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breathe in...



the big news is, we've changed

Restructured, refocused, ready for growth

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We've ticked a number of strategic boxes in 2005

Restructured the business. Closed six sites.
Cut costs.

Focused on pulmonary products. Marketed
products. Industrialised device technology.

Strengthened corporate governance. New
Chairman and Chief Executive Officer. New
Board of Directors.

Acquired Quadrant. Excellent strategic fit.
Increased revenue base. Expanded intellectual
property estate.

Created a new organisation. Integrated
competences (formulation and device
development). Strengthened management team.

And a commercially focused business.
Closing deals (Duohaler®, Adept®).
Divestment of non-core assets.

Innovata brings together two strong businesses –
they work in combination very well

non-pulmonary

Growing revenues –
from marketed products

pulmonary

The growth driver –
the opportunities are breath-taking

To use the momentum of 2005 to generate growth in 2006, there are a few more boxes we'd like to tick

priorities '06

Financial results.
Revenues and costs.

Business growth. License devices and formulation technology. Strengthen corporate partnerships. Explore mergers and acquisitions.

Products. Achieve regulatory approval for key products. Strengthen pipeline of new products.

Intellectual property. Invest, protect, enforce, out-license.

People. Create a high performance organisation.

The opportunities for growth are breath-taking

now

A substantial and growing market

Why deliver drugs to the lungs?

In respiratory disease

- **It delivers drugs to the site of action**
– resulting in fewer systemic side effects.

For other conditions

- **It's faster** – with a rapid onset of action compared to tablets or subcutaneous injection.
- **It's needle-free** – using inhalation devices rather than invasive procedures.
- **It's simpler** – compared to injections or intravenous drugs.
- **Potential greater bioavailability** – more drug may be absorbed through the lungs than through the gut.

The majority of treatments for asthma and chronic obstructive pulmonary disease (COPD) are delivered by inhalation with many patients taking more than one type of therapy. With over 17 million people suffering from asthma in the US alone, global markets are valued in excess of \$13 billion today and are forecast to grow to over \$25 billion in 2010.*

In parallel, the COPD market, with approximately 20 million sufferers in the US, often under or misdiagnosed, is worth just over \$3 billion and is forecast to grow to over \$7 billion by 2010.*

The growth in these markets is being driven by several trends including improved diagnosis of asthma and COPD, the use of fixed combination therapy and new treatments for COPD.

Inhaled fixed combination therapy is the use of two drugs in a fixed dose

combination in one inhaler in order to gain optimal clinical benefits by improving patient compliance and exploiting improved efficacy. One new combination product, Advair®/Seretide® is now the 7th largest pharmaceutical product with worldwide sales of over \$5 billion.** Fixed combination therapy is forecast to have a significant impact in both the asthma and COPD sectors.

Unlike asthma, for which the treatment options are extremely effective, COPD responds relatively poorly to the same medications. The COPD market is therefore less developed but recently introduced treatments such as Spiriva® have boosted this sector and are driving growth forecasts.

*Source: ING Financial Markets, Asthma & COPD, July 2004.

**Source: GlaxoSmithKline, 3Q 2005 and 2004 annual results.

the future

Delivering more drugs by inhalation

Over recent years, taking medicines by inhalation has evolved to include a variety of approaches for different diseases. Today, small molecules are delivered by inhalation both locally to the lungs and systemically via the lungs.

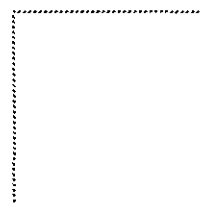
With Exubera®, an inhaled insulin intended to treat diabetes being filed with the US Food and Drug Administration ("FDA"), it is likely that insulin will be the first macromolecule delivered by inhalation. (With 194 million diabetics globally in 2003, forecast to reach 333 million by 2025, there is already a considerable market, with global sales in the diabetes category of \$14 billion, in 2004.*) Nebulised solutions of dornase-alpha and tobramycin, both used in the treatment of patients with cystic fibrosis, have also entered the market.

Innovata believes that in the future, inhalation will be used to deliver a wide range of small molecules such as antibiotics and antivirals and larger macromolecules such as antibodies and interferon. Innovata also believes that its intellectual property and technologies will be the basis on which it will develop novel therapies to the lungs and exploit this potentially large market.

*Source: S G Cowen, Insulated Growth, January 2006.

Quadrant was identified as an ideal strategic fit

acquisition



+ Additional revenue

+ Formulation

+ Intellectual property

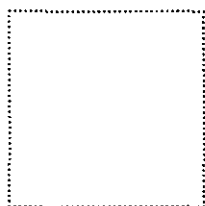
Following the restructuring of M L Laboratories in March 2005, the Company's new strategy was to focus on its revenue generating pulmonary product business. The acquisition of Quadrant for £48.5 million was identified as a significant step in implementing this strategy.

Raj Uppal,
former Chief Executive Officer
Quadrant

"From the outset we believed that our two businesses would fit well together. Quadrant was already providing development support and formulations services for two of the Group's pulmonary drug programmes. The combined business has greater critical mass and a more credible base on which to build a profitable and growing business."

Successful integration was enabled by rapid decision making

integration



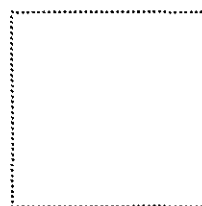
Paul Ballington,
Director of Commercial Operations

"This newly formed company provides a synergy of product offerings which I believe gives Innovata a unique position when pitching for business with potential new partners."



Colin Dalton,
Corporate Development Director

"Considering how much change resulted from the M L Laboratories' restructuring and how challenging it was for some staff, it is a major achievement that we have a significant number of people operating very effectively. It is not simple to integrate under these circumstances and we must remain an attractive organisation to work for. People have stopped thinking that they are part of M L Laboratories or Innovata Biomed or Quadrant and now think of being part of a new organisation; a new business which they are themselves creating."



Terence Chadwick,
Research & Development Director

"The integration has gone well. It was helped by having a vision for the enlarged company that was easy to communicate to staff. M L Laboratories and Quadrant were complementary in terms of skills, knowledge and competences and so it was easy to create an organisational structure reflecting the business needs, with departments that had clear responsibilities and accountabilities and to populate these departments with minimal disruption to the people involved."

We will benefit from offering broad pulmonary capabilities to the marketplace

on the market

Asmasal®

Clickhaler product with salbutamol, used to treat mild, intermittent asthma.

Salbutamol is a short-acting beta-2 agonist for the quick relief of asthma symptoms.

Asmasal is marketed by UCB in UK, France and Ireland.

Asmabec®

Clickhaler product with beclomethasone used for the longer term control of mild asthma.

Beclomethasone is an inhaled steroid and is used as standard preventative therapy for asthma.

Asmabec is marketed by UCB in UK, France and Ireland.

Innovata receives royalties and/or product margin on these Clickhaler product sales and continues to search for licensees for Clickhaler products in other European countries and worldwide.

Budesonide Clickhaler®

Clickhaler product with budesonide used for the longer term control of mild, intermittent asthma.

Budesonide is an inhaled steroid and is used as standard preventative therapy for asthma.

It is marketed by Merck Respiratory (the respiratory unit of Merck KGaA) in a first European country.

Formoterol Clickhaler®

Clickhaler product with formoterol used for the longer term control of moderate to severe persistent asthma.

Formoterol is a long-acting beta-2 agonist which has a fast onset of action and longer duration than the shorter-acting beta-2 agonists, benefiting patients with more severe symptoms.

It is marketed by Merck Respiratory (the respiratory unit of Merck KGaA) in a first European country.

Meptin™ Clickhaler®

Clickhaler product with Otsuka's asthma treatment, Meptin (procaterol) used to treat mild, intermittent asthma.

Meptin is a short-acting beta-2 agonist for the quick relief of asthma symptoms.

Otsuka markets Meptin in Japan.

in the pipeline

Product name	Product profile	Partner	Pre-clinical	Phase I	Phase II	Phase III	Regulatory approval	Marketed
Clickhaler®	Budesonide Clickhaler and Formoterol Clickhaler to treat asthma	Merck Respiratory						
Clickhaler®	Clickhaler with budesonide to treat asthma	Undisclosed Japan						
Duohaler®	Duohaler with undisclosed fixed dose combinations to treat asthma	Undisclosed Europe						
Inhaled insulin	Rapid acting insulin in DPI format to treat diabetes	Unpartnered	Undisclosed					
Ventavis®	Extended-release formulation of iloprost for use in DPI	CoTherix Inc	Undisclosed					

Budesonide Clickhaler® and Formoterol Clickhaler®

Further European Union approvals are being sought for these Clickhaler products.

Clickhaler® with budesonide

An undisclosed Japanese pharmaceutical company is developing the Clickhaler with budesonide for the treatment of asthma.

Duohaler®

Innovata is developing the Duohaler with two different combinations of established respiratory drugs for an undisclosed leading European pharmaceutical company.

Inhaled insulin

QDose Limited, a company owned equally by Innovata and MicroDose Technologies Inc, is developing a rapid acting inhaled insulin product for the treatment of diabetes. Innovata is developing the formulation and filling method and MicroDose is developing the device.

Ventavis®

Innovata has a collaborative research and development agreement with CoTherix Inc to develop an extended-release formulation of CoTherix's iloprost inhalation product. Ventavis is for the treatment of pulmonary hypertension. Innovata is reformulating the active pharmaceutical ingredient into a dry powder format with controlled release properties.

Solid, reliable growth with our non-pulmonary business

non-pulmonary portfolio

Adept®

A solution used during surgery to prevent post surgical adhesions, a frequent complication following gynaecological and other abdominal surgery and which is acknowledged as a major surgical problem.

Baxter has a global licence for Adept.

Following completion of Phase III trials, the pre-market approval for Adept was accepted for filing by the FDA in May 2005.

Innovata receives royalties on product sales.

Extraneal®

A peritoneal dialysis solution containing icodextrin for the treatment of renal failure patients; over 15,000 patients worldwide are using the solution on a daily basis.

Baxter markets Extraneal worldwide.

Innovata receives royalties on product sales.

Additional value obtained from intellectual property estate

Further value is derived from Innovata's intellectual property from licensing its technologies for the development of non-pulmonary products. Three examples of products being developed using Innovata's technologies are as follows:

Vaccine delivery

A broad-based patent licence was entered into with GlaxoSmithKline ("GSK"), which permits GSK to use Innovata's formulation and delivery patents for DNA vaccines delivered onto, into and across the skin. Innovata will receive payments based on the completion of development milestones achieved and royalties on future product sales. *PowderMed Limited, a company that is developing prophylactic and therapeutic vaccines, has subsequently taken a sub-licence from GSK to use these licensed patents within certain fields. Milestone and royalty payments will also be due to Innovata from PowderMed upon the successful development and commercialisation of its vaccine products.*

ADVATE®

Baxter is licensed to use Innovata's stabilisation patents for the serum-free formulation of Factor VIII (a complex protein which aids blood clotting) for the treatment of haemophilia A.

Baxter markets ADVATE worldwide and 2005 sales are estimated by Baxter to be over \$600 million.

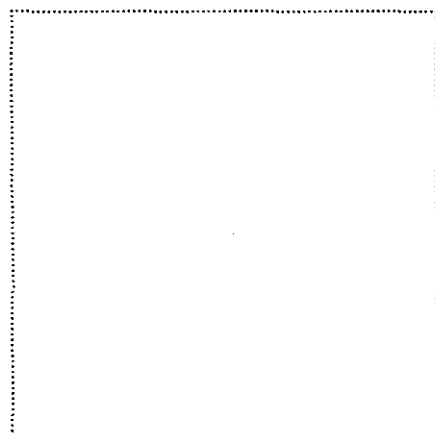
Innovata receives royalties on product sales.

Fibrocaps

Profibrix BV is licensed to use Innovata's patents for the development of Fibrocaps, a novel dry powder tissue sealant that stops acute and severe bleeding after trauma injury or elective surgery. Innovata also entered into a development agreement with Profibrix to develop Fibrocaps, a mixture of fibrinogen and thrombin, in a unique dry powder formulation.

breathe out...

Chairman's statement Creating a new company



It has been an eventful year for this Company.

On 2 March 2005 Kieran Murphy and I were appointed to the Board of M L Laboratories PLC and Stuart Sim resigned as a Director and Executive Chairman.

On 6 April 2005 Fred Hallsworth was appointed as a Non-Executive Director and Chairman of the Audit Committee. Fred had been senior client service partner of Deloitte, Scotland, until January 2005 and has 25 years' experience in the accounting profession.

On 25 April 2005 we announced the restructuring and consolidation of the Group to focus on the respiratory business, reduce costs and improve efficiency. This entailed the closure of the Warrington, Liverpool, Blaby, Keele and Tewkesbury sites, a loss of 65 jobs and the divestment of Devacade®, the gene therapy products, the MATS business and the UCOE gene expression technology.

On 16 May 2005 we announced further changes to the Board: Professor Dayan, Dr Medinger, Professor Davies and Dr Boyes resigned, and Drs Foden and Fromson were appointed. I am very grateful to these

outgoing members of the Board for their contributions over many years.

