



Interim Report 2004

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Drug Development

Drug Development Services

Medical Solutions' drug development services offer support to the Biotechnology and Pharmaceutical industry using state of the art Reference Laboratory facilities and image analysis. This collaboration at the cutting edge of technology contributes towards the development of potential targets for drug discovery and often draws from the Biomaterials Resource.

Biomaterials Resource

Sourced from a network of NHS hospitals with the expressed, informed consent of the donor, the Biomaterials Resource acquires, processes and stores human biomaterials including snap frozen and matching paraffin embedded tissue, tissue microarrays and genomic RNA and DNA.

Diagnostics Pathology

Pathology Services

Remote Locum and Medical Solutions London offer a diagnostic cellular pathology service to the NHS and private hospitals using the expertise of in house pathologists and a panel of over 70 specialist pathologists based around the UK.

Reference Laboratory

The Reference Laboratory offers specialist diagnostic services including tumour classification, prognostic assays, predictive assays and breast cancer profiling.

Technology

Liquid Based Cytology

SurePath™ is a Liquid Based Cytology ("LBC") system for cervical cancer screening and is one of only two NICE piloted commercial systems available. Rollout of LBC began in 2004 and the system will be used throughout the UK.

Scanning Telepathology/Digital Telepathology

PathSight is a dynamic telepathology system for presenting diagnostic quality, digital images and associated clinical data. It can be used for multi-disciplinary team meetings, second opinion and remote diagnosis.

PathScope is a unique, patented virtual microscopy program designed for uses such as diagnostic pathology, Quality Assurance schemes and training and education programs.

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

Highlights

- Turnover increased 30% to £3.7 million (2003 H1: £2.9 million)
- Operating loss before amortisation of goodwill and know-how £1.7 million* (2003 H1: loss £1.0 million) following investment in operational capacity
- Operating loss £2.1 million (2003 H1: loss £1.1 million)
- Loss before tax £1.5 million (2003 H1: loss £1.0 million)
- Significant contract wins in Drug Development Services and Private Diagnostic Pathology Markets

Post period events

- Secured leading position in Dubai through acquisition of majority shareholdings in two additional, profitable laboratories
- Awarded first two Liquid Based Cytology (“LBC”) contracts in UK to supply Wales and Birmingham Women’s Hospital/Good Hope Hospital with SurePath™ systems and consumables

* This figure is derived from the profit and loss account on page 7.

Chairman's statement

"I am pleased with the progress the Group has made since the beginning of the year. We have won the first two Liquid Based Cytology contracts to be awarded in England and Wales and are confident of adding further contracts in the coming months. Our footprint in the Middle East has been strengthened with the acquisition of majority shareholdings in Dubai Medical Laboratories and Specialised Clinical Laboratories. In line with previous years and given the nature of our business it remains difficult at this time to precisely predict the likely out-turn for the full year. However we now have growing, recurring income streams, which are historically weighted to the second half, and are well placed to deliver increased revenues in the coming months."

Introduction

Medical Solutions is now a highly focused business with two core divisions, Services and Technology.

Our Services division delivers specialist pathology-based services, Biomaterials Resources and expertise to the global Pharmaceutical and Biotechnology industry, as well as public and private healthcare providers based in the UK and Dubai. The combination of world-renowned expertise, state of the art Reference Laboratory facilities and image analysis coupled with innovative technology places Medical Solutions in a unique position to fully exploit the increasing international demand for outsourced support services, particularly in the fight against cancer.

Our Technology division has a range of products, which includes specialist software in virtual microscopy, telepathology, image analysis and tissue quantification. It also includes SurePath™ our system for preparing Liquid Based Cytology ("LBC") smear samples. The SurePath™ system is more effective than conventional smear tests in picking up

likely cancer cases and US studies have demonstrated a 64.4% improvement over conventional methods in the detection of high-grade abnormalities. On 20 October 2003, the Department of Health accepted the decision by the National Institute of Clinical Excellence ("NICE") that LBC should replace the current cervical smear test in England and Wales. Medical Solutions has already demonstrated its ability to capitalise on this market opportunity having been awarded contracts since the period under review to supply the whole of Wales together with the Birmingham Women's Hospital and Good Hope Hospital, Sutton Coldfield.

Financial overview

Turnover in the first half of 2004 rose 30% to £3.7 million (2003 H1: £2.9 million), split as to £2.8 million (2003 H1: £1.9 million) from the Services division and £0.9 million (2003 H1: £1.0 million) from the Technology division. Growth in the Services division was primarily generated by diagnostic pathology services as a result of acquisitions in the UK and Dubai in 2003.

