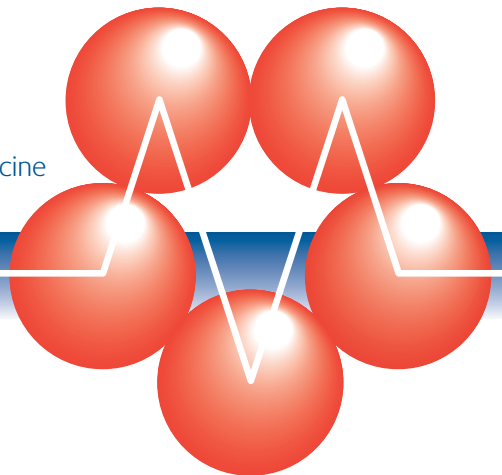




Interim Report 2007

Innovative solutions in laboratory medicine



Corporate Overview

Medical Solutions plc is a provider of expert, quality services and products to the healthcare, pharma biotech and life sciences research sectors.

The Group has its headquarters in Nottingham, UK where it operates state of the art reference laboratory facilities.

Pathology Services

Pathology Services comprises Diagnostic Pathology and Drug Development Services based in Nottingham, UK. Pathology Services provides a range of expert pathology services to public and private healthcare providers and clients in the pharmaceutical and biotechnology industries. Pathology Services also has access to an established bank of normal and diseased processed human tissue and a network of over 60 specialist consultant pathologists.

Cytology

Our Cytology division provides the latest cytology screening equipment and techniques. The division distributes the SurePath™ liquid based cytology system (“LBC”) in the UK and Ireland for both gynaecological and non-gynaecological applications.

Medical Solutions has an unparalleled combination of expertise in diagnostic pathology and cytology. This places Medical Solutions in a unique position to fully exploit the increasing demand for outsourced support services and specialist diagnostic capabilities. The acquisition of Geneservice has added cutting edge genomic technologies, creating a “one-stop shop” for diagnostic and drug development support services as well as additional UK laboratory facilities in Cambridge and Oxford.

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Highlights

Financial highlights – continuing operations

- 16% improvement in normal administrative expenses, reduced to £1,735,000 (2006: £2,065,000)
- 31% improvement in operating loss (before exceptional credit) to £880,000 (2006: £1,270,000 loss)
- Exceptional credit of £206,000 achieved
- 77% improvement in loss before tax to £304,000 (2006: £1,310,000 loss)
- Net cash of £14.1 million (30 June 2006: £2.7 million)

Key events

- Post period end acquisition of Geneservice Limited (“Geneservice”), enhancing the Group’s service offering by including genomic technologies, creating a “one-stop shop” for diagnostic and drug development support services. Geneservice traded profitably prior to acquisition, producing a profit before tax of £216,000 for the eleven months to February 2007
- Appointment as exclusive UK distributor for Oncotype DX™, a cutting edge breast cancer diagnostic assay, by Genomic Health, Inc.
- Geneservice chosen by Applied Biosystems, Inc. to be the UK service provider of its SNPlex™ Genotyping System
- Acquisition of a 40% equity stake in Number One Health Group Limited (“Number One Health”), providing access to the private healthcare market
- Laboratory licensed by the Human Tissue Authority; maintained GLP compliance and CPA accreditation

CHAIRMAN'S STATEMENT

Introduction

The first half of 2007 has seen Medical Solutions take the first steps in realigning the activities of the business and enhancing our service offering in both our core pathology expertise and our drug development support services.

At the same time as looking to grow the business we have continued to review the cost base of the Group to ensure it is appropriate. We have made further savings in operating expenses and have reduced operating costs (before an exceptional credit) by £0.4 million compared with the same period last year.

The acquisition of Geneservice, which was completed in July, has revolutionised our diagnostic services which now include the latest DNA and RNA based techniques. This represents a significant enhancement of our service offering to both the healthcare and the pharmaceutical and biotechnology sectors and opens up new markets for the Group in the life sciences research sector.

The rapid and effective integration of the Geneservice business, including consolidation onto the Nottingham site, is a key priority for management for the second half of this year and significant progress has already been made.

Financial review

Turnover for the six months ended 30 June 2007 was consistent with that achieved in the first half of 2006 at £3.1 million (2006: £3.2 million) although we experienced pressure on sales volumes in our Diagnostic Pathology business as highlighted below.