Dr Susan Foden, who has been appointed as Chairman of the Remuneration Committee, brings significant experience of pharmaceutical patenting and licensing, having been Chief Executive of both Cancer Research Campaign Technology Limited and Cancer Research Ventures. Dr John Fromson, who has been appointed as Chairman of the Nomination and Corporate Governance Committee, has over 30 years' experience in the pharmaceutical industry and in particular in the development of new drugs.

The Board felt it appropriate to review the Company's advisers, consequently Code Securities was appointed as financial adviser/broker, Jones Day as solicitors and Financial Dynamics for financial press relations. After a competitive tendering process, Deloitte & Touche LLP were appointed Auditors.

A month later, on 16 June 2005 we announced the proposed acquisition of Quadrant Technologies Limited, the acquisition of the outstanding minority interest in Innovata Biomed Limited and the proposed change in the name of the Group to Innovata plc. These proposals were subject to shareholder approval and to the success of a Vendor Placing and Placing and Open Offer of 137,499,998 Ordinary Shares at 19p per share. Following the publication of a prospectus on 1 July 2005, these transactions were successfully completed following an EGM on 14 July 2005.

The acquisition of Quadrant strengthened the Group's focus and expertise in the pulmonary delivery of drugs and provided a cash flow from royalty streams. It also enabled us to complete the consolidation of our operations by closing the St Albans site so that, with the exception of a small

site in Farnham which will close in 2006, all staff are now located in a single facility in Nottingham. The acquisition also brought further changes to the Board: Paul Ballington stood down to allow him to focus on his role as Director of Commercial Operations; Drs Dalton and Chadwick were appointed as Executive Directors and Raj Uppal as a Non-Executive Director.

In addition to these actions the Group has reviewed and strengthened its corporate relationships with its collaborators and this is discussed in more detail in the Chief Executive Officer's strategic overview.

Innovata presents a fundamentally different new business proposition: it is focused on pulmonary drug delivery, with strong royalty flows from pharmaceutical companies; it has an appropriate cost base and robust corporate governance.

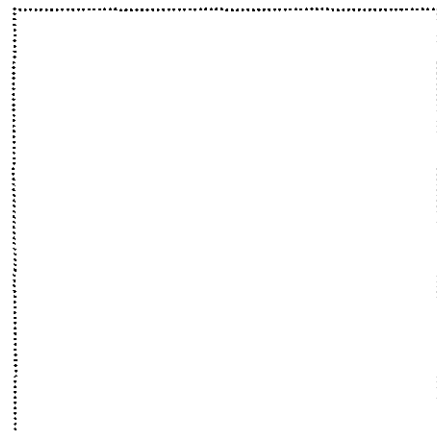
This amount of change would not have been possible without the co-operation of our staff; I thank them for their support during this challenging period and their on-going dedication to Innovata.

Equally critical in this period were our institutional shareholders who encouraged us to take up this challenge and who backed the proposed changes by overwhelmingly supporting the July fundraising, for which we thank them.

Ian Kent, Chairman

Chief Executive Officer's strategic overview

A powerful new force in pulmonary product development



2005 was a turnaround year for this Company. The restructuring of M L Laboratories was executed in an intense period from March to July, during which time we also acquired Quadrant and successfully undertook a fundraising to partially finance the acquisition.

The integration of Quadrant and the relocation of several teams to the new headquarters to create an effective organisation were completed by September. Despite the inevitable upheaval, we have combined the strengths of both companies and created a foundation on which to build a great company. The synergies from bringing together the skill sets of drug formulation, project management, clinical development, regulatory affairs, quality and manufacturing under one roof are already visible.

Unlike many biotech companies, we have a strong revenue base from marketed products, including ADVATE® and Extranal®, both marketed globally by Baxter and enjoying continued growth. We were pleased to announce in recent days a further deal with Baxter for the global marketing of Adept®, for which we expect to gain approval from the US Food and Drug Administration during 2006.

The continuing success of Clickhaler® products, which have gained marketing authorisations in Europe and Japan, demonstrates our capacity to fully develop and industrialise devices and products. We were delighted to announce the launch of Budesonide and Formoterol Clickhalers in Europe in September 2005 and confirm our partner as Merck KGaA who also announced the establishment of a new international respiratory medicines business unit. We are also enjoying growth in the sales of Clickhaler in Japan where it is marketed by Otsuka.

We understand that our success depends on creating alliances with pharmaceutical companies with the marketing infrastructure to promote and deliver products to patients or consumers. The signing of a second Duohaler® deal with our European pharmaceutical partner demonstrates our ability to build relationships, deliver value and gain the confidence of key collaborators.

We will continue to explore the further use of our dry powder inhalers ("DPIs") and intellectual property for other respiratory conditions and for the delivery of systemic drugs by the pulmonary route, including insulin which is part of our joint venture with MicroDose Technologies Inc, the US based device company. We will be actively seeking new partners for our inhaled insulin programme over the coming months.

We have signalled our intent to acquire and integrate complementary businesses, products and technologies and we will continue to evaluate further opportunities in the year ahead.

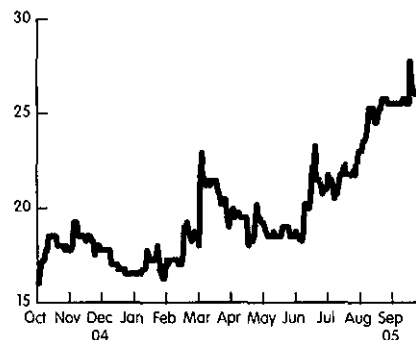
For the financial year ending 30 September 2006, we are pleased to report progress on several fronts. The conclusion of an agreement for Adept, the second Duohaler agreement, the restructuring of our relationship with Bristol-Myers Squibb on insulin and Baxter's confidence on

the prospects for ADVATE have helped to get the Company off to a strong start. We remain confident in the outlook for the business particularly given the prospects for further approvals for the Clickhaler in Europe, the triggering of Duohaler milestones and the potential approval of Adept by the FDA. The Executive Management team will continue to focus on growing revenues and margins, with an emphasis on the execution of well developed strategies and cost control.

We are fortunate to work with outstanding legal and financial advisers who have helped us greatly over the past year and I would like to take this opportunity to thank them for their efforts. Finally, the intensity of purpose demonstrated by the emerging team at Innovata gives me great confidence as we plan for future success and sustainable growth and I am extremely grateful to everyone for their energy, creativity and commitment to the Company over the past year.

Kieran Murphy, Chief Executive Officer

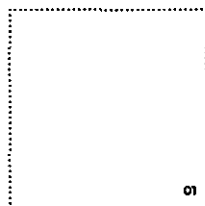
Share price
(pence)



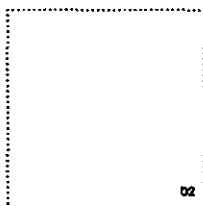
Board of Directors

The Board comprises an Executive Chairman, four Non-Executive Directors and four Executive Directors

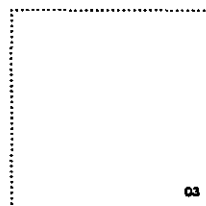
Details of the four Executive Directors may be found on page 15 which also explains the composition of the Executive Management team.



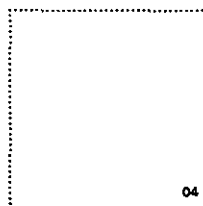
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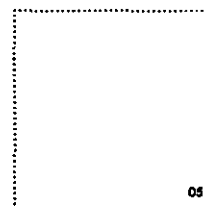
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03



04



05

01 Ian Kent (61), Chairman

Ian Kent joined the Company as Chairman in March 2005. He brings significant experience in the life sciences sector having been Chairman and Non-Executive Director of a number of successful public and private companies. He is currently *Chairman of three privately held biotech companies*, Argenta Discovery Limited, Intercytex Group plc and Plarmed Limited and also Chairman of LGC Group Holdings plc. He was a founder and Chairman of Ardana Biosciences Limited of which he is now a Non-Executive Director and a founder and Chairman of Imutran. His previous Non-Executive appointments include Vernalis plc, Biofocus plc, Adprotech Limited and Roslin Biomed Limited.

02 Dr Susan Foden MA, DPhil (52) Non-Executive Director

Susan Foden joined the Board in May 2005 as a Non-Executive Director and Chair of the Remuneration Committee. She holds a number of Non-Executive Directorships with both public and private companies and public funding bodies in the biotech and healthcare field. She was an Investor Director with venture capital firm Merlin Biosciences Limited, Chief Executive Officer of the technology transfer company, Cancer Research Campaign Technology Limited, Cancer Research Ventures and headed up the academic liaison function at Celltech Limited. She studied biochemistry at the University of Oxford from where she obtained an MA and DPhil.

03 Dr John Fromson BSc, PhD (64) Non-Executive Director

John Fromson joined the Board in May 2005 as a Non-Executive Director and Chair of the Nominations and Corporate Governance Committee. He has over 30 years of experience in multinational pharmaceutical and biotechnology companies which included the development of three major products: Novaldex®, Claforan® and Frovatriptan®. He was formerly Executive Chairman of Ultrafine Limited which he restructured and sold to Sigma-Aldrich Inc in 2004. Prior to Ultrafine, he was Chief Scientific Officer at DevCo Limited and prior to DevCo, Vice President Pre-Clinical Development at Vanguard Medica. He now runs a healthcare consultancy focusing on due diligence and strategic planning for venture capital and technology transfer companies, including Innoven Partenaires, one of the largest technology VC funds in France.

04 Fred Hallsworth BAcc, CA (52) Non-Executive Director

Fred Hallsworth joined the Board in April 2005 as a Non-Executive Director, Chair of the Audit Committee and Senior Independent Director. He has held a number of senior management positions including Managing Partner of Andersen Cambridge and Scotland and latterly Senior Client Service Partner and Head of TMT for Deloitte Scotland until his retirement in January 2005. He is currently a Non-Executive Director of Scottish Enterprise, Infinite Data Storage Group plc, The

Scottish Institute for Enterprise and The Kelvin Institute. He has advised a number of technology and life sciences companies including Inveresk Research Group Inc. and Quadrant during its initial start-up fundraising.

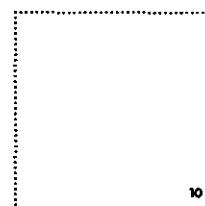
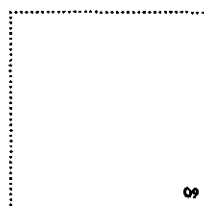
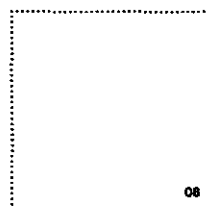
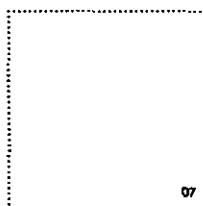
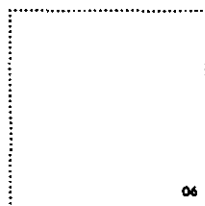
05 Rajan Uppal ACA (43) Non-Executive Director

Raj Uppal was Chief Executive Officer of Quadrant Technologies Limited and is now a Non-Executive Director of Innovata plc. He was previously a Senior Vice President within the Drug Delivery division of Elan Corporation plc ("Elan") when he led the management buy out of the Quadrant business from Elan in July 2003. He joined Elan in 2000 when it acquired Quadrant Healthcare plc, where he was Chief Financial Officer and had undertaken its flotation on the London Stock Exchange. After qualifying as an accountant in 1986, he started his career in industry in 1989 as the Chief Financial Officer of a European printing and packaging group, Ferry Pickering Group plc, where he carried out its successful disposal. He is also a Non-Executive Director of Oxford Biomedica plc, which specialises in the development of novel gene-based therapeutics.

Executive Management team

The day-to-day operations of the Company are managed by Innovata's Executive Management team

The Executive Management team comprises the four Executive Directors (Kieran Murphy, Peter Shennan, Terence Chadwick and Colin Dalton) and Paul Ballington.



06 Kieran Murphy MSc (42) Chief Executive Officer

Kieran Murphy joined the Company as Chief Executive Officer in March 2005 with over 15 years of experience in the life sciences sector. He was previously Chief Executive of Adprotech Limited, a privately-owned UK biotech company, acquired by Inflazyme Pharmaceuticals Inc in 2004. Prior to Adprotech he was Chief Executive Officer of Novartis Animal Vaccines where he led a merger and acquisitions strategy to build a food animal vaccines business. Prior to that he was Chief Executive of Vericore Holdings Limited which he restructured and sold to Novartis AG in 2000. Before Vericore, he spent six years at Mallinckrodt where he held a variety of senior management positions and latterly served as Managing Director for the UK and Ireland businesses. He started his career in the sector working in sales and marketing positions at Janssen UK.

07 Peter Shennan BA, FCA, MSI (55) Finance Director

Peter Shennan joined the Company as Finance Director in 1997 from Coopers & Lybrand. He qualified as a chartered accountant in 1977 and is a Member of the Securities Institute.