We have continued to invest in additional staff and facilities to provide the necessary operating capacity, particularly for our drug development services to pharmaceutical and biotechnology companies. This has led to a reduction in overall gross margin to 31.3% during the period. Our revenue profile is typically weighted towards the second half of the year in line with the purchasing trends of large pharmaceutical customers. We remain confident that such a profile will be repeated in 2004 thus improving margin performance for the full year.

Operating expenses excluding amortisation of goodwill and know-how increased to £2.9 million for the six months ended 30 June 2004 from £2.5 million during the equivalent period in 2003. Amortisation of goodwill and know-how amounted to £0.4 million (2003 H1: £0.1 million). During the period, we increased our sales and marketing investment in order to maximise potential market share from the UK cytology market and this has already yielded two contract wins. Administrative expenses increased as a result of increased costs associated with new management in the UK and Dubai and, under a new sale and leaseback arrangement signed in February, rent on our laboratories in Nottingham for the first time.

The Group generated a profit of £1.0 million from the aforementioned sale and leaseback transaction. Kinetic Imaging was sold in June 2004 for a total consideration of £0.6 million

saving approximately £150,000 of overheads on an annual basis. An exceptional loss on disposal, after writing off unamortised goodwill, of £259,000 has been recognised on this transaction.

The loss before and after tax for the period was £1.5 million (2003 H1: loss before tax of £1.0 million; profit after tax of £0.5 million). The results for the equivalent period in 2003 were helped by the release of £1.5 million of the December 2002 provision for tax of £2.1 million, which related mainly to the disposal of Adams Healthcare.

On 28 February 2004 we completed the sale and leaseback of our headquarters, for a consideration of £4.6 million and an annual rental payment of £400,000, the first instalment of which was paid on 28 February 2004. On the same day we repaid bank loans secured on the building of £1.9 million. During the period we invested £0.7 million in capital expenditure on laboratory equipment, and fittings in Nottingham and Harley Street. We also received £450,000 of the £0.6 million consideration for the sale of Kinetic Imaging, and paid a further £200,000 of deferred consideration in respect of the Welcare Laboratory in Dubai.

In July 2004, the Company raised approximately £1.1 million before expenses, through a placing for cash of 3,100,000 new ordinary shares of 2 pence each in the capital of the Company with institutional investors to provide

Chairman's statement

Financial overview (continued)

additional working capital primarily for planned expansion of our tissue banks and to satisfy the increased demand for our SurePath™ LBC system.

Operational review

Services division

Since the beginning of 2004 we have made good progress in driving this side of the business forward. Divisional revenues have increased by 55% to £2.8 million from £1.8 million.

In the drug development services area, we announced a significant new contract with Synexus, the largest patient recruitment organisation in Europe and in April we announced a unique cancer drug development service in conjunction with Inveresk, one of the world's largest drug development contract research organisations. This new service will enhance the speed and reliability of early cancer drug development and combines our experience in the supply, analysis and curation of tissue to validate drug targets and Inveresk's expertise in drug development services.

Last December we announced a new service to provide specialist biomarker assessment services for the development of new cancer drugs and began working with AstraZeneca. Since then, we have worked closely with AstraZeneca's scientists and clinicians to develop assays for over 25 biomarkers in human tissue samples. Having invested to ensure the necessary capacity is available during the first half of 2004, we anticipate

increasing the level of revenue generated from this work during the second half of the year and beyond.

In the UK diagnostic pathology area, we have integrated the Farrer-Brown business acquired in 2003 and announced a significant new contract with Syon Healthcare. We are the only UK private sector Reference Laboratory providing immuno-histopathology tests such as the HER-2 test for Herceptin treatment of breast cancer. Medical Solutions has been appointed by a further major pharmaceutical company as the sole UK Reference Laboratory responsible for diagnostic testing to determine the suitability of patients for treatment with their drug. We anticipate that our Reference Laboratory clinical services will continue to grow with the introduction of further biological therapeutics.

We believe that our handling of human tissue is fully compliant with the new legislation proposed in the UK Human Tissue Act.

Medical Solutions is an established provider and partner in Dubai Healthcare City whose aim is to provide the highest quality healthcare services through the creation of a world-class cluster of healthcare professionals and service providers. Since the beginning of 2004, we have further strengthened our diagnostic pathology market position in Dubai through a strategic alliance and further acquisitions.