Gross margins have also remained consistent although a slight improvement from 39% to 41% was evident in the first half of 2007 compared with the first half of 2006. However it is likely that we could see pressure on gross margins during the second half of 2007 as we seek to grow our sales volumes in Diagnostic Pathology.

The Board has continued to focus on the control of costs in the business and operating expenses have been reduced to £2.1 million (before an exceptional credit of £0.2 million, note 6) for the six months ended 30 June 2007 from £2.5 million during the same period in 2006. These savings have been achieved through a combination of further efforts to improve the efficiency of the operations and the impact of the staff restructuring that was undertaken at the start of the year.

We have utilised £0.6 million of cash in our trading activities in the first half of 2007. In addition, we have invested £0.3 million in the acquisition of a 40% equity stake in Number One Health and have paid £0.2 million of transaction and restructuring expenses resulting from the Dubai disposal. The Group also earned interest of £0.4 million, of which £0.2 million was not received until the second half of the year. Net cash outflow in the six months ended 30 June 2007, including the non-trading items, amounted to £1.1 million (2006: cash outflow £0.7 million). The Group had a net cash balance of £14.1 million as at 30 June 2007 (30 June 2006: £2.7 million; 31 December 2006: £15.2 million).

“The acquisition of Geneservice has revolutionised our diagnostic services which now include the latest DNA and RNA based techniques”

Operational review

Diagnostic Pathology

The second half of 2006 and first half of 2007 have been challenging periods for Diagnostic Pathology. Sales in the six months ended 30 June 2007 were £0.8 million compared with £1.3 million during the same period in 2006.

We have identified opportunities to grow this business by expanding the range of diagnostic and theranostic testing services offered by the Group and by entering strategic relationships with healthcare providers thereby increasing demand for diagnostic testing and reducing volatility in that demand.

We have made significant progress in the first half of this year towards realising these opportunities. We have launched the first of our tailored packages of tests, targeted at breast cancer, aimed at supporting clinicians in their clinical decision making and helping them achieve the best possible outcome for the patient.

In April we announced the acquisition of a 40% stake in the private healthcare provider Number One Health, based in Harley Street. This opens up a new channel for Medical Solutions to market our portfolio of diagnostic tests directly to the public.

In June we announced our exclusive distribution agreement with Genomic Health, Inc. to distribute their *Oncotype DX™* breast cancer test in the UK and this represents a key strategic relationship for Medical Solutions. The addition of *Oncotype DX™* to our portfolio significantly strengthens our position as a leading provider of cutting edge diagnostic and prognostic cancer testing in the UK.

During the second half of the year, we are looking to develop this area of our business through investment in new specialist testing services, enhancement of our diagnostic portfolio and an increase in the size of our sales and business development team.

Drug Development Support Services (“DDS”)

The increased focus of our sales and marketing activity on the small to medium sized pharmaceutical and biotechnology companies is starting to show some reward and sales have increased 30% to £207,000 in the first half of the year compared with the same period last year (2006: £156,000).

There has been increasing demand from the pharmaceutical and biotechnology sectors for companies that could offer a portfolio of services from classical tissue pathology through to the latest DNA and RNA based techniques including mutation testing and gene expression profiling. In response to this demand, the Board sought to identify and target appropriate investment and acquisition opportunities to bring these genomic technologies in-house and on 3 July 2007 we completed the acquisition of Geneservice (note 7).

Medical Solutions now provides a “one-stop shop” for diagnostic services from tissue analysis to genomic services including gene expression profiling and genotyping. This enables us to offer molecular diagnostic analysis for pre- and early-stage clinical therapeutic development programmes as well as a full suite of pharmacogenomic services.

CHAIRMAN'S STATEMENT

Operational review (continued)

Clearly there remains much to do, however the sales pipeline is encouraging as is the increasing number of companies engaging Medical Solutions for regulatory study work and the increase in repeat business. The expansion of our service offering to include the genomic expertise and technology platforms acquired with Geneservice, is crucial to the growth of this element of our business.

Cytology

Cytology continues to be a great success story for Medical Solutions. The growth in the business has been strong and we have now completed the roll out programme for the Surepath™ liquid based cytology ("LBC") systems, consolidating our 47% share of the LBC market in England and Wales.