08 Dr Terence Chadwick BSc, MB, ChB, MRCP, MFPM (55) Research & Development Director

Terence Chadwick joined Quadrant Healthcare plc in 1998 as the Board Director responsible for Research and Development. Following the acquisition

of Quadrant by Elan Corporation in 2000, he was appointed Vice President for Research and Development at Elan Drug Delivery Ltd. In 2003 he took part in a management buy out which led to the formation of Quadrant Technologies Limited. Following Quadrant's acquisition by M L Laboratories in July 2005, he was appointed Research and Development Director at Innovata plc.

He has over 23 years of experience in the pharmaceutical and biotechnology sector and has held senior international posts in research and development in Novo Nordisk (UK and Copenhagen), Fisons plc and Rhone-Poulenc Rorer (Paris and Philadelphia). He has extensive experience of developing products in a variety of therapeutic areas including diabetes, endocrinology, respiratory, cardiovascular, central nervous system and allergy. He trained as a physician in the UK, obtained honours degrees in Medical Microbiology and Medicine and is a Member of the Royal College of Physicians and the Faculty of Pharmaceutical Medicine. He worked in hospital-based internal medicine and endocrinology for seven years before joining the pharmaceutical industry.

09 Dr Colin Dalton BTech (Hons), PhD (55) Corporate Development Director

Colin Dalton rejoined Quadrant in 2005 as Corporate Development Director and continues in this role with Innovata plc. For five years prior to Quadrant, he was Director of Business Development at GSK

Biologicals where he managed a group responsible for licensing new products and technologies, collaborations and alliances. He previously worked in business development at Quadrant Healthcare plc and British Sugar plc and was a senior consultant in the biotechnology practice at PA Consulting. He started his career as a fermentation scientist at BP Co Ltd. He trained as an applied biologist at Brunel University and obtained a PhD in 1977 at Leicester University.

10 Paul Ballington BSc (51) Director of Commercial Operations

Paul Ballington joined the Company in 1994, became Managing Director of Innovata Biomed in 1999 and was appointed Director of Commercial Operations at Innovata plc in July 2005. Prior to joining the Company, he held a number of divisional management and business development positions at Abbott Laboratories Inc. He previously worked in a commercial capacity for Baxter Healthcare and Schering AG. He started his career working for Forest Laboratories in regulatory affairs and medical information and has a degree in biochemistry from UMIST.

Business review Transition to Innovata plc

M L Laboratories

At the start of the financial year, M L Laboratories' business was organised into two principal operations: M L Pharmaceuticals and Innovata Biomed.

M L Pharmaceuticals was a pharmaceutical product development business with a track record of successful clinical development, regulatory approval and licensing of pharmaceutical products and a development pipeline targeted at specialist markets. Its activities were supported by revenue streams from products which had been successfully developed and licensed to other pharmaceutical companies. Innovata Biomed provided inhalation drug delivery technology to the pharmaceutical industry. Licence agreements generated development fees, milestone and royalty income which supported the business's ongoing development programmes.

Both businesses operated as distinct divisions with their own research, clinical development and business development capabilities supported by a centralised provision of regulatory affairs, intellectual property management, finance and administration. Innovata Biomed operated out of its premises in St Albans and Tewkesbury and M L Laboratories operated out of five sites in Warrington, Liverpool, Blaby, Keele and Farnham.

On 2 March 2005 the Board of M L Laboratories replaced its Executive Chairman, Stuart Sim, with Ian Kent and Kieran Murphy, as Chairman and Chief Executive Officer respectively.

Following their appointment, as part of a strategic review to reduce costs and improve efficiency, it was decided to consolidate M L Laboratories' operations at one site in St Albans, the then headquarters of Innovata Biomed. This activity involved the closure of five sites at Warrington, Liverpool, Blaby, Keele and Tewkesbury with one further site in Farnham due to close in 2006. It also involved the loss of 65 jobs and resulted in the Company having approximately 50 employees, the majority of whom were based at St Albans.

The restructuring signalled the intent to place greater focus on M L Laboratories' respiratory business, building on the successful collaborations already in place to exploit further the large and growing market for pulmonary products.

Quadrant

Quadrant Technologies Limited was a privately owned company based in Nottingham, which provided specialist drug formulation and stabilisation technologies to biotechnology and pharmaceutical companies with an emphasis on dry powder delivery to the lungs.

On 16 June 2005, as part of its strategic focus on respiratory/pulmonary product development, the Board of M L Laboratories agreed terms for its acquisition of Quadrant Technologies Limited for £48.5m (£29m by the issue of new M L Laboratories shares and £19.5m from the proceeds of a Vendor Placing and Placing and Open Offer). The Board agreed terms to acquire an outstanding minority interest in Innovata Biomed, which was owned by a former Director of the Company, for £1.9m. The Board also announced the change of the Company's name to Innovata plc.

On 14 July 2005, at an Extraordinary General Meeting, the Quadrant and Innovata Biomed acquisitions and change in Company name were approved.

The Company then moved its headquarters to Quadrant's premises in Nottingham and closed its St Albans site, giving the Company a combined headcount of 90.

Disposal of non core assets

Following the strategic decision to focus on pulmonary products, non core assets were or are being disposed of in the following way:

Alpharen™: negotiations are ongoing for the return of rights to this project to its founder, Ineos.

Gene therapy CTL 102: the current studies in prostate cancer (Phase II) and prosthesis repair (Phase I/II) are being completed with the intention of out-licensing the programmes.

Gene therapy CTL 901: it is intended that the rights to this programme will be out-licensed in the future.

UCOE gene expression technology: has been sold to Celliance Corporation.

Devacade®: the rights are being returned to Panos Therapeutics, its founding company.

Dexemel®: the rights to the programme have been out-licensed to Baxter as part of the Adept® deal to Baxter.

The new business: Innovata plc

Following the disposal of non core projects, the combined pipeline of the Innovata Group comprises 13 marketed and revenue generating products and clinical stage products, treating both respiratory and non-respiratory conditions.

Revenue generating – marketed products

There are eight marketed and revenue generating products which provided income to Innovata in 2005.

Asmasal® and Asmabec®

Two Clickhaler products containing salbutamol and beclomethasone, for the treatment of asthma and marketed by UCB in UK, France and Ireland.

Budesonide Clickhaler® and Formoterol Clickhaler®

Two further Clickhaler products, the Budesonide Clickhaler and the Formoterol Clickhaler, for the treatment of asthma and marketed by Merck Respiratory (the respiratory unit of Merck KGaA) in Europe.

Meptin™ Clickhaler

A fifth Clickhaler product for the delivery of Otsuka's asthma treatment, Meptin (procaterol), which is marketed in Japan by Otsuka.

Innovata receives royalties and/or product margin on these Clickhaler product sales and continues to search for licensees for Clickhaler products in other European countries and worldwide.

Adept®

Adept is a solution used during surgery to prevent post surgical adhesions, a frequent complication following gynaecological and other abdominal surgery and which is acknowledged as a major surgical problem. In 2001, Shire was granted pan-European marketing rights to Adept which it subsequently launched in 19 countries. This agreement terminated at the end of 2005 and Innovata has licensed Adept, on a global basis, to Baxter.

Following completion of Phase III trials in the US, the pre-market approval for Adept was accepted for filing by the FDA in May 2005.

Extraneal®

Extraneal is a peritoneal dialysis solution containing icodextrin, licensed to Baxter in 1996 and which Baxter now markets worldwide. Baxter is currently negotiating the reimbursement price for Extraneal with the US authorities and Innovata believes that the successful negotiation will result in a significant increase in sales from the US market. Innovata receives a royalty on the sales of Extraneal in Europe which will cease in 2006. Royalties on sales in US, Japan and the rest of the world will continue.

ADVATE®

In 2000, Baxter was granted exclusive and non-exclusive worldwide rights to use Quadrant's stabilisation patents and has utilised the technology in its serum-free recombinant Factor VIII, ADVATE. ADVATE is indicated for the treatment of haemophilia A and is marketed by Baxter worldwide. Innovata receives royalties on sales of ADVATE.

Products in clinical development

Clickhaler® with budesonide for Japan

In 2004 an exclusive agreement was signed with a Japanese pharmaceutical company for the marketing rights to the Clickhaler for use with budesonide in Japan. Under the agreement, Innovata supplies the device on commercial terms, will receive milestone payments based on its successful clinical and regulatory development and royalty payments on future sales. The Japanese pharmaceutical company will undertake the clinical development of the Clickhaler with budesonide and it is anticipated that Phase III trials will start in 2006. Innovata will assist the Japanese company to obtain regulatory approval for this product.

Duohaler®

In 2004 an exclusive agreement was signed with a leading European pharmaceutical company for the marketing and distribution of a combination of two established respiratory drugs in the Duohaler, in European and other specified countries (but excluding the US and Japan). During 2005 Innovata worked on the formulation development and scale-up for clinical trials and also pilot scale production of the Duohaler. Industrial scale-up for commercial quantities is planned for 2006. It is hoped that the Duohaler will enter clinical trials in 2006. In 2005, a second agreement was signed with the same European pharmaceutical company for the development of a further Duohaler product, also combining two established respiratory drugs for combination therapy.

Inhaled insulin

QDose Limited, a company formed in 1999 and equally owned by Innovata plc and MicroDose Technologies Inc, is developing a rapidly acting inhaled insulin product for the treatment of diabetes. In 2003 QDose entered into a licence, collaboration and development agreement with Bristol-Myers Squibb for the exclusive rights to the DPI product for rapid acting insulin. During 2005 the formulation was scaled-up and transferred to a GMP facility for the manufacture of clinical supplies (to enable clinical trials to commence in 2006) and a filling process for low volume doses was also identified and optimised. Bristol-Myers Squibb funded the development of this project until 2005 when it returned the rights to QDose as part of a restructuring of the agreement. QDose will be seeking a new licensing partner in 2006.

Ventavis®

In 2004 a collaborative research and development agreement was signed with CoTherix Inc to develop an extended-release formulation of CoTherix's iloprost inhalation product Ventavis, for the treatment of pulmonary hypertension. Under the terms of the agreement, CoTherix will have the right to market the second generation Ventavis in the US and Innovata is to receive development milestones and royalties on any future sales. Innovata is reformulating the active pharmaceutical ingredient into a dry powder format with controlled release properties, making the treatment quicker and easier to use and one that requires reduced frequency. During 2005, pre-clinical work was undertaken on the formulation in support of a Phase I trial which is due to commence in 2006.

Vaccine delivery

In 2003 a broad-based patent licence was entered into with GlaxoSmithKline ("GSK"), which permits GSK to use Innovata formulation and delivery patents for DNA vaccines delivered onto, into and across the skin. Innovata will receive payments based on the completion of development milestones achieved and royalties on future product sales. PowderMed Limited, a company that is developing prophylactic and therapeutic vaccines, has subsequently taken a sub-licence from GSK to use these licensed patents within certain fields. Milestone and royalty payments will also be due to Innovata from PowderMed upon the successful development and commercialisation of its vaccine products.

Licences, collaborations and relationships

The licensing of Innovata's intellectual property is a key commercial activity of the Company and one that requires significant technical support in order to turn a concept into a product that will generate revenue for Innovata and its licensees.

Developing and maintaining such relationships is an essential part of Innovata's activities from the initial contacts, often created by Business Development, through to the Programme Directors' control of an ensuing development activity. In addition Innovata's Manufacturing Operations group ensures that, where the Company has taken programmes through to the market, its partners and its suppliers are aligned to maximise product success.

The whole focus of Innovata is to ensure that the partner is kept well informed, the progress of any development activity is well communicated and that the relationship is maintained to the highest possible degree. The fact that a number of partners have worked with Innovata on more than one programme, the Company believes, is testament to its capabilities as well as its product range.

Intellectual property

Innovata protects its device and formulation technologies with a substantial intellectual property portfolio (patents, trademarks, design rights and confidential know-how). The patent portfolio contains about 65 patent families containing over 500 granted cases globally, with patents in the key territories of the US, Japan and the main European member states. The Company actively maintains and protects its estate.

In light of the refocusing and acquisition of Quadrant, Innovata has actively reviewed its intellectual property portfolio and rationalised its activities so as to reduce the expense of maintaining and prosecuting its patents.

Interference and oppositions

Innovata patents may present freedom to operate issues for unlicensed third parties. Oppositions against eleven of Innovata's patents have been filed at the European Patent Office. The opponents are Aventis Pharma Deutschland GmbH, Boehringer Ingelheim Pharma GmbH & Co, Chiron Corporation, Advanced Inhalation Research Inc (Alkermes Inc), Bracco Research SA, Nektar Therapeutics, Anhydro Limited, PowderMed Limited, National Blood Authority and Hemostatix. PowderMed Limited and the National Blood Authority are now licensed under certain Quadrant patents and have withdrawn their oppositions.

Nektar is involved in three of the patent oppositions referred to above. In addition, a patent application belonging to Nektar and a patent of the Innovata Group are involved in interference proceedings in the US Patent and Trademark Office.

