(11,617)
Shares in EBT	(5)	—	45	—	5	—	—	(45)	—
At 31 December 2004	**1,960**	**27,912**	**—**	**3,467**	**5**	**1,136**	**—**	**(25,416)**	**9,064**

250,000 ordinary shares bought by the Company during 2003 were cancelled on 30 July 2004.

23 Reconciliation of Operating Loss to Operating Cash Outflow

	2004 £'000	2003 £'000
Operating loss	**(9,503)**	(2,233)
Goodwill amortisation	**715**	435
Impairment of goodwill	**1,712**	—
Depreciation charges	**895**	372
Amortisation of development costs and know-how	**225**	316
Impairment of development costs	**1,226**	—
(Increase)/decrease in stocks	**272**	(441)
(Increase)/decrease in debtors	**467**	(1,551)
Increase/(decrease) in creditors	**1,155**	1,045
Net cash outflow from operating activities	**(2,836)**	(2,057)

24 Analysis of Cash Flows

	2004 £'000	2003 £'000
Returns on investments and servicing of finance		
Interest received	**—**	134
Interest paid	**(4)**	(23)
Interest element of finance leases and hire purchase rental payments	**(16)**	(48)
Net cash (outflow)/inflow	**(20)**	63
Taxation	**(61)**	—
Capital expenditure and financial investment		
Purchase of tangible fixed assets	**(789)**	(5,623)
Development costs	**(248)**	(451)
Sale of tangible fixed assets	**4,600**	—
Net cash inflow/(outflow)	**3,563**	(6,074)
Acquisitions and disposals		
Deferred consideration for acquisitions paid	**(200)**	(650)
Sale of businesses	**555**	(78)
Deposit on acquisition of SCL and DML	**(2,030)**	—
Purchase of subsidiary undertakings	**—**	(6,535)
Net cash outflow	**(1,675)**	(7,263)
Financing		
Issue of ordinary share capital	**3,030**	—
Capital element of finance leases and hire purchase rental payments	**(26)**	31
Increase/(decrease) in short-term borrowings	**1,384**	364
Increase/(decrease) in long-term borrowings	**(3,556)**	1,673
	(2,198)	2,068
Net cash inflow	**832**	2,068

The disposal of the trade and assets of Kinetic Imaging Inc and Kinetic Imaging Limited during the year contributed £555,000 to the Group's net operating cash flows. No other consideration was received.

25 Analysis and Reconciliation of Net Funds

	At 1 January 2004 £'000	Cash flow £'000	Other non-cash changes £'000	Translation differences £'000	**At 31 December 2004 £'000**
Cash in hand and at bank	3,250	(1,260)	—	—	**1,990**
Overdrafts	(1,741)	1,063	—	—	**(678)**
	1,509	(197)	—	—	**1,312**
Debt due after one year	(4,007)	3,556	—	—	**(451)**
Debt due within one year	(914)	(1,384)	—	—	**(2,298)**
Finance leases	(61)	26	(117)	—	**(152)**
	(4,982)	2,198	(117)	—	**(2,901)**
Total	(3,473)	2,001	(117)	—	**(1,589)**

	2004 £'000	2003 £'000
(Decrease)/increase in cash in the year	**(197)**	(13,263)
Cash inflow from increase in debt and lease financing	**2,198**	(2,068)
Change in net debt funds resulting from cash flows	**2,001**	(15,331)
New finance leases	**(117)**	—
Translation differences	**—**	(60)
Movement in net funds in year	**1,884**	(15,391)
Net funds at 1 January	**(3,473)**	11,918
Net funds at 31 December	**(1,589)**	(3,473)

26 Financial Commitments

Group

Contracted, but not provided capital commitments as at 31 December 2004 were £Nil (2003: £Nil).

The Group is committed to making the following payments during the next year under non-cancellable operating leases:

	2004		2003	
	Land and buildings £'000	**Motor vehicles and other £'000**	Land and buildings £'000	Motor vehicles and other £'000
Date of lease termination				
– within one year	**—**	**12**	—	1
– between two to five years	**170**	**29**	92	151
– after five years	**400**	**—**	—	—

27 Pension Arrangements

The Group operates a defined contribution pension scheme for which pension costs charged for the year amounted to £76,000 (2003: £51,000). The year end creditor amounted to £13,000.