On 8 March 2004, we entered into a strategic alliance with United Laboratories Company ("ULC") a subsidiary of United Medical

Services, a major investor in the healthcare sector in Kuwait. The key aim of the alliance is to enhance the delivery of reference and diagnostic laboratory services in Kuwait and Qatar. Through an exclusive partnering agreement, Medical Solutions will provide specialised laboratory services, in particular, histopathology, to enhance the technical capabilities of ULC.

In August we acquired majority shareholdings in two profitable laboratory based businesses, Dubai Medical Laboratory and Specialised Clinical Laboratory, financed through a placing of approximately £2 million of shares. Following these acquisitions, we intend to consolidate our Dubai laboratory operations in Dubai Healthcare City and secure our position as the leading provider of pathology services in that region.

Technology division

After approval by NICE and the Department of Health in the last quarter of 2003, individual centres have been evaluating Liquid Based Cytology systems, including our SurePath™ product. It is pleasing that Medical Solutions has been selected by each of the first two bodies to award contracts (Cervical Screening, Wales and Birmingham Women's Hospital/Good Hope Hospital, Sutton Coldfield). In each case, Medical Solutions will supply the SurePath™ system and related consumables under five year contracts, together expected to be worth £0.75 million per year. These contract wins demonstrate the compelling scientific and economic reasons for choosing SurePath™ and justifies our significant investment in

people, time and capital to be a leader in this market. We remain confident in our ability to secure our targeted market share in this important market segment.

Management

We have strengthened the operational management of the Company with a number of key appointments. Carol Knott and Cliff Murray have been appointed to the positions of General Manager, Diagnostic Pathology and Senior Scientist in Drug Development respectively. Carol joins Medical Solutions from Barnet and Chase Farm NHS Trust where she was Associate Director Operations. Previous to that Carol spent eight years at BUPA, most recently as General Manager of Pathology. Cliff is a highly respected research scientist who is currently Reader in Oncology at Nottingham University and Head of the CRUK Tumour Cytokine Biology Group. Both Carol and Cliff are widely respected in their fields and significantly strengthen the operational management of the Company.

Prospects

Medical Solutions is well positioned for growth in each of its targeted markets.

Our Services division has grown strongly and now has laboratories and a commercial infrastructure in the UK and Dubai, serving both public and private healthcare markets and the drug development industry worldwide. The Board remains confident that the recent acquisitions in Dubai, whilst not consolidated within these results, will be earnings enhancing

Chairman's statement

Prospects (continued)

when the Group reports its results for the full year ending 31 December 2004.

With many current cancer drugs becoming generic by 2009, the Board believes that there is a key role for the Group in helping to support the pharmaceutical industry in its efforts to convert the thousands of chemical entities being investigated by the major drug companies into new effective, commercial drugs.

In our Technology division, the SurePath™ system has begun to penetrate the UK cytology market and we remain confident of further growth in this area.

With regard to the likely out-turn for the full year, it is very difficult to predict precisely the final form and size of contracts currently under discussion with existing and potential new partners. In our experience, it is also difficult to forecast accurately the timescales over which revenue will be generated as many of the factors are outside our direct control. We have a focused business, an experienced and ambitious Board and the necessary infrastructure, strategic alliances, skills and technology to build a substantial and profitable business for the future.



Sir Gareth Roberts FRS, FREng
Non-Executive Chairman
21 September 2004

Unaudited consolidated profit and loss account

For the six months ended 30 June 2004

	Six months ended 30 June 2004 £'000	Six months ended (not reviewed) 30 June 2003 £'000	Year ended 31 December 2003 £'000
Turnover	3,749	2,881	7,300
Gross profit	1,174	1,491	3,430
Selling and distribution expenses	(513)	(349)	(832)
Research and development	(122)	(447)	(1,070)
Administrative expenses	(2,651)	(1,766)	(3,761)
Operating (loss)	(2,112)	(1,071)	(2,233)
Operating (loss) before amortisation	(1,738)	(1,000)	(1,798)
Amortisation of goodwill and know-how	(374)	(71)	(435)
	(2,112)	(1,071)	(2,233)
Profit on sale of fixed assets	1,000	—	—
Loss on sale of operations	(289)	(91)	(91)
Interest (payable)/receivable	(53)	123	63
(Loss) before taxation	(1,454)	(1,039)	(2,261)
Taxation	—	1,537	2,126
Profit/(loss) on ordinary activities after taxation	(1,454)	498	(135)
(Loss)/earnings per ordinary share	(1.63)p	0.63p	(0.16)p

All results are derived from continuing activities.