Innovata is opposing two of Nektar's patents in the European Patent Office which are entitled "Methods and compositions for pulmonary delivery of insulin" and "stable glassy state powder formulations". The other opponents of the first patent are Eli Lilly and Co, Vectura Limited and Advanced Inhalation Research Inc. The second patent has also been opposed by Advance Inhalation Research Inc.

Intellectual property continued

Litigation

In December 2004, legal proceedings were commenced against Pall Corporation for breach of contract, claiming that the agreement had been validly terminated, unspecified damages, contractual or statutory interest and costs. The Directors estimate that its legal costs in connection with these proceedings will amount to approximately £1m. Depending on the outcome of the litigation, Innovata may recover a proportion of these legal costs from Pall Corporation. Pall Corporation has estimated that its legal costs will be approximately £1.5m and depending on the outcome of this litigation it is possible that Innovata may be ordered to pay a proportion of these costs.

Dry powder inhalers

Innovata has three dry powder inhalers ("DPIs") on the market or in development:

Clickhaler®

The Clickhaler is a multi-dose, reservoir DPI using proven technology. It is approved for use and marketed to treat asthma and COPD with a number of different drugs (salbutamol, beclomethasone, formoterol, budesonide and procaterol) in a number of countries in Europe and Japan. It is inexpensive to produce and production is fully automated.

Duohaler®

The Duohaler is a fixed combination therapy, multi-dose DPI. It has two separate drug reservoirs which feed two separate drugs to two separate metering chambers from which the drugs are delivered to the patient in the same breath which overcomes co-formulation issues. It is in the industrialisation validation phase of development and it is hoped that it will enter clinical trials in 2006. The Duohaler is therefore ideally suited for the delivery of fixed combination therapy for asthma and COPD.

S2 Unit Dose

The S2 Unit Dose is a re-useable or disposable single-dose DPI at an early stage of development which has the potential to be used for the delivery of a wide range of therapeutics in high concentrations. Its innovative dispersion mechanism means that minimal patient effort is required to ensure excellent drug delivery to the patients' lungs, a feature of particular benefit to systemic drug delivery. The S2 is easy to use and has a passive engine so no battery or power source is required. During 2005, the production of the engine to GMP was implemented and it is anticipated that in 2006 the engine will be integrated into the unit dose device, alongside an undisclosed product, for clinical development.

Extensive formulation skills

The formulation of drugs for inhalation is more complex than for oral delivery. Different formulations are needed depending on whether the treatment is for local or systemic action. For systemic delivery the dose needs to be formulated and produced such that particles are less than five microns in size. Innovata has know-how and expertise in the following:

- **Micronisation** is the process whereby drugs are milled to this size by particle to particle collision. At this point the drug particles become highly cohesive and will not flow or disperse easily, so they need to be blended.
- **Blending** with lactose improves aerosol performance, providing optimal deaggregation, reliable metering and accurate dosing. The active drug molecules sit on the surface of the lactose and, during inhalation, the drug particles detach from the lactose, flow into the lower airways and the lactose hits the back of the throat and is swallowed.
- **Spray drying** is applicable to a wide range of materials, and may be used for macromolecules, eg proteins and peptides as well as small molecules. The process gives control over particle characteristics important for pulmonary drug delivery and produces particles designed for better, deep lung delivery. In addition, the inclusion of non-active excipients such as trehalose or hyaluronic acid can stabilise and alter the kinetics of the active pharmaceutical ingredient. Spray drying is also suitable for the preparation of other solid dose delivery formats.
- **Polyol stabilisation** may be used to stabilise peptides and proteins. The incorporation of trehalose into a dry powder formulation using spray drying or foam drying offers the potential for room temperature stability to the drug in the resulting formulation, avoiding the need for refrigerated storage.
- **Pulmonary controlled release** uses oligosaccharide ester derivatives (a modified carbohydrate matrix) or hyaluronic acid encapsulation of the active pharmaceutical ingredient to enable controlled drug release within the lung. The powder formulations which combine the active drug and the excipient controlling the rate of release are obtained through the use of spray drying.

Effective clinical development

Innovata has an in-house clinical development team which has demonstrated its ability to develop products through all stages of pre-clinical and clinical development. This team supports the development of Innovata's own products as well as those developed on behalf of other companies. Key functions include liaising with thought-leaders, clinical investigators and experts in the design of clinical trials (and associated pre-clinical programmes) and the selection and management of specialist Clinical Research Organisations ("CROs") responsible for conducting clinical trials. Ultimately, the successful management of relationships with CROs and clinical investigators is a crucial element of their work.

In December 2004, the PAMELA Adept® study, a Phase III pivotal clinical trial to demonstrate safety and efficacy in the reduction of post operative adhesions following gynaecological surgery, was completed. 449 patients were involved in 16 units in the US. On the basis of these results, a filing for a pre-marketing approval was submitted to the FDA and formally accepted in May 2005.

Preparation for the clinical development of the Duohaler® project took place in 2005 with a CRO selected for the Phase III clinical programme. In 2006, pivotal Phase III studies are planned for different doses and populations on an international basis.

Regulatory affairs

Innovata has an in-house regulatory affairs group with a proven track record in obtaining and maintaining approvals to market pharmaceutical products and devices.

The group provides the regulatory support for products of its own and partner programmes. It works closely with all functions within Innovata, advising on regulatory strategy and data requirements to ensure timely approvals. The group is responsible for the preparation and maintenance of clinical trials and marketing authorisation ("MAs") applications and preparation of response to questions on a worldwide basis, as required. Responsibility for submission of dossiers and liaison with individual regulatory authorities is also undertaken, as appropriate, depending on whether the programme is Innovata's or a partner's.

In 2005, European MAs were obtained in a first European country for the Budesonide Clickhaler® and Formoterol Clickhaler®, also a MA application (pre-market approval) for Adept® was submitted and filed with the FDA and European MAs were also maintained for salbutamol and beclomethasone Clickhalers.

In 2006, discussions with the FDA will continue with a view to securing marketing approval for Adept; further European MAs will be sought for the Budesonide and Formoterol Clickhalers from ongoing national applications and clinical trial applications will be submitted in several European and non-European countries to support the Duohaler® pivotal clinical studies. Regulatory support will be provided for the second Duohaler programme, working towards clinical trial applications to support the pivotal clinical studies. European MAs will be maintained for salbutamol and beclomethasone Clickhalers (including MA renewal submissions), as appropriate.

Risk management

The Group's business involves exposure to a number of risks, many of which are inherent in pharmaceutical product development. Particular risks include:

- The partial dependence of financial performance on milestone receipts.
- The risk of competition to both projects under development by the Group and licensees sales from which the Group derives income.
- Reliance on key collaborators and suppliers.
- Product and development failure.
- Regulatory failure.
- Failure to attract collaboration partners for projects.
- Potential threats to intellectual property rights and the cost of protecting intellectual property.
- Product liability beyond reasonable commercial insurance.
- The exposure of significant revenues to currency fluctuations, and in particular the fact that certain royalties are calculated and/or paid in US dollars.

Given that risk is a necessary and unavoidable part of its operations, the Group is aware of the need to achieve a balance of risk and potential reward and operates procedures for identifying and managing significant business risks. These involve regular reviews of strategic risks and opportunities undertaken by the Chief Executive Officer and discussed by the Board and detailed reviews of operational issues and risks at weekly meetings of the Executive Management team. Each member of the team has operational responsibilities for identifying and managing the relevant risks.

Corporate and social responsibility

Innovata takes its broader responsibilities seriously. These responsibilities extend into the areas of environment, health and safety, ethical and social issues and its employees.

Environmental, health and safety policies

The Group recognises its responsibility for safeguarding the environment and where practically and economically possible seeks to manage its activities efficiently so as to minimise any adverse environmental effects. The Group also recognises its obligations for the health and safety of its employees in the workplace and has made an assessment of risks at the sites at which the Group's activities are undertaken and has in place formal procedures for managing, co-ordinating and reporting to the Board on health and safety matters. The Group has provided training to individuals who are responsible for health and safety. The Group continues to keep environmental, health and safety practices under review.

Ethical and social policies

The Group's principal activities are undertaken within the pharmaceutical industry which is subject to a highly regulated ethical framework with which the Group complies. In addition, the Group seeks to conduct its activities generally in accordance with good business ethics.

The Group does not consider it appropriate at its current stage of development to make significant financial donations to charitable, community or social activities, but considers that its most important contribution to the communities within which it operates is to provide high quality employment opportunities and to develop new therapies for serious diseases.

Employees

The Group recognises that in an industry based on innovation, research and development, its employees are one of its biggest assets and seeks to communicate and, where appropriate, consult with them on matters affecting them as employees, in the most appropriate manner. The Group operates a policy of equal opportunities with no discrimination on race, sex, disability or any other grounds.

The Group provides training and development appropriate to individual needs and offers remuneration packages, including pensions, private medical, permanent health and life insurance, and a working environment which are designed to be both fair and competitive with larger companies within the industry. Participation in the Group's share option scheme is extended to all of the Group's employees.

Financial review For the year ended 30 September 2005

The Group's financial performance during the year has been significantly affected by two key developments in the Group's business – the acquisition of the Quadrant group and the restructuring of the Group's continuing activities, involving the ultimate closure of the Group's previously existing sites and the location of all of its activities at the Quadrant site in Nottingham. The benefit of the significant revenues of the Quadrant group has begun to be felt in the two and a half months from the date of acquisition up to 30 September 2005. The impact of the restructuring on the year's results is reflected principally in the exceptional costs related thereto. However the benefit of the significant reduction in the Group's operating costs arising from the restructuring is expected to be felt in the current year ending 30 September 2006.

Group operating results for the year have been analysed in the consolidated profit and loss account between the Group's continuing activities and Quadrant which has been included from the date of acquisition, 15 July 2005. The results for the comparative year have been analysed between continuing activities and those discontinued as a result of the divestment of the educational training business in February 2004.

Turnover and gross profit

Turnover includes fee income from licensing and evaluation agreements, development fees, royalties and product sales. Royalties are stated net of the entitlements of Paul Royalty Fund ("PRF") where appropriate.

Total turnover in the year was £15.7m (2004: £7.9m) of which £1.5m related to Quadrant. The increase in turnover included an increase in licensing and evaluation fees to £6.5m (2004: £2.7m). Such "milestone" receipts under licensing deals are typically triggered by the signing of new licence agreements or by regulatory or commercial events and as such tend to be irregular in timing and subject to substantial variation from one period to another. Significant items in 2005 were the approval and launch milestones relating to the Budesonide and Formoterol Clickhaler® products, the regulatory and pricing approval milestone relating to Otsuka's Meptin™ Clickhaler and a milestone received from Shire in relation to the US clinical trial of Adept®.

Development fees charged to licensees for conducting development programmes under licence agreements were £3.9m (2004: £1.6m), of which £0.7m was contributed by Quadrant.

Royalty income increased to £3.6m (2004: £2.5m), of which £0.8m was generated by Quadrant.

Pharmaceutical products sales were £1.4m (2004: £0.6m), comprising principally sales of Clickhaler devices. Non-

pharmaceutical turnover from "other activities" was reduced to £0.4m (2004: £0.5m) following the sale of the educational training business. This represented income from the Group's materials analysis business which was sold during the year. The results of this business are not sufficiently material to require separate disclosure as a discontinued business.

The increase in turnover resulted in an increase in gross profit to £11.7m (2004: £5.4m).

Operating costs

Research and development expenditure at £10.4m (2004: £12.9m) was reduced from the comparative period. This expenditure is made up of internal costs, comprising principally people and premises costs, and external spending and is expected to reduce further following the restructuring of the Group's activities and a reduction in "self-sponsored" development programmes. Selling, marketing and distribution costs of £0.5m (2004: £0.5m) were at a similar level to the previous year. Administrative expenses increased to £6.6m (2003: £4.5m). This increase includes £0.3m in relation to the administrative expenses of Quadrant and £0.5m additional goodwill amortisation following the Quadrant acquisition. In addition there were increases in legal and professional expenses and other costs relating to disputes or to the reorganisation of the Group's activities and associated changes which, while not expected to recur, do not qualify to be treated as part of the exceptional charge for restructuring costs.

Other operating income of £2.7m (2004: £0.5m) comprised monies received on the settlement of a dispute. The comparative figure represented the release to the consolidated profit and loss account of the final portion of the deferred element of funds received from PRF in 2001, which related specifically to the clinical development of Adept in the US.

Loss before taxation

The operating loss for the period after amortisation of goodwill on the Quadrant acquisition of £0.5m was £3.0m (2004: £12.0m). There was an exceptional charge of £6.1m on the restructuring of the Group. This was made up of non-cash write-offs of intangible and tangible fixed assets totalling £3.7m, together with the costs of redundancies and site closures (including provisions for anticipated costs) and is stated net of the proceeds of sale of the UCOE gene expression technology and the Group's materials analysis business. The comparative figure represents an exceptional profit of £0.8m which arose on the disposal of the balance of the shares held by the Group in Cobra Biomanufacturing Plc ("CBM"). After net interest income, the loss before taxation was £8.9m (2004: £10.9m).