28 Contingencies

Company

Under the terms of the Group's current bank facilities, the Company was liable for the repayment and discharge of all monies owing in respect of the bank borrowings of all subsidiary undertakings.

At 31 December 2004 this amounted to £2,749,000 (2003: £4,921,000).

There is deferred contingent consideration payable in respect of the PathLore Limited acquisition in 2000 up to a total of £400,000. In accordance to the deed dated 24 January 2001 between Medical Solutions plc and Prof I O Ellis containing the restrictive covenant and consideration, the first £200,000 payment shall be due when the operating profit of Medical Solutions plc and its subsidiaries (derived from turnover less cost of sales and other operating expenses only) as shown by the consolidated accounts of Medical Solutions plc (the Operating Profit) for any financial year ending prior to 31 December 2005 shall reach £300,000 with the second £200,000 when the Medical Solutions plc Operating Profits reach £600,000, for any financial year ending prior 31 December 2006. In the event of any sale of any business or subsidiary of the Medical Solutions plc Group during the period of the deed or any change in the accounting reference date of Medical Solutions plc or any of its subsidiaries, the terms of the deed shall be further adjusted so as to ensure that Prof I O Ellis is not prejudiced by the sale or the change in accounting reference date.

29 Post Balance Sheet Events

Placing and Open Offer

On 22 December 2004, the Group announced that it intended to raise approximately £6.4 million before expenses through a Placing and Open Offer. The net proceeds of the Placing and Open Offer (approximately £5.6 million) were to be used to invest in specialist laboratory equipment required to drive future revenue growth within the Group's drug discovery/development and Liquid Based Cytology operations, reduce the Group's debt position, pay deferred consideration in respect of historic acquisitions of HSL and SCL in Dubai and to fund the Group's general working capital requirements.

At an Extraordinary General Meeting of the Company held on 14 January 2005, all resolutions necessary to approve the Placing and Open Offer together with certain other matters were duly passed and dealings in the new shares issued commenced on 19 January 2005. As a result of the Placing and Open Offer, the Group raised net proceeds of approximately £5.6 million.

Acquisition of Subsidiary Undertakings

On 14 January 2005 the Group completed the acquisition of Dubai Medical Laboratories ("DML") and Specialised Clinical Laboratories ("SCL"). The acquisitions were made by two newly established 100% subsidiaries DML FZ LLC and SCL FZ LLC respectively. These subsidiaries entered into civil partnership agreements with the existing laboratory owners to effectively acquire 80% (DML) and 100% (SCL) of the existing laboratory businesses. Each of the acquisitions was deemed as having gone unconditional on 14 January 2005. Cash consideration totalling £2.0 million was paid to the owners of DML and SCL at that time and, together with related legal and professional costs (£292,000) have been shown within Prepayments (part of Debtors) in the consolidated Group balance sheet at 31 December 2004.

Dubai Medical Laboratories ("DML")

DML FZ LLC acquired an 80% shareholding in DML, a clinical analytical and diagnostic services laboratory which operates as a civil partnership in the Emirate of Dubai. DML FZ LLC acquired the 80% holding in DML for total consideration of approximately £1.7 million. The total purchase consideration can be broken down as cash of £1.2 million and 3,887,853 new ordinary shares in Medical Solutions plc, with an aggregate value of £267,000. The Group incurred legal and professional costs of £250,000 in connection with the acquisition of DML. At the date of acquisition, DML had net assets of £72,000.

Specialised Clinical Laboratories ("SCL")

SCL FZ LLC acquired 100% of SCL, a provider of specialised investigations, routine tests and other clinical laboratory services. SCL operates as a civil partnership registered in the Emirate of Dubai. SCL FZ LLC acquired a 100% holding in SCL for total consideration of approximately £1.1 million. The total purchase consideration can be broken down as cash of £0.8 million and 3,575,730 new ordinary shares with an aggregate value of £246,000. The Group incurred legal and professional costs of £42,000 in connection with the acquisition of SCL. At the date of acquisition, SCL had net assets of £18,000.