Sales in the first half of 2007 were £2.1 million compared with £1.7 million in the first half of 2006 and the segment result improved to £0.5 million (2006: £0.3 million) over the same period.

With the roll out programme for LBC systems now complete, sales in Cytology are expected to plateau over the next year as we achieve the anticipated run rate on the installed systems. However, there are exciting new opportunities for the Cytology business.

The key opportunities for continued growth are provided by extending the use of the LBC systems for non-gynaecological applications, the use of ProExC™, a molecular diagnostic assay, to assist in the identification of pre-cancerous cervical cells in borderline cases and, the opportunity with the greatest potential, the introduction of automated screening for cervical cancer in the UK.

Medical Solutions has continued to support the Health Technology Assessment ("HTA") trial on automated cervical cancer screening technologies being conducted in Manchester, but because of the importance of automated screening we have invested in co-sponsorship of further trials. During the period an automated screening trial in Wales has been undertaken in conjunction with Cervical Screening Wales. We expect the results of this trial to be published during the second half of this year. The HTA trial is not expected to conclude until late 2008 or early 2009.

Post period events

On 3 July 2007 we were delighted to announce the completion of the acquisition of Geneservice Limited for consideration of £3.86 million. Geneservice is a profitable, expanding company offering genomic products and technology services for applications in life sciences and clinical research and development. The acquisition was in line with the Group's strategy to grow our healthcare and diagnostic business by enhancing our portfolio of products and services to include DNA and RNA based techniques. It also benefits Medical Solutions by providing an expanded service offering and enhanced customer base, higher value quality assured service and a "one-stop shop" for diagnostic services. The integration will also bring cost benefits to the enlarged business including consolidation of operations to Nottingham.

“We will continue to enhance our portfolio of healthcare testing and further develop our “one-stop shop” offering for diagnostic services to the pharma biotech sector”

Board

At the start of the year it was essential to create a stable platform for the growth of the business and establish a Board to deliver that growth. Dr Nick Ash was appointed Managing Director on 1 February 2007, from his former position of Chief Financial Officer. On the same date Sir Gareth Roberts retired from the Board on the grounds of ill health.

On 3 July 2007, following the acquisition of Geneservice, the Board was further strengthened by the appointment of Dr Tom Weaver, former Chief Executive Officer of Geneservice, as Commercial Director. We are sure Tom will be a great asset to the Group as we seek to expand our operations.

Prospects

The short term objective remains to return the Group to profitability and cash generation. This will be achieved through a combination of organic growth and prudent, appropriate investment in acquisition opportunities. With the acquisition of Geneservice, investment in Number One Health and launch of our first cancer diagnostic portfolio, we are already making progress towards our stated aims of expanding our healthcare diagnostic portfolio and enhancing our services to include DNA and RNA based technologies.

During the second half of this year we will focus on the speedy and effective integration of the Geneservice business to accelerate the delivery of the financial benefits of that acquisition. We will continue to enhance our portfolio of healthcare testing and further develop our “one-stop shop” offering for diagnostic services to the pharma biotech sector.

We are equipping the Group with the breadth and depth of service offering, technology platforms and expertise to deliver controlled growth and value to shareholders.



Laurie Turnbull

Executive Chairman
10 September 2007

UNAUDITED CONSOLIDATED INCOME STATEMENT

For the six months ended 30 June 2007

		Six months ended 30 June 2007	Six months ended 30 June 2006 (as restated*)	Year ended 31 December 2006
	Note	£'000	£'000	£'000
Continuing operations				
Revenue	2	3,120	3,157	6,025
Cost of sales		(1,851)	(1,921)	(3,640)
Gross profit		1,269	1,236	2,385
Selling and distribution expenses		(353)	(341)	(609)
Administrative expenses:				
– normal		(1,735)	(2,065)	(3,837)
– restructuring costs		–	–	(185)
– exceptional credit	6	206	–	–
Administrative expenses		(1,529)	(2,065)	(4,022)
Research and development		(61)	(100)	(167)
Operating loss from continuing operations		(674)	(1,270)	(2,413)
Finance income		386	44	186
Finance costs		(12)	(84)	(105)
Share of results of associate		(4)	–	–
Loss before tax from continuing operations		(304)	(1,310)	(2,332)
Taxation		–	–	–
Loss after tax but before profit from discontinued operations		(304)	(1,310)	(2,332)
Discontinued operations				
Profit from discontinued operations		–	1,262	946
Loss for the period		(304)	(48)	(1,386)
Attributable to:				
Equity holders of the parent company		(304)	(69)	(1,386)
Minority interest		–	21	–
Loss for the period		(304)	(48)	(1,386)
Loss per share attributable to the equity holders of the company				
Basic and diluted loss per ordinary share from continuing operations	3	(0.15)p	(0.64)p	(1.14)p
Basic and diluted total loss per ordinary share	3	(0.15)p	(0.03)p	(0.68)p

* For details of restatement see note 5.