Taxation

Tax credits in relation to eligible research and development expenditure estimated to be receivable amounted to £0.2m (2004: £2.0m). Withholding taxes suffered on income received were £0.3m (2004: £0.2m), leaving a net tax charge position of £Nil (2004: net tax credit £1.9m). The reduction in tax credits reflected a reduction in eligible R&D expenditure and the individual taxable results of relevant Group companies.

Loss after taxation

The loss for the period after taxation was £8.9m (2004: £9.0m), giving a loss per Ordinary Share of 3.11p (2004: 4.48p).

Net assets and shareholders' funds

Shareholders' funds at 30 September 2005 were £58.5m compared with £12.9m at 30 September 2004, a net increase of £45.6m. This increase resulted from the issue of shares in connection with the acquisitions of Quadrant and the minority interest in Innovata Biomed Limited, offset by the loss for the year of £8.9m.

Intangible assets at 30 September 2005 of £54.4m comprised the goodwill arising on the acquisitions of Quadrant and the minority interest in Innovata Biomed, less amortisation for the period between the date of acquisition and 30 September 2005 on the basis of an estimated useful economic life of 20 years. Intangible assets at 30 September 2004 of £3.1m represented goodwill relating to the UCOE technology which was written-off during the year as part of the exceptional charge for restructuring costs.

Capital expenditure of £1.9m and the inclusion of Quadrant's net assets on acquisition of £0.4m, net of depreciation charges of £0.8m, disposals of £0.2m and write-offs as a result of restructuring of £0.7m, resulted in an increase in the net book value of tangible fixed assets of £0.6m. Capital expenditure related principally to further spending on the Duohaler® tooling programme.

Stocks of £0.3m were at the same level as 30 September 2004, while debtors increased to £8.6m from £5.5m. This increase reflected milestones receivable, the inclusion of Quadrant and the timing of royalty receipts, net of a reduction in R&D tax credits receivable. Total creditors of £12.2m (2004: £9.3m) showed an increase reflecting restructuring liabilities, the inclusion of Quadrant and additional leasing liabilities related to the Duohaler tooling programme. Creditors include £4m of potentially repayable milestones which have not yet been taken to income.

Provisions of £9.0m (2004: £Nil) relate principally to the inclusion of Quadrant's estimated liability for the deferred consideration payable to Elan as a result of the buy out of the Quadrant business from Elan in 2003.

Deferred income of £1.1m (2004: £0.7m) represents licensing and evaluation fees and development income received, the revenue recognition of which has been deferred in accordance with our accounting policy on turnover.

Cash balances and cash flow

Cash and short term deposits at 30 September 2005 were £13.9m (2004: £10.8m). There were net cash outflows from operations of £5.4m, restructuring costs of £1.0m, capital expenditure of £1.6m and acquisitions of £16.4m. These were offset by inflows from net interest receivable of £0.3m, tax credits of £2.3m, net lease finance of £0.4m and the proceeds of share issues for cash of £24.5m resulting in a net increase of £3.1m.

IFRS

The Group will be adopting International Financial Reporting Standards ("IFRS") for the year ended 30 September 2006. Our first reporting under IFRS will be in relation to the Interim Results to 31 March 2006. We have established a project team to manage the transition to IFRS and have carried out work to identify the principal areas in which the adoption of IFRS will or may result in changes to reported results in comparison with UK GAAP. These include the following:

- Business combinations – under IFRS 3 and IAS 38 goodwill is not amortised but reviewed annually for impairment and intangible assets on acquisition are recognised separately from goodwill and amortised. The accounting for the acquisition of Quadrant will be restated to reflect this. The impact of IAS 12 on recognition of a deferred tax liability is also being reviewed.
- Share based payments – under IFRS 2 a charge is required to be recognised in the profit and loss account in respect of share option awards.
- Royalty sharing arrangements with PRF – the implications of IFRS for the accounting for these arrangements are currently under consideration.
- Other adjustments – it is expected that the application of IFRS will result in a number of other minor adjustments and reclassifications, including the recognition of holiday pay.

P J Shennan, Finance Director

11 January 2006

Directors' report

The Directors present their Annual Report and the audited Group financial statements for the year ended 30 September 2005.

Acquisition and change of name

During the year the Company acquired Quadrant Technologies Limited and changed its name from M L Laboratories PLC to Innovata plc.

Principal activities

The Group's principal activity is the development and commercialisation of pharmaceutical products and technologies.

Business review

The Chairman's Statement on page 12, the Chief Executive Officer's Strategic Overview on page 13, the Business Review on pages 16 to 23 and Financial Review on pages 24 to 25 should be read in conjunction with this Directors' Report.

Results and dividends

The Group loss on ordinary activities before taxation amounted to £8,865,000 (2004: £10,905,000). The Group loss for the year after taxation of £8,897,000 (2004: £9,046,000) has been added to the deficit brought forward on profit and loss account reserves as shown in Note 21 on page 61. The Directors do not recommend the payment of a dividend.

The loss for the year is stated after charging research and development expenditure of £10,366,000 (2004: £12,903,000).

Directors

The Directors who held office during the year were:

I F Kent – Chairman (appointed 2 March 2005)
K P Murphy – Chief Executive (appointed 2 March 2005)
Dr T S Chadwick – Executive Director (appointed 15 July 2005)
Dr C C Dalton – Executive Director (appointed 15 July 2005)
P J Shennan – Executive Director
Dr S E Foden – Non-Executive Director (appointed 16 May 2005)
Dr J M Fromson – Non-Executive Director (appointed 16 May 2005)
F S Hallsworth – Non-Executive Director (appointed 6 April 2005)
R Uppal – Non-Executive Director (appointed 15 July 2005)
S W Sim – Executive Chairman (resigned 2 March 2005)
P J Ballington – Executive Director (resigned 15 July 2005)
Dr R N Boyes – Executive Director (resigned 16 May 2005)
Prof D S Davies – Executive Director (resigned 16 May 2005)
Prof A D Dayan – Non-Executive Director (resigned 16 May 2005)
Dr T Medinger – Non-Executive Director (resigned 16 May 2005)

Under the Articles of Association Dr Chadwick, Dr Dalton and Mr Uppal, being Directors who were appointed as additional Directors following the last AGM, are required to resign from the Board and offer themselves for re-election at the forthcoming Annual General Meeting. Further, Dr Fromson and Mr Hallsworth retire from office by rotation, and, being eligible, offer themselves for re-election at the forthcoming Annual General Meeting.

Details of the Directors' service contracts and share options are shown in the Remuneration Report on pages 31 to 37.

Directors' interests

The interests (beneficial unless otherwise stated) in the shares of the Company of the Directors, who held office at 30 September 2005, were as follows:

	2005 Number of Ordinary Shares	2004 Number of Ordinary Shares	2005 Percentage of Ordinary Share capital	2004 Percentage of Ordinary Share capital
I F Kent	-	-(2)	-	-(2)
K P Murphy	-	-(2)	-	-(2)
Dr T S Chadwick	18,470,535	18,470,535 ⁽²⁾	3.67%	3.67% ⁽²⁾
Dr C C Dalton	2,371,956	2,371,956 ⁽²⁾	0.47%	0.47% ⁽²⁾
P J Shennan	30,000	25,000	0.01%	0.01%
Dr S E Foden	-	-(2)	-	-(2)
F S Hallsworth	-	-(2)	-	-(2)
Dr J M Fromson	-	-(2)	-	-(2)
R Uppal	65,966,196 ⁽¹⁾	65,966,196 ⁽²⁾	13.12%	13.12% ⁽²⁾

1. R Uppal's interests include 25,219,555 shares held non-beneficially as a trustee of the Uppal Children and Nephews Settlement 2003.

2. Holding as at date of appointment.

There were no changes to the above holdings between 30 September 2005 and 11 January 2006.

Substantial interests

As at 11 January 2006, the Company has been notified of the following interests in 3% or more, or in the case of fund managers, 10% or more, of its share capital. The holdings shown are as notified under the Companies Act 1985:

Shareholder	Number of Ordinary Shares	Percentage of Ordinary Share capital
Morley Fund Management Limited	66,777,861	13.29
Rajan Uppal	65,966,196 ⁽¹⁾	13.12
AQR Holdings Limited	28,758,436	5.72
Channel Hotels and Properties Limited	26,175,000	5.21
UBS AG	18,518,430	3.68
Dr T S Chadwick	18,470,535	3.67

1. R Uppal's interests include 25,219,555 shares held non-beneficially as a trustee of the Uppal Children and Nephews Settlement 2003.

Creditor payment policy

The Group's policy and practice in relation to the payment of its creditors is to make payments in accordance with appropriate payment terms for each business transaction. At 30 September 2005 trade creditors for the Group represented 56 days of amounts invoiced by suppliers (2004: 56 days) and for the Company represented 28 days (2004: 53 days).

Charitable and political donations

During the year the Group made no charitable donations (2004: £Nil) and no contributions were made to political organisations (2004: £Nil).

Directors' report continued

Corporate and social responsibility

The Group's policies on the environment, health and safety, ethical and social issues and its employees are described in the Business Review on page 23.

Auditors

PricewaterhouseCoopers LLP resigned on 3 May 2005 and Deloitte & Touche LLP were appointed as Auditors on 12 May 2005. Deloitte & Touche LLP have indicated their willingness to continue in office and a resolution to re-appoint them as Auditors to the Company will be proposed at the Annual General Meeting.

Statement of Directors' responsibilities

United Kingdom company law requires the Directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit or 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.
- State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements.
- Prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the Group will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and the 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 hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The maintenance and integrity of the Innovata plc website is the responsibility of the Directors; the work carried out by the Auditors does not involve consideration of these matters and, accordingly, the Auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Annual General Meeting

Notice of the 2006 Annual General Meeting ("AGM") of Innovata plc is enclosed with this document.

Resolution 9 in the notice of the AGM is a resolution to renew the general authority of the Directors to issue relevant securities (as defined in the Companies Act 1985 ("the Act")). It is proposed that such authority be granted over shares with an aggregate nominal value of £1,675,426, being approximately one-third of the current issued share capital, and that the authority should continue until the 2007 AGM, or 15 months from the date of the resolution if earlier. This resolution will be proposed as an ordinary resolution.

Resolution 10 in the notice of the AGM is a resolution to disapply the statutory pre-emption rights on the allotment for cash of equity securities (as defined in the Act). This limited authority would empower the Directors to allot equity securities (a) in connection with bonus or rights issues where such allotments are proportionate to existing shareholdings, but would not meet the statutory requirements for pre-emptive issues, and, (b) for cash on a non pre-emptive basis provided they do not exceed a nominal value of £502,627 being approximately 10% of the currently issued share capital of the Company. It is proposed that the disapplication should take effect until the 2007 AGM, or 15 months from the date of the resolution if earlier. This resolution will be proposed as a special resolution.

Resolution 11 in the notice of AGM is a resolution to amend the Company's existing Articles of Association so as to afford the Company's Directors and its other officers the maximum protections now permitted by law from claims which may be brought against them by third parties as a result of actions carried out by them in the proper exercise of their duties as officers of the Company. This change is being proposed following the introduction of the Companies (Audit, Investigations and Community Enterprise) Act 2004, pursuant to which the extent that a company may indemnify its Directors has been widened and the previous prohibition against a company indemnifying officers other than Directors and auditors has been removed. This resolution will be proposed as a special resolution.

The Directors believe that it is important that they are granted the powers and authorities proposed pursuant to Resolutions 9 and 10 so as to enable them to take advantage of commercial opportunities as they arise. Your Board also considers it appropriate that the additional protections proposed in Resolution 11 against liability for the proper performance of their duties as officers of the Company should be made available to all of the Company's Officers. Accordingly the Directors unanimously recommend that you vote in favour of these resolutions, as they and those connected with them intend to do in respect of a total of 86,838,687 Ordinary Shares (representing approximately 17.27% of the current issued Ordinary Shares).

In addition to the ordinary business set out in the notice of the AGM, an advisory resolution (resolution 2) will be proposed to approve the Remuneration Report, set out on pages 31 to 37.

You will find enclosed with the notice of the AGM a proxy card for use at the AGM. Whether or not you propose to attend the AGM in person, you are requested to complete and return the proxy card to the Company's Registrars in accordance with the instructions printed thereon as soon as possible and in any event, so as to be received no later than 48 hours before the meeting. Please note that completion and return of the proxy cards will not preclude you from attending the AGM and voting in person if you wish.

By order of the Board
Peter J Shennan, Secretary
11 January 2006



Corporate Governance

The Board is committed to principles of good corporate governance and has fully addressed the provisions of the new Combined Code on Corporate Governance issued in July 2003 (the "Combined Code"). It considers that the Group is compliant with Section 1 of the Combined Code and that, in particular, the changes made since the last Annual Report of the Company dated 25 January 2005 to the composition of the Board and its various committees and to relevant Directors' service contracts have eliminated the instances of non-compliance with the provisions of Section 1 of the original Combined Code noted therein, namely that, prior to these changes, certain Executive Directors had contracts with notice periods of more than one year, there was no Nominations Committee and there were only two Non-Executive Directors.