30 Related Party Transactions

The Company has taken advantage of the exemption available to parent companies under FRS 8 "Related party disclosures" whereby transactions and balances between Group entities that have been eliminated on consolidation are not required to be disclosed.

With effect from 17 September 2004, the Company entered into an agreement with NKJ Consulting Limited to provide consultancy services to the Company. Dr N G Johnston is a Director of NKJ Consulting Limited. In consideration for the services provided, the Company was charged by NKJ Consulting Limited a total of £57,222 during the year ended 31 December 2004, of which £17,080 was outstanding at 31 December 2004.

Manntex Limited provided advice on the renewal of the Company's banking facilities during the year ended 31 December 2004. Mr R Slinger is an employee of Manntex Limited. In consideration for the services provided, the Company was charged by Manntex Limited a total of £23,500 during the year ended 31 December 2004, of which £23,500 was outstanding at 31 December 2004.

Notice is hereby given that the Annual General Meeting of Medical Solutions plc will be held at 1 Orchard Place, Nottingham Business Park, Nottingham NG8 6PX on 27 June 2005 at 10.00 am for the following purposes:

Ordinary Business

1 To receive and adopt the financial statements for the year ended 31 December 2004 together with the Directors' Report, the auditors' report on those financial statements and the auditable part of the Directors' Remuneration Report.

2 To re-elect Sir Gareth G Roberts as a Director of the Company who retires in accordance with the articles of association.

3 To re-elect Prof K Sikora as a Director of the Company who retires in accordance with the articles of association.

4 To re-elect Dr N G Johnston as a Director of the Company who retires in accordance with the articles of association and provision A.7.1 of the Combined Code.

5 To re-elect Mr R Slinger as a Director of the Company who retires in accordance with the articles of association and provision A.7.1 of the Combined Code.

6 To re-appoint Deloitte & Touche LLP as auditors of the Company to hold office from the conclusion of the Meeting to the conclusion of the next Meeting at which the accounts are laid before the Company and to authorise the Directors to determine their remuneration.

Special Business

To consider and, if thought fit, to pass the following resolutions of which resolutions 7 and 9 will be proposed as ordinary resolutions and resolution 8 will be proposed as a special resolution:

7 That the Directors be and they are generally and unconditionally authorised for the purposes of section 80 of the Companies Act 1985 (the Act) to allot and issue relevant securities (as defined in that section) up to a maximum aggregate nominal amount of £1,334,951 representing 33% of the Company's issued share capital as at 30 April 2005 provided that this authority shall expire on the earlier of the conclusion of the next Annual General Meeting of the Company and 15 months after the date of passing of this resolution or such earlier date (if any) on which this authority is revoked save that the Company may prior to the expiry of such period make an offer or agreement which would or might require relevant securities to be allotted after the expiry of this period and the Directors may allot relevant securities in pursuance of any such offer or agreement notwithstanding the expiry of the authority given in this paragraph, so that all previous authorities of the Directors pursuant to section 80 of the Act be and they are revoked.

8 That subject to resolution 7 being passed the Directors be and they are generally empowered pursuant to section 95 of the Act to allot equity securities (within the meaning of section 94 of the Act and including without limitation section 94(3A) of the Act) of the Company for cash or sell relevant securities (as defined in section 94 of the Act) pursuant to the authority of the Directors under section 80 of the Act conferred by resolution 7 as if section 89(I) of the Act did not apply to such allotment or sale and at any time prior to the expiry of such power conferred by this resolution to make an offer or agreement which would or might require equity securities to be allotted after the expiry of such power notwithstanding the expiry of such power provided that such power shall, subject as aforesaid, expire on the earlier of the conclusion of the next Annual General Meeting of the Company and 15 months after the date of passing of this resolution or such earlier date (if any) on which the said authority is revoked, and provided that the power conferred by this resolution shall be limited to:

(i) allotments of equity securities where such securities have been offered (whether by way of rights issue, open offer or otherwise) to holders of ordinary shares in the capital of the Company made in proportion (as nearly as may be) to their existing holdings of ordinary shares but subject to the Directors having a right to make such exclusions or other arrangements in connection with the offering as they deem necessary or expedient:

(a) to deal with equity securities representing fractional entitlements; and

(b) to deal with legal or practical problems under the laws of, or the requirements of any recognised regulatory body or any stock exchange in, any territory; and

(ii) the allotment of equity securities for cash other than pursuant to paragraph (i) above up to a maximum aggregate nominal amount of £400,486 representing approximately 10% of the nominal value of the current issued ordinary share capital of the Company.

9 That the Company's Remuneration Report set out in the 2004 Annual Report and Accounts be approved.

By order of the Board

Dr N G Johnston
Secretary
24 May 2005

Registered office:
1 Orchard Place
Nottingham Business Park
Nottingham NG8 6PX

Notes

1 Only those shareholders registered in the register of members of the Company as at 10.00 am on 25 June 2005 shall be entitled to attend or vote at the aforesaid General Meeting in respect of the number of shares registered in their name at that time. Changes to entries on the relevant register of securities after 25 June 2005 shall be disregarded in determining the rights of any person to attend or vote at the Meeting.

2 Members who are entitled to attend and vote at the Meeting are entitled to appoint one or more proxies to attend and, on a poll, to vote instead of them. A proxy need not be a member of the Company.

3 In the case of joint holders the signature of one holder on the form of proxy will be accepted but the vote of the senior who tenders a vote whether in person or by proxy will be accepted to the exclusion of the votes of any other joint holders and for this purpose seniority shall be determined by the order in which the names stand in the register of members in respect of such joint holding.

4 In the case of a corporation the form of proxy must be executed under its common seal or signed on its behalf by a duly authorised attorney or a duly authorised officer of the corporation.

5 To be valid the form of proxy together with any power of attorney or other authority under which it is executed or a notarially certified copy thereof must be sent to the Company's registrars at Lloyds TSB, Registrar's Department, The Causeway, Worthing, West Sussex BN99 6ZL no later than 48 hours before the start of the Meeting.

6 Completion of the form of proxy will not affect the right of a member to attend and vote at the Meeting.

7 The register of Directors' share interests and copies of the Directors' services contracts will be available for inspection at the registered office of the Company during normal business hours on any weekday (public holidays excluded) from the date of this Notice until the Annual General Meeting and will be available for inspection at the place of the Annual General Meeting from 9.45 am on 27 June 2005 and during the Meeting.

Item 1: Annual Report and Accounts
The Directors must present to shareholders at the Annual General Meeting the report of the Directors and the accounts of the Company for the year ended 31 December 2004. The report of the Directors, the accounts, the report of the Remuneration Committee and the report of the Company's auditors on the accounts, are contained within the 2004 Annual Report and Accounts.

Items 2–5: Re-election of Directors
The annual report at pages 12 and 13 gives full biographical details of the Directors and the reasons for their re-election. The Company's Articles of Association state that any Director appointed since the previous Annual General Meeting shall hold office until the next Annual General Meeting and shall then be eligible for re-appointment. The Articles also state that one third of the Directors subject to retirement by rotation shall retire at each Annual General Meeting. The Code of Best Practice of the Combined Code also requires Directors to submit themselves for re-election at intervals of no more than three years. Each re-election shall be considered separately at the Meeting.

Item 6: Re-appointment of Auditors
The auditors of a Company must be appointed at each General Meeting at which accounts are presented. Resolution 6 proposes the re-appointment of Deloitte & Touche LLP, to hold office until the conclusion of the next Annual General Meeting to be held in 2006. The resolution also gives authority to the Directors to determine the auditors' remuneration.

Item 7: Authority to Allot Shares
Resolution 7 proposes to seek renewal of the authority of the Directors to allot ordinary shares. The nominal amount of £1,334,951 of relevant securities to which this authority will relate represents approximately 33% of the nominal amount of the issued ordinary share capital of the Company at 30 April 2005. The authority will expire on the earlier of the conclusion of the next Annual General Meeting of the Company and 15 months after the date of passing of this resolution or earlier if revoked.