Unaudited consolidated balance sheet

As at 30 June 2004

	Six months ended 30 June 2004 £'000	Six months ended (not reviewed) 30 June 2003 £'000	Year ended 31 December 2003 £'000
Fixed assets			
Tangible	3,271	5,009	6,594
Intangible	14,537	14,788	15,634
	17,808	19,797	22,228
Current assets			
Stocks	1,419	1,267	1,461
Debtors	3,503	2,013	2,783
Cash at bank	2,528	6,105	3,250
	7,450	9,385	7,494
Current liabilities			
Creditors: Amounts falling due within one year	(4,266)	(3,814)	(5,565)
Net current assets	3,184	5,571	1,929
Total assets less current liabilities	20,992	25,368	24,157
Creditors: Amounts falling due after one year	(4,354)	(6,844)	(6,045)
Net assets	16,638	18,524	18,112
Share capital and reserves	16,638	18,524	18,112

Unaudited consolidated cash flow statement

For the six months ended 30 June 2004

	Six months ended 30 June 2004 £'000	Six months ended (not reviewed) 30 June 2003 £'000	Year ended 31 December 2003 £'000
Net cash (outflow) from operating activities	(1,078)	(1,458)	(2,057)
Returns on investments and servicing of finance	(53)	123	63
Capital expenditure and financial investment	4,255	(4,295)	(6,074)
Acquisitions and disposals	214	(7,697)	(7,263)
Cash inflow/(outflow) before management of liquid resources	3,338	(13,327)	(15,331)
Financing			
– issue of shares	—	2,000	—
– (decrease)/increase in debt	(2,547)	1,622	2,068
Increase/(decrease) in cash in the period	791	(9,705)	(13,263)

Reconciliation of operating profit to net cash (outflow) from operating activities

Operating (loss)	(2,112)	(1,071)	(2,233)
Depreciation	279	191	372
Amortisation	479	158	751
Exchange movements on consolidation	(63)	—	—
Decrease/(increase) in stocks	42	(240)	(441)
Increase in debtors	(615)	(711)	(1,551)
Increase in creditors	912	215	1,045
Net cash outflow from operating activities	(1,078)	(1,458)	(2,057)

Unaudited divisional sales

For the six months ended 30 June 2004

	Six months ended 30 June 2004 £'000	Six months ended (not reviewed) 30 June 2003 £'000	Year ended 31 December 2003 £'000
Continuing operations			
Technology	904	1,038	2,199
Services	2,845	1,841	5,101
	3,749	2,879	7,300

Notes to the financial statements

30 June 2004

1. This interim report does not comprise the Group's statutory accounts. The interim accounts have been prepared using accounting practices stated in the Group's report and accounts for the year ended 31 December 2003 and are unaudited.
2. The results for the year ended 31 December 2003 are extracts from the published accounts as filed with The Registrar of Companies. These were audited and reported upon without qualification by Deloitte and Touche LLP and did not contain a statement under section 237(2) or (3) of the Companies Act 1985.
3. No interim dividend has been declared (2003: nil).
4. The calculation of profit/(loss) per ordinary share is based on a weighted average number of shares in issue during the six months of 89,403,240 (2003: 79,623,020).
5. The interim statement is being sent to shareholders and further copies are available from the Company's registered office at 1 Orchard Place, Nottingham Business Park, Nottingham NG8 6PX.

Independent review report

To Medical Solutions plc

Introduction

We have been instructed by the Company to review the financial information for the six months ended 30 June 2004 which comprises the profit and loss account, the balance sheet, the summarised cash flow statement and related notes 1 to 5. We have read the other information contained in the interim report and considered whether it contains any apparent misstatements or material inconsistencies with the financial information.

This report is made solely to the Company in accordance with Bulletin 1999/4 issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the Company those matters we are required to state to them in an independent review 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, for our review work, for this report, or for the conclusions we have formed.

Directors' responsibilities

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

Review work performed

We conducted our review in accordance with the guidance contained in Bulletin 1999/4 issued by the Auditing Practices Board for use in the United Kingdom. A review consists principally of making enquiries of group management and applying analytical procedures to the financial information and underlying financial data and, based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit performed in accordance with UK auditing standards and therefore provides a lower level of assurance than an audit. Accordingly, we do not express an audit opinion on the financial information.

Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial information as presented for the six months ended 30 June 2004.

Deloitte & Touche LLP

Chartered Accountants

Nottingham

21 September 2004

Directors and advisors

Directors

Sir G.G. Roberts	Non-Executive Chairman
Dr S Foden	Non-Executive Director
C.A. Green	Chief Executive Officer
Professor K. Sikora	Scientific Director
Professor I.O. Ellis	Medical Director
A.D. Longstaffe	Finance Director and Company Secretary

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