The Board

The Company has a Chairman and Chief Executive, each having his own separate responsibilities. The Chairman is responsible for the effective working of the Board and the Chief Executive is responsible for all operational matters.

The Board, which is constituted to have a balance between Executive and Non-Executive Directors and includes a nominated Senior Independent Non-Executive Director, F S Hallsworth, meets regularly throughout the year. The members of the Board and their respective roles are described on page 14 of this document. F S Hallsworth, Dr S E Foden and Dr J M Fromson are considered to be independent Non-Executive Directors. Mr Uppal is not considered to be independent in view of his recent involvement in the Executive Management of Quadrant and his substantial shareholding in the Company. Non-Executive Directors hold meetings at which the Executive Directors are not present.

The Board meets regularly, normally at least eight times per year, to deal with matters specifically reserved for its decision. These matters include agreeing and monitoring strategic plans and financial targets, major decisions on resource, overseeing management of the Company in the interest of the shareholders, ensuring processes are in place to manage major risks, corporate governance issues, litigation and reporting to shareholders. The Executive managers of the business make day-to-day operating decisions to ensure proper management of the Company's business and implement the Board's approved strategy to deliver operational performance. They recommend strategy and plans to the Board, make routine decisions on resources and ensure that adequate operational and financial controls are in place.

All Directors have full and timely access to information to assist them in performing their duties, to independent professional advice and to the services of the Company Secretary, who is responsible to the Board for ensuring adherence to Board procedures and compliance with applicable rules and regulations. All Directors are covered by appropriate insurances for legal action which may be taken against them relating to the performance of their duties as a Director.

Appointment of Directors

The appointment of Directors is overseen by the Nominations and Corporate Governance Committee. Its members are Dr J M Fromson as Chairman, Dr S E Foden and F S Hallsworth.

New appointments to the Board will be subject to formal, rigorous and transparent procedures covering the criteria for appointment and the method by which the Board assesses that the appointees can satisfy the criteria. External search consultancies and/or open advertising will be used unless considered inappropriate. The Board will continue to review procedures for succession for appointments to the Board and Senior Management so as to maintain an appropriate balance of skills and experience within the Company and on the Board.

Board performance appraisal

Individual performance evaluation of Executive Directors other than the Chief Executive is carried out by the Chief Executive and the results reviewed with the Chairman and the Remuneration Committee. Evaluation of the Chief Executive's performance is carried out by the Chairman and the results reviewed with the Non-Executive Directors. Non-Executive Directors are appraised by the Chairman. The Chairman is appraised by the Non-Executive Directors.

The Board as a whole addresses its overall performance as a body and those of its committees at least annually.

Re-election of Directors

A minimum of one third of the Directors retire by rotation annually and each Director is subject to re-election at the first opportunity after their appointment and thereafter at least every three years. All Non-Executive appointments are made for an initial specified term subject to re-election.

Remuneration Committee

The Remuneration Committee consists of Dr S E Foden as Chairman, Dr J M Fromson and F S Hallsworth. It is responsible for setting the remuneration of Executive Directors, for establishing and monitoring the level and structure of senior management's remuneration and for the operation of the Group's share option schemes.

Audit Committee

The Audit Committee of the Board consists of F S Hallsworth as Chairman, Dr S E Foden and Dr J M Fromson. It is responsible for ensuring that the financial performance of the Group is properly measured and reported on, and it achieves this through regular reviews of financial reports, contact with external auditors and questioning of key financial staff. It reviews and approves interim and annual financial statements and reviews external auditors' reports relating to financial reporting and control matters. It is also responsible for ensuring the ongoing objectivity and independence of external auditors and achieves this by reviewing and approving audit scope and fees as well as the level of non-audit work carried out by the Group's Auditors.

Corporate Governance continued

The Audit Committee has reviewed whether it would be appropriate to introduce a separate internal audit function and has concluded that this is not necessary given the structure and size of the Group.

The terms of reference of the Board's Committees are available upon request.

Attendance at meetings

	Board meetings	Corporate Governance/ Nominations Committee meetings	Audit Committee meetings	Remuneration Committee meetings
I F Kent	7 (7)	–	N/A	N/A
K P Murphy	7 (7)	–	N/A	N/A
Dr T S Chadwick	1 (1)	–	N/A	N/A
Dr C C Dalton	1 (1)	–	N/A	N/A
P J Shennan	11 (11)	–	N/A	N/A
Dr S E Foden	3 (3)	–	1 (1)	1 (1)
Dr J M Fromson	3 (3)	–	1 (1)	1 (1)
F S Hallsworth	3 (4)	–	1 (1)	1 (1)
R Uppal	1 (1)	–	N/A	N/A
S W Sim	3 (3)	–	N/A	N/A
P J Ballington	8 (9)	–	N/A	N/A
Dr R N Boyes	5 (8)	–	N/A	N/A
Prof D S Davies	8 (8)	–	N/A	N/A
Prof A D Dayan	8 (8)	–	N/A	N/A
Dr T Medinger	8 (8)	–	N/A	N/A

Figures in brackets indicate the maximum number of meetings in the period during which the individual was a Director.

The review with the Auditors of the financial statements and audit for the year ended 30 September 2004 was conducted at a full meeting of the Board, as opposed to the then constituted Audit Committee. In addition to the meeting included in the table, the currently constituted Audit Committee has met twice since 30 September 2005 and would normally expect to meet at least three times per year.

Internal financial control and reporting

The Directors are responsible for the Group's system of internal controls and as such have put in place a framework of controls to ensure that the ongoing financial performance is measured in a timely and correct manner and that risk is identified as early as is practicably possible. There is a comprehensive budgeting

system and monthly management accounts are prepared which compare actual results against both the budget and the previous year. They are reviewed and approved by the Board and revised forecasts are prepared on a regular basis.

Operational control, compliance and risk management

As explained in the Business Review, the Group operates procedures for identifying and managing significant business risks. These involve regular reviews of strategic risks and opportunities undertaken by the Chief Executive Officer and discussed by the Board and detailed reviews of operational issues and risks at weekly meetings of the Executive Management team. Each member of the team has operational responsibilities for identifying and managing the relevant risks.

The Group's system of internal control, which is in accordance with the guidance in the Turnbull report, is designed to manage rather than to eliminate the risk of failure to achieve business objectives and can only provide reasonable assurance that financial information is relevant, reliable and accurate and that the Group's assets are correctly accounted for and adequately safeguarded.

The Directors have reviewed the effectiveness of internal control, including internal financial control, during the year and to the date of approval of these financial statements.

Relations with shareholders

The Company reports to shareholders twice a year. The Company despatches the notice of its Annual General Meeting, together with a description of the items of special business, at least 20 working days before the meeting. Each substantially separate issue is the subject of a separate resolution and all shareholders have the opportunity to put questions at the Annual General Meeting. The Senior Independent Director and the Chairmen of the Audit and Remuneration Committees normally attend the Annual General Meeting and will answer questions which may be relevant to their work. The Chairman advises the meeting of the details of proxy votes cast on each of the individual resolutions after they have been voted on in the meeting.

The Chairman and the Non-Executive Directors seek to maintain a good and continuing understanding of the shareholders' objectives and views.

Going concern

The Directors have a reasonable expectation that the Group will have adequate cash resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.

Remuneration report

Remuneration Committee (unaudited)

The Remuneration Committee (the "Committee") comprises the independent Non-Executive Directors on the Board, Dr S E Foden, Dr J M Fromson and F S Hallsworth and is chaired by Dr Foden. Prior to the Board changes announced on 16 May 2005, the Committee comprised the two independent Non-Executives then on the Board, Dr T Medinger and Professor A Dayan. The Committee held one meeting during the past financial year on 14 July 2005, which was attended by all of its members. The principal functions of the Committee are to make recommendations to the Board on the Company's policy for executive remuneration and to determine, on behalf of the Board, the remuneration, including the terms and conditions of service, for the Executive Directors and appropriate other senior Executives. The full terms of reference for the Committee are available on request. The Committee has been advised in its work during the past financial year by the Chairman and Chief Executive Officer except in matters relating to their own remuneration. The Committee has also appointed New Bridge Street Consultants LLP ("NBSC") to provide them with independent remuneration advice. NBSC provides no other services to the Company.

Remuneration policy (unaudited)

The Committee's policy is to set remuneration packages for Executive Directors and senior management that are competitive with the market, allowing the Company to attract, motivate and retain Executives of the highest calibre. Remuneration packages are designed to incentivise and reward Executives for improved performance via annual bonus payments and awards of share options, which together constitute a potentially significant portion of the total remuneration opportunity.

The remuneration of Executive Directors comprises the following five elements, except in the case of Mr Kent who does not receive taxable benefits or pension contributions (Mr Kent is a Director of a number of other companies, as set out on page 14, and retains his earnings from those appointments):

(i) Basic salary

A salary which reflects the market rate for each position and the individual Director's experience and value to the business and takes into consideration levels of remuneration and increases awarded to other employees. Salaries were reviewed on 14 July 2005 and will in future be reviewed as from 1 October in each year, taking into account personal performance.

(ii) Taxable benefits

Taxable benefits comprise the provision of a car, including the option of fuel benefit, or car allowance, and private medical insurance.

(iii) Share options

Share options are granted to Executive Directors, senior management and the majority of other employees within the Group under the Innovata plc 1999 Executive Share Option Scheme ("the 1999 Scheme") and are normally exercisable between three and ten years from the date of grant, subject to continued employment and the satisfaction of performance conditions.

Executives may be granted options over shares with a value of up to two times their total remuneration in any year. Grants may be made in excess of this limit, however, if the Committee decides that this is justified in the circumstances of recruitment or to reflect prevailing market practices outside the UK where an Executive carries on his duties overseas or in other exceptional circumstances.

Grants made to Executive Directors so far under this scheme are only exercisable subject to the achievement of share price growth targets (as outlined later in this Report). It is the Committee's current intention that future option grants will also be subject to share price growth targets that it considers to be appropriately demanding at the date of grant. The Committee believes that the use of share price targets clearly aligns the interests of the Executives with the interests of shareholders. The share options granted to individual Executive Directors to date are disclosed later in this Report and include grants made in prior years under a previous option scheme where relevant.

(iv) Bonus

In the case of Executive Directors and senior management the Company operates a non-pensionable discretionary bonus scheme based upon individual performance and achievement of personal and corporate objectives. A bonus of £20,000 was paid in August 2005 to Mr P J Ballington who ceased to be a Director on 15 July 2005 but who continues to be employed by the Company as a senior Executive. The bonus represented 11% of his basic salary and was in relation to business development performance. No other Executive Director received a bonus for the past financial year.

(v) Pension arrangements

The Company currently makes pension contributions equal to 15% of salary for Executive Directors, either into the Innovata plc Staff Non-Contributory Pension Scheme, a defined contribution scheme, details of which are given in Note 29 on page 64, or into their own personal pension schemes.

Executive Directors' service contracts (unaudited)

	Date of contract
I F Kent	10 March 2005
K P Murphy	10 March 2005
Dr T S Chadwick	28 August 2003
Dr C C Dalton	13 December 2004
P J Shennan	23 May 1997
S W Sim	27 July 1992
P J Ballington	14 September 2005
Dr R N Boyes	31 March 1993
Prof D S Davies	21 January 2003

Mr Kent is engaged as part time Executive Chairman of the Company under a service agreement dated 10 March 2005 pursuant to which he is required to devote not less than one working day per week to the affairs of the Company. The term of his engagement is for a period of not less than six months nor more than 12 months from 2 March 2005 although it is terminable on the giving of one month's notice by either party provided such notice cannot be given during the initial six months of the term. Once notice to terminate has been given by either party, the Company has the right in its absolute discretion to terminate the Director's employment by making a payment in lieu of the notice required or any unexpired part of such notice.

Remuneration report continued

Each of Mr Murphy and Mr Shennan has a service contract with the Company which is terminable by either party on not less than 12 months' notice. Once notice to terminate has been given by the party, the Company has the right in its absolute discretion to terminate the Director's employment by making a payment in lieu of the notice required or any unexpired part of such notice.

Each of Dr Chadwick and Dr Dalton has a service contract with Quadrant Healthcare Limited, which is terminable by either party on not less than six months' notice in the case of Dr Chadwick and not less than 12 months' notice in the case of Dr Dalton. Once notice to terminate has been given by either party, the Company has the right in its absolute discretion to terminate the Director's employment by making a payment in lieu of the notice required or any unexpired part of such notice.

Mr Ballington, who resigned from the Board on 15 July 2005, continues to be employed by the Company under a service contract terminable by either party on not less than 12 months' notice. Once notice to terminate has been given by either party, the Company has the right in its absolute discretion to terminate his employment by making a payment in lieu of the notice required or any unexpired part of such notice.

Professor Davies resigned from the Board on 16 May 2005 but continued to be employed by the Company until his retirement on 30 September 2005.

Dr R N Boyes resigned from the Board on 16 May 2005 but continued to be employed until his retirement date on 6 January 2006.