In relation to resolution 7, the Directors have no present intention of allotting further shares other than in relation to the outstanding deferred consideration owed to the Varkey Group. As at 15 May 2005, the outstanding amount stood at approximately £2.4 million of which approximately £1.4 million is currently due for payment. Under the sale and purchase agreement, Medical Solutions plc has the option to pay the deferred consideration in cash or shares. Based on a closing mid-market price as at 12 May 2005 of 4.5p, payment of the £1.4 million currently due would result in the allotment and issuance of approximately 31.1 million shares, representing approximately 15.5% of the Company's issued share capital as at 12 May 2005 or approximately 13.4% extra of the Company's enlarged issued share capital should such an issue be effected.

Item 8: Disapplication of Pre-emption Rights
At the Annual General Meeting held on 20 May 2004, the Directors were empowered to make limited allotments of ordinary shares for cash other than according to the statutory pre-emption rights, which require a company to offer all allotments of ordinary shares for cash proportionately to existing shareholders first.

Resolution 8 proposes to seek renewal of this power of the Directors to continue to provide for the best interests of shareholders when opportunities arise, so that the Company can follow normal practices in the event of a rights issue or other pre-emptive issue and so that ordinary shares may be issued wholly for cash other than proportionately to existing ordinary shareholders up to a maximum nominal amount of £400,486, representing approximately 10% of the Company's issued ordinary share capital at 30 April 2005.

There are presently no plans to allot ordinary shares wholly for cash. Shares allotted under an employee share scheme are not subject to statutory pre-emption rights. This resolution also allows for the sale by the Company of treasury shares which it may hold.

The authority sought by resolution 8 will last until the earlier of the conclusion of the next Annual General Meeting of the Company and 15 months after the date of passing of the resolution or earlier if revoked.

Resolution 8 will be proposed as a special resolution.

Item 9: Directors' Remuneration Report
Resolution 9 proposes the approval of the Directors' Remuneration Report by shareholders at the Annual General Meeting.

The report, which is made on behalf of the full Board, explains the different elements which comprise Executive remuneration, including how base salaries and annual and long-term incentive remuneration are determined for Executive Directors of the Company.

Directors
Sir Gareth G Roberts
Non-Executive Chairman

C A Green
Executive Director

Dr N G Johnston
Executive Director

Prof K Sikora
Executive Director

Dr S Foden
Non-Executive Director (Senior Independent Director and Chairman of the Remuneration Committee)

R Slinger
Non-Executive Director
(Chairman of the Audit Committee)

Company Secretary
Dr N G Johnston

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1 Orchard Place
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Nottingham NG8 6PX

Registered Number
0079136

Auditors
Deloitte & Touche LLP
Nottingham

Financial Advisors and Joint Brokers
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Nomura House
St Martins-le-Grand
London EC1A 4NP

Joint Brokers
Charles Stanley & Co Limited
25 Luke Street
London EC2A 4AR

Solicitors
Hammonds
2 Park Lane
Leeds LS3 1ES

Principal Bankers
The Royal Bank of Scotland plc
1 Spinningfields Square
Manchester M3 3AP

Registrars
Lloyds TSB Registrars
The Causeway
Worthing
West Sussex BN99 6DA

Medical and Scientific Advisory Board
Sir Gareth G Roberts (Chairman)

External Members
Professor N Wright
Imperial Cancer Research Fund

Dr H Danielsen
Radium Hospital, Oslo

Professor G Duff
University of Sheffield

Professor N Lemoine
Head of Molecular Oncology
at Imperial College, London

Professor G McVie
Cancer Intelligence and former Director General, Cancer Research Campaign

Members on Boards of Medical Solutions' Companies
Dr N Clinch
Fairfield Imaging

Professor K Sikora
Medical Solutions plc

Professor I O Ellis
Medical Solutions plc (resigned from the Board on 21 December 2004)

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