UNAUDITED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

As at 30 June 2007

	Attributable to equity holders of the Company						Total Equity £'000
	Share capital £'000	Share premium £'000	Merger and other reserves £'000	Translation reserve £'000	Profit and loss reserve £'000	Minority interest £'000	
Balance at 1 January 2006	4,075	32,284	4,608	117	(24,201)	52	16,935
Currency translation adjustments	-	-	-	(255)	-	(1)	(256)
Net income recognised directly to equity	-	-	-	(255)	-	(1)	(256)
Loss for the period (as restated note 5)	-	-	-	-	(69)	21	(48)
Total recognised (expense)/income for the period	-	-	-	-	(69)	21	(48)
Employee share option scheme:							
- value of services provided	-	-	-	-	83	-	83
Minority interest settled in cash	-	-	-	-	-	(52)	(52)
Balance at 30 June 2006	4,075	32,284	4,608	(138)	(24,187)	20	16,662
Balance at 1 July 2006	4,075	32,284	4,608	(138)	(24,187)	20	16,662
Currency translation adjustments	-	-	-	(152)	-	(1)	(153)
Net income recognised directly to equity	-	-	-	(152)	-	(1)	(153)
Realisation of merger reserve	-	-	(2,200)	-	2,200	-	-
Loss for the period	-	-	-	-	(1,317)	8	(1,309)
Total recognised (expense)/income for the period	-	-	(2,200)	(152)	883	7	(1,462)
Employee share option scheme:							
- value of services provided	-	-	-	-	(36)	-	(36)
Disposal of overseas subsidiary	-	-	-	290	-	(27)	263
Balance at 31 December 2006	4,075	32,284	2,408	-	(23,340)	-	15,427
Balance at 1 January 2007	4,075	32,284	2,408	-	(23,340)	-	15,427
Loss for the period	-	-	-	-	(304)	-	(304)
Total recognised income for the period	-	-	-	-	(304)	-	(304)
Employee share option scheme:							
- value of services provided	-	-	-	-	15	-	15
Balance at 30 June 2007	4,075	32,284	2,408	-	(23,629)	-	15,138

UNAUDITED CONSOLIDATED BALANCE SHEET

As at 30 June 2007

	As at 30 June 2007 £'000	As at 30 June 2006 (as restated) £'000	As at 31 December 2006 £'000
Non-current assets			
Goodwill	583	14,641	583
Other intangible assets	80	154	117
Investment in associate	144	–	–
Loan to associate	125	–	–
Property, plant and equipment	1,411	1,983	1,634
	2,343	16,778	2,334
Current assets			
Inventories	455	726	533
Trade and other receivables	1,608	3,287	1,172
Financial assets – cash and cash equivalents	14,083	2,688	15,229
	16,146	6,701	16,934
Current liabilities			
Trade and other payables	3,064	3,801	3,473
Financial liabilities – borrowings	166	240	162
Provisions	–	2,489	–
	3,230	6,530	3,635
Net current assets	12,916	171	13,299
Total assets less current liabilities	15,259	16,949	15,633
Non-current liabilities			
Financial liabilities – borrowings	121	287	206
Net assets	15,138	16,662	15,427
Equity			
Issued share capital	4,075	4,075	4,075
Share premium	32,284	32,284	32,284
Other reserves	2,408	4,470	2,408
Profit and loss reserve	(23,629)	(24,187)	(23,340)
Total equity attributable to equity holders of the parent company	15,138	16,642	15,427
Minority interest	–	20	–
Total equity	15,138	16,662	15,427