Stuart Sim's employment as an Executive of the Company was terminated with immediate effect on 2 March 2005. Mr Sim was employed by the Company pursuant to a service contract dated 27 July 1992 as amended by a deed of amendment dated 13 January 1999. Pursuant to a compromise agreement dated 16 May 2005, Mr Sim's contract was terminated with effect from 2 March 2005. Pursuant to the terms of the compromise agreement, the Company agreed to pay, *inter alia*, to Mr Sim within 21 days of the date of the agreement, the sum of £221,434 and certain other provisions with respect to his company car, private medical insurance and pension payments. In accordance with the rules of the 1999 Scheme, the Company exercised its discretion to allow Mr Sim to retain and exercise certain of his outstanding share options, being:

Ordinary Shares of 1p each	Subscription price	Expiry date
869,387	£0.19	19 April 2014
1,028,410	£0.15	17 April 2013
489,355	£0.37	2 November 2011

The Company also agreed that, in accordance with the rules of the 1999 Scheme, the options would become immediately exercisable with effect from 2 March 2005 and that the performance conditions would be treated as satisfied. Mr Sim provided several warranties as to having no reason to present any claims or complaints to any employment tribunals or any courts against the Company or any member of the Group.

Non-Executive Directors (unaudited)

The Non-Executive Directors with the exception of Mr Uppal are subject to a notice period of three months and receive fees which are determined by the Board.

Mr Uppal's appointment as a Non-Executive Director is subject to a three months' notice period. He also continues to be an employee of the Group for the period of the six months' notice period from 15 July 2005 under his service contract with Quadrant Healthcare Limited.

Retirement by rotation (unaudited)

All Directors are subject to the requirements of the Articles of Association which state that at least one third of the Directors will retire by rotation each year.

Directors' remuneration (audited)

The information on Directors' remuneration in the financial year ended 30 September 2005 set out below should be read in conjunction with the Directors' Report and Note 9 on page 52 which also constitute part of this Remuneration Report.

	Basic salary £000	Bonus £000	Taxable benefits £000	Pension contributions £000	Fees £000	Termination payments £000	Total 2005 £000	Total 2004 £000
Executive Directors								
I F Kent (From 2 March 2005)	36	–	–	–	–	–	36	–
K P Murphy (From 2 March 2005)	120	–	3	18	–	–	141	–
Dr T S Chadwick (From 15 July 2005)	36	–	5	5	–	–	46	–
Dr C C Dalton (From 15 July 2005)	34	–	2	5	–	–	41	–
P J Shennan	207	–	17	31	–	–	255	274
S W Sim (To 2 March 2005)	138	–	28	21	–	370	557	412
P J Ballington (To 15 July 2005)	143	–	13	20	–	–	176	56*
Dr R N Boyes (To 16 May 2005)	77	–	10	12	–	–	99	154
Prof D S Davies (To 16 May 2005)	71	–	12	11	–	–	94	147
Non-Executive Directors								
Dr S E Foden (From 16 May 2005)	–	–	–	–	12	–	12	–
Dr J M Fromson (From 16 May 2005)	–	–	–	–	12	–	12	–
F S Hallsworth (From 6 April 2005)	–	–	–	–	15	–	15	–
R Uppal (From 15 July 2005)	38	–	2	3	6	–	49**	–
Prof A D Dayan (To 16 May 2005)	–	–	–	–	27	–	27	43
Dr T Medinger (To 16 May 2005)	–	–	–	–	43***	–	43	37
Total	900	–	92	126	115	370	1,603	1,123

*The figure for Mr Ballington for 2004 is from 29 June 2004.

**The figures for Mr Uppal represent remuneration as an employee under his service contract as explained above and fees under his Non-Executive appointment.

***The figure for Dr Medinger includes a payment in lieu of notice.

Remuneration report continued

In the period from 15 July 2005, (the date of his resignation from the Board) to 30 September 2005, Mr Ballington received remuneration as an employee comprising salary of £37,500, bonus of £20,000, taxable benefits of £3,500 and pension contributions of £5,000.

In the period from 16 May 2005 (the date of his resignation from the Board) to 30 September 2005, Dr Boyes received remuneration as an employee comprising salary of £45,750, taxable benefits of £5,500, and pension contributions of £4,500.

In the period from 16 May 2005 (the date of his resignation from the Board) to 30 September 2005, Dr Davies received remuneration as an employee comprising salary of £42,500, taxable benefits of £7,000, and pension contributions of £4,250.

Dr C B Brown, a former Director who remained employed by the Company in an executive role as Medical Director until 30 September 2005, had remuneration in the period of £220,000 (2004: £217,000) comprising basic salary £179,000 (2004: £177,000), taxable benefits £13,000 (2004: £13,000) and pension contributions £28,000 (2004: £27,000). In connection with the termination of his employment Dr Brown is to receive payments totalling £170,000.

Mr G P Fothergill, a former Director, remained employed by the Company in a part-time capacity until 8 April 2005 and received remuneration in that period of £137,000 (2004: £260,000) comprising basic salary of £120,000 (2004: £226,000) and pensions contributions of £17,000 (2004: £34,000). He also received termination payments totalling £185,675 under a Compromise Agreement dated 7 July 2005.

Directors' share options (audited)

Share options have been granted to Directors under two schemes, being the M L Laboratories PLC Executive Share Option Scheme, which was set up originally in 1989, and the Innovata plc (formerly M L Laboratories PLC) 1999 Executive Share Option Scheme. In addition options have been granted to Mr I Kent and Mr K Murphy by resolution of shareholders in general meeting.

The M L Laboratories PLC Executive Share Option Scheme adopted in 1989 had a fixed life of ten years and no further options may now be granted under it. There was no performance condition attaching to the outstanding options granted and they are therefore exercisable at the discretion of the option holder.

The Executive Directors who served during the year have outstanding options over the Ordinary Shares of 1p each of the Company under the M L Laboratories PLC Executive Share Option Scheme as follows:

Name of Director	1 October 2004	Granted in the year	Exercised	Lapsed	30 September 2005	Subscription price	Exercise date	Expiry date
P J Shennan	324,137	—	—	—	324,137	£1.24	09/02/01	09/02/08
	22,891	—	—	—	22,891	£0.88	06/07/01	06/07/08
	50,646	—	—	—	50,646	£1.06	08/03/02	08/03/09
	397,674	—	—	—	397,674			
S W Sim	23,833	—	—	23,833	—	£1.68	04/09/98	04/09/05
	37,150	—	—	37,150	—	£3.69	23/07/99	23/07/06
	417,894	—	—	417,894	—	£1.24	09/02/01	09/02/08
	40,059	—	—	40,059	—	£0.88	06/07/01	06/07/08
	50,646	—	—	50,646	—	£1.06	08/03/02	08/03/09
	569,582	—	—	569,582	—			
P J Ballington	47,667	—	—	47,667	—	£1.68	04/09/98	04/09/05
	21,503	—	—	—	21,503	£3.69	23/07/99	23/07/06
	183,797	—	—	—	183,797	£1.24	09/02/01	09/02/08
	25,323	—	—	—	25,323	£1.06	08/03/02	08/03/09
	278,290	—	—	47,667	230,623			

Name of Director	1 October 2004	Granted in the year	Exercised	Lapsed	30 September 2005	Subscription price	Exercise date	Expiry date
Dr R N Boyes	23,833	–	–	23,833	–	£1.68	04/09/98	04/09/05
	3,231	–	–	–	3,231	£3.69	23/07/99	23/07/06
	120,012	–	–	–	120,012	£1.24	09/02/01	09/02/08
	52,649	–	–	–	52,649	£0.88	06/07/01	06/07/08
	50,646	–	–	–	50,646	£1.06	08/03/02	08/03/09
	250,371	–	–	23,833	226,538			
Prof D S Davies	11,917	–	–	11,917	–	£1.68	04/09/98	04/09/05
	2,186	–	–	–	2,186	£3.69	23/07/99	23/07/06
	43,651	–	–	–	43,651	£1.24	09/02/01	09/02/08
	16,116	–	–	–	16,116	£0.88	06/07/01	06/07/08
	50,646	–	–	–	50,646	£1.06	08/03/02	08/03/09
	124,516	–	–	11,917	112,599			
Total	1,620,433	–	–	652,999	967,434			

The Innovata plc (formerly M L Laboratories PLC) 1999 Executive Share Option Scheme (the "1999 Scheme") is administered by the Board of Directors and governed by the 1999 Scheme Rules, adopted in 1999 and amended in 2001 and 2004. There are two parts to the 1999 Scheme, an "Approved" element, which has been approved by the Inland Revenue, which is primarily used for the grant of options to employees at all levels, and an "Unapproved" part which is intended primarily to be used where Executives have more than £30,000 worth of outstanding approved options. The 1999 Scheme has a fixed life of ten years. The price at which a participant may acquire Ordinary Shares is to be not less than the higher of nominal value and the mid-market quotation on the date of grant. Options may be exercised only on the satisfaction of the associated performance conditions.

For all options granted under the scheme prior to 2001, the performance condition for Basic Options (vesting after three years) to be exercisable requires the share price to achieve a level at least twice the option price on or after the vesting date. For larger awards of Super Options (vesting after five years) to be exercisable requires the share price to achieve a level at least three times the option price on or after the vesting date. In 2001 the scheme was amended to discontinue Basic and Super options and to allow for annual grants of options.

Since the 1999 Scheme was amended in 2001 and up to 14 July 2005, (i) for options granted over shares with a value of up to 100% of total remuneration in a year to be exercisable the Company's share price (based on a 30 day average) must have achieved a level of at least 50% growth (rising by 10% a year from the fifth anniversary of grant) from the option price at some time in the period from three years from the date of grant until option exercise, (ii) for options granted over shares with a value over 100% of total remuneration in a year to be exercisable the Company's share price (based on a 30 day average) must have achieved a level of at least 100% growth (rising by 20% a year from the fifth anniversary of grant) from the option price at some time in the period from three years from the date of grant until option exercise.

Options granted to employees after 14 July 2005 are subject to performance conditions related to the performance of the Company's share price between the date of grant and the date of exercise. The Options will vest as to 50% should the Company's share price equal or exceed 30p, as to 25% should the Company's share price equal or exceed 60p and as to the balance should the Company's share price equal or exceed 90p. These performance conditions must be met within five years of the date of grant of the Options and the relevant share price must have reached and stayed at, or above, the performance target price for a minimum of 30 trading days. The Options will be exercisable subject to the satisfaction of the performance conditions between the third and tenth anniversary of the date of grant.

Since the amendment of the 1999 Scheme in 2001, options granted on an all employee basis need not be subject to a performance condition if the Committee considers this appropriate, although the Committee has not, as yet, exercised this discretion. The maximum number of Ordinary Shares which may be issued under the 1999 Scheme is 10% of the issued Ordinary Shares. The 1999 Scheme makes special provision for the grant of options to newly recruited members of staff.

Remuneration report continued

The Executive Directors who served during the year have outstanding options over the Ordinary Shares of 1p each of the Company under the 1999 Scheme as follows:

Name of Director	1 October 2004	Granted in the year	Exercised	Lapsed	30 September 2005	Subscription price	Exercise date	Expiry date
I F Kent	–	1,000,000	–	–	1,000,000	£0.22	03/03/08	03/03/15
	–	1,000,000	–	–	1,000,000			
K P Murphy	–	2,000,000	–	–	2,000,000	£0.22	03/03/08	03/03/15
	–	2,000,000	–	–	2,000,000			
Dr T S Chadwick	–	1,000,000	–	–	1,000,000	£0.22	15/07/08	15/07/15
	–	1,000,000	–	–	1,000,000			
Dr C C Dalton	–	1,000,000	–	–	1,000,000	£0.22	15/07/08	15/07/15
	–	1,000,000	–	–	1,000,000			
P J Shennan	28,940	–	–	–	28,940	£1.39	20/08/04	20/08/09
	256,654	–	–	–	256,654	£0.37	02/11/04	02/11/11
	653,968	–	–	–	653,968	£0.15	17/04/06	17/04/13
	552,845	–	–	–	552,845	£0.19	19/04/07	19/04/14
	–	1,000,000	–	–	1,000,000	£0.22	15/07/08	15/07/15
	1,492,407	1,000,000	–	–	2,492,407			
S W Sim	115,039	–	–	115,039	–	£1.39	20/08/04	20/08/09
	489,355	–	–	–	489,355	£0.37	02/11/04	02/11/11
	1,028,410	–	–	–	1,028,410	£0.15	17/04/06	17/04/13
	869,387	–	–	–	869,387	£0.19	19/04/07	19/04/14
	2,502,191	–	–	115,039	2,387,152			
P J Ballington	48,749	–	–	–	48,749	£1.39	20/08/02	20/08/09
	48,202	–	–	–	48,202	£1.39	20/08/04	20/08/09
	217,129	–	–	–	217,129	£0.37	02/11/04	02/11/11
	352,262	–	–	–	352,262	£0.15	17/04/06	17/04/13
	298,080	–	–	–	298,080	£0.19	19/04/07	19/04/14
	–	1,000,000	–	–	1,000,000	£0.22	15/07/08	15/07/15
	964,422	1,000,000	–	–	1,964,422			
R N Boyes	1,120	–	–	–	1,120	£1.39	20/08/04	20/08/09
	37,949	–	–	–	37,949	£1.39	20/08/04	20/08/09
	183,764	–	–	–	183,764	£0.37	02/11/04	02/11/11
	386,183	–	–	–	386,183	£0.15	17/04/06	17/04/13
	326,468	–	–	–	326,468	£0.19	19/04/07	19/04/14
	935,484	–	–	–	935,484			
D S Davies	9,767	–	–	–	9,767	£1.39	20/08/04	20/08/09
	154,489	–	–	–	154,489	£0.37	02/11/04	02/11/11
	358,151	–	–	–	358,151	£0.15	17/04/06	17/04/13
	302,770	–	–	–	302,770	£0.19	19/04/07	19/04/14
	825,177	–	–	–	825,177			
Total	6,719,681	7,000,000	–	115,039	13,604,642			

The following options over the Ordinary Shares of 1p each in the Company were granted by resolution of the shareholders at the EGM on 14 July 2005 and remain outstanding:

Name of Director	1 October 2004	Granted in the year	Exercised	Lapsed	30 September 2005	Subscription price	Exercise date	Expiry date
I F Kent	—	1,000,000	—	—	1,000,000	£0.22	14/07/05	14/07/15
K P Murphy	—	2,000,000	—	—	2,000,000	£0.22	14/07/05	14/07/15
	—	3,000,000	—	—	3,000,000			

These Options will be subject to performance conditions related to the performance of the Company's share price between the date of grant and the date of exercise. The Options will vest (and therefore be exercisable) as to 50% should the Company's share price equal or exceed 30p, as to 25% should the Company's share price equal or exceed 60p and as to the balance should the Company's share price equal or exceed 90p. These performance conditions must be met within five years of the date of grant of the Options and the relevant share price must have reached and stayed at, or above, the performance target price for a minimum of 30 trading days.

In connection with the grant of these options the shareholders also approved at the EGM on 14 July 2005 a bonus scheme to be operated by the Board for K P Murphy as follows:

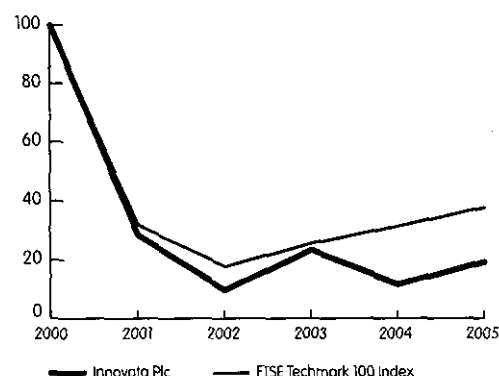
1. Mr Murphy will be entitled to receive the following cash payments (net of tax and national insurance): £250,000 when the Ordinary Share price reaches 30p; £100,000 when the Ordinary Share price reaches each of 40p, 50p and 60p per Ordinary Share; and £250,000 when the Ordinary Share price reaches 100p.
2. The relevant Ordinary Share price targets must be reached, and remain at or above the target level described in (1) above for a minimum of 30 trading days.
3. Mr Murphy will only be permitted to use the cash payments to exercise options held by him under the Company's 1999 Executive Share Option Scheme or under the Option described above.
4. The benefits under the Bonus Scheme will not be pensionable.

The market price of the shares at 30 September 2005 was £0.2575 and the range during the financial year was £0.1602 to £0.2775.

Performance graph (unaudited)

The graph below illustrates the relative Total Shareholder Return performance of the Company and the FTSE Techmark 100 Index over the last five financial years. Total Shareholder Return comprises the impact of share price movements and dividends paid. The FTSE Techmark 100 Index has been used as a comparator because the Committee considers it to be the most appropriate index of which the Company is currently a constituent.

Total Shareholder Return



This graph shows the value, by 30 September 2005, of £100 invested in M L Laboratories PLC (now Innovata plc) on 30 September 2000 compared with the value of £100 invested in the FTSE Techmark 100 Index. The other points plotted are the values at intervening financial year-ends.

Signed on behalf of the Board

Dr S E Foden, Chairman Remuneration Committee

11 January 2006

Independent Auditors' report to the members of Innovata plc

We have audited the financial statements of Innovata plc for the year ended 30 September 2005 which comprise the profit and loss account, the balance sheets, the cash flow statement, the statement of accounting policies and the related Notes 1 to 34. 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 also report to you if, in our opinion, the Company has not complied with any of the four Directors' remuneration disclosure requirements specified for our review by the Listing Rules of the Financial Services Authority. These comprise the amount of each element in the remuneration package and information on share options, details of long-term incentive schemes, and money purchase and defined benefit schemes. We give a statement, to the extent possible, of details of any non-compliance.

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 30 September 2005 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
Cambridge

11 January 2006

Deloitte & Touche LLP

**Consolidated profit and loss account
for the year ended 30 September 2005**

	Notes	2005 Continuing £000	2005 Acquisition £000	2005 Total £000	2004 Continuing £000	2004 Discontinued £000	2004 Total £000
Turnover	4	14,194	1,504	15,698	7,696	198	7,894
Cost of sales	4	(3,654)	(335)	(3,989)	(2,369)	(98)	(2,467)
Gross profit		10,540	1,169	11,709	5,327	100	5,427
Research and development expenditure	4	(9,959)	(407)	(10,366)	(12,903)	–	(12,903)
Selling, marketing and distribution costs	4	(537)	–	(537)	(487)	(7)	(494)
Administrative expenses	4	(6,289)	(292)	(6,581)	(4,273)	(247)	(4,520)
Other operating income	4/5	2,739	–	2,739	508	–	508
Operating (loss)/profit		(3,506)	470	(3,036)	(11,828)	(154)	(11,982)
Exceptional (loss)/profit:	3						
Current year: costs of fundamental reorganisation or restructuring having a material effect on the nature and focus of operations				(6,113)			–
Prior year: profit on divestment				–			755
Loss before interest				(9,149)			(11,227)
Interest receivable	6(a)			438			390
Interest payable	6(b)			(154)			(68)
Loss on ordinary activities before taxation	4, 7			(8,865)			(10,905)
Taxation	8			(32)			1,859
Loss for financial year	21(a)			(8,897)			(9,046)
Loss per Ordinary Share (p)	25			(3.11)p			(4.48)p

Continuing results relate to the ongoing activities of the Innovata Group. The acquisition results relate to the activities of the Quadrant Group for the post acquisition period from 15 July 2005. The discontinued results for 2004 relate to the activities of Healthcare Education Services Limited up until 6 February 2004, the date of disposal.

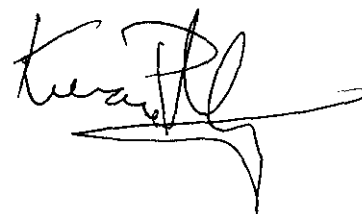
There were no recognised gains or losses other than those shown in the above profit and loss account and therefore no separate statement of total recognised gains and losses has been presented.

There is no difference between the loss on ordinary activities before taxation and the loss for the year stated above, and their historical cost equivalents.

**Consolidated balance sheet
at 30 September 2005**

	Notes	2005 £000	2004 £000
Fixed assets			
Goodwill	10	54,401	3,100
Tangible assets	11	3,443	2,858
Investments	12	250	250
		58,094	6,208
Current assets			
Stocks	13	320	329
Debtors	14	8,555	5,534
Investments	15	-	-
Cash and short-term deposits	16	13,935	10,868
		22,810	16,731
Current liabilities			
Creditors: Amounts falling due within one year	17(a)	(11,385)	(9,012)
Net current assets		11,425	7,719
Total assets less current liabilities		69,519	13,927
Creditors: Amounts falling due after more than one year	17(b)	(848)	(322)
		68,671	13,605
Provisions	18	(9,028)	-
Deferred income	19	(1,146)	(673)
Net assets		58,497	12,932
Capital and reserves			
Called-up share capital	20, 21(a)	5,026	2,287
Share premium account	21(a)	73,230	50,155
Merger reserve	21(a)	36,984	8,336
Profit and loss account	21(a)	(56,743)	(47,846)
Equity shareholders' funds	21(a)	58,497	12,932

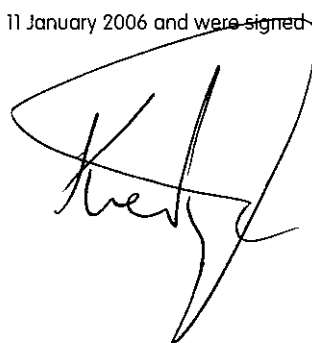
The financial statements on pages 39 to 66 were approved by the Board of Directors on 11 January 2006 and were signed on its behalf by K P Murphy.



**Parent company balance sheet
at 30 September 2005**

	Notes	2005 £000	2004 £000
Fixed assets			
Goodwill	10	–	3,100
Tangible assets	11	192	996
Investments	12	55,875	4,428
		56,067	8,524
Current assets			
Stocks	13	–	10
Debtors – due within one year	14(a)	2,383	3,019
Debtors – due after more than one year	14(b)	2,735	170
Total debtors		5,118	3,189
Investments	15	–	–
Cash and short-term deposits	16	34,566	36,440
		39,684	39,639
Current liabilities			
Creditors: Amounts falling due within one year	17(a)	(3,721)	(2,458)
Net current assets		35,963	37,181
Total assets less current liabilities		92,030	45,705
Creditors: Amounts falling due after more than one year	17(b)	(316)	(411)
Deferred income	19	–	(4)
Net assets		91,714	45,290
Capital and reserves			
Called-up share capital	20, 21(b)	5,026	2,287
Share premium account	21(b)	73,230	50,155
Merger reserve	21(b)	36,984	8,336
Special reserve	21(b)	4,049	4,049
Profit and loss account	21(b)	(27,575)	(19,537)
Equity shareholders' funds	21(b)	91,714	45,290

The financial statements on pages 39 to 66 were approved by the Board of Directors on 11 January 2006 and were signed on its behalf by K P Murphy.



**Consolidated cash flow statement
for the year ended 30 September 2005**

	Notes	2005 £000	Restated 2004 £000
Net cash outflow from operating activities	30	(5,437)	(10,802)
Returns on investments and servicing of finance			
Interest received		456	355
Interest paid		(18)	(16)
Interest paid on finance leases		(140)	(48)
Net cash inflow from returns on investments and servicing of finance		298	291
Taxation			
UK Corporation tax recovered		2,279	816
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(1,823)	(1,831)*
Receipts from sale of current asset investments		-	2
Receipts from sale of tangible fixed assets		209	78
Net cash outflow for capital expenditure and financial investment		(1,614)	(1,751)
Acquisitions			
Acquisition of Quadrant		(19,500)	-
Fees incurred in acquisition of Quadrant		(1,011)	-
Cash acquired as part of Quadrant		5,060	-
Acquisition of Innovata Biomed minority interest		(925)	-
Net cash outflow from acquisitions		(16,376)	-
Disposals and restructuring			
Disposal of shares in Cobra		-	1,231
Disposal of subsidiary		-	(402)
Net cash outflow from restructuring		(965)	-
Net cash (outflow)/inflow from disposals and restructuring		(965)	829
Net cash outflow before management of liquid resources and financing		(21,815)	(10,617)
Management of liquid resources			
Cash withdrawn from/(placed on) short-term deposits		1,587	(4,208)
Net cash inflow/(outflow) from management of liquid resources		1,587	(4,208)
Financing			
Issue of Ordinary Share capital		26,125	15,519
Expenses paid in connection with share issue		(1,675)	(1,162)
Net cash inflow from issue of Ordinary Share capital		24,450	14,357
Capital element of finance lease rental payments		(877)	(432)
Lease finance acquired		1,787	555*
New unsecured loan finance		-	473
Capital element of unsecured loan payments		(478)	(49)
Increase in debt and lease financing	32/33	432	547
Net cash inflow from financing		24,882	14,904
Increase/(decrease) in net cash	32/33	4,654	79

*The comparative figures for purchase of tangible fixed assets and lease finance acquired have each been amended by the inclusion of £393,000 to ensure consistency of treatment of new finance leases.

Principal accounting policies

The financial statements have been prepared in accordance with the Companies Act 1985 and Accounting and Financial Reporting Standards applicable in the United Kingdom. A summary of the most significant accounting policies, which have been applied consistently, is set out below.

Basis of accounting

The financial statements have been prepared under the historical cost basis of accounting.

Basis of consolidation

The consolidated profit and loss account and balance sheet include the financial statements of the Company and all its subsidiary undertakings made up to 30 September in each year. The results of any subsidiaries acquired are included from the date that control was acquired. The results of any subsidiaries disposed of are included up to the date of disposal or loss of control. Intra-group sales, profits and losses and intra-group balances outstanding at the year end are eliminated fully on consolidation.

Goodwill

Goodwill arises on the acquisition of a business and represents the excess of the fair value of consideration over the fair value of the net assets acquired. Goodwill arising up to 30 September 1998 was written-off on acquisition against reserves. Goodwill arising from 1 October 1998 is capitalised and amortised over its useful life, not exceeding 20 years. Goodwill