UNAUDITED CONSOLIDATED CASHFLOW STATEMENT

For the six months ended 30 June 2007

	Note	Six months ended 30 June 2007 £'000	Six months ended 30 June 2006 (as restated) £'000	Year ended 31 Dec 2006 £'000
Cash flows from operating activities (continuing operations)				
Cash used in operations	4	(863)	(457)	(841)
Interest paid		(12)	(23)	(45)
Net cash used in operating activities (continuing operations)		(875)	(480)	(886)
Cash flows from investing activities (continuing operations)				
Investment in associate		(148)	-	-
Loan to associate		(125)	-	-
Purchases of property, plant and equipment		(64)	(141)	(255)
Purchases of intangible assets		-	(11)	(12)
Proceeds from sale of property, plant and equipment		-	2	2
Proceeds from sale of subsidiary		-	-	13,963
Transaction costs arising from sale of subsidiary		(53)	-	(748)
Cash remaining in disposal group		-	-	(1,623)
Interest received		200	44	180
Net cash (used in)/generated from investing activities (continuing operations)		(190)	(106)	11,507
Cash flows from financing activities (continuing operations)				
Repayment of borrowings		(53)	(143)	(277)
Finance lease principal repayments		(28)	(12)	(37)
Net cash used in financing activities (continuing operations)		(81)	(155)	(314)
Net (decrease)/increase in cash and cash equivalents (continuing operations)		(1,146)	(741)	10,307
Cash flows from operating activities (discontinued operations)				
Cash generated from operations		-	1,233	2,744
Net cash generated from operating activities (discontinued operations)		-	1,233	2,744
Cash flows from investing activities (discontinued operations)				
Purchases of property, plant and equipment		-	(54)	(83)
Net cash used in investing activities (discontinued operations)		-	(54)	(83)
Cash flows from financing activities (discontinued operations)				
Payment of accrued minority interest		-	(52)	(52)
Net cash used in financing activities (discontinued operations)		-	(52)	(52)
Net increase in cash and cash equivalents (discontinued operations)		-	1,127	2,609
Net (decrease)/increase in cash and cash equivalents		(1,146)	386	12,916
Cash and cash equivalents at beginning of period		15,229	2,313	2,313
Exchange losses on cash and cash equivalents		-	(11)	-
Cash and cash equivalents at end of period		14,083	2,688	15,229

NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

For the six months ended 30 June 2007

1. BASIS OF PREPARATION

These 30 June 2007 consolidated interim financial statements do not constitute statutory financial statements within the meaning of section 240 of the Companies Act 1985. Our auditor, PricewaterhouseCoopers LLP, has issued an unqualified opinion on the Group's IFRS financial statements for the year ended 31 December 2006 and has not included a statement under section 237(2) or (3) of the Companies Act 1985.

These consolidated interim financial statements have been prepared in accordance with IAS 34 Interim Financial Reporting. They have been prepared in accordance with IFRS and the accounting policies applied are consistent with those applied in the preparation of the Group's consolidated financial statements for the year ended 31 December 2006, except for the adoption of the following amendments which are mandatory for annual periods beginning on or after 1 January 2007:

- Amendment to IAS 1 Capital disclosures. The IASB has issued an amendment to IAS1 requiring new disclosures about entities' management of their capital resources;
- IFRS7 Financial instruments: Disclosures. The IASB has issued a new standard on disclosures in respect of financial instruments. This replaces IAS 30 and the disclosure requirements in IAS 32 and locates in one place all disclosures relating to financial instruments. The new requirements incorporate many of the IAS 32's disclosures as well as additional qualitative and quantitative disclosures on the risks arising.

The adoption of these amendments did not affect the Group results or financial position.

2. SEGMENTAL ANALYSIS

Primary reporting format – operating divisions

At 30 June 2007, the Group is organised into two main operating divisions:

- Pathology Services
- Cytology

Pathology Services comprises the business units of Diagnostic Pathology and Drug Development Support.

During the period there were immaterial sales between business segments (six months ended 30 June 2006: immaterial; year ended 31 December 2006: immaterial) and, where these do occur, are at arm's length pricing.

Unallocated costs represent corporate expenses and common operating costs including property expenses. Segment assets include goodwill, plant and equipment, stocks and debtors. Unallocated assets include leasehold improvements, central debtors and prepayments and operating cash.

Segment liabilities comprise operating liabilities and exclude borrowings.

Capital expenditure represents additions to both tangible fixed assets, comprising additions to plant and equipment, and intangible fixed assets, comprising capitalised development expenditure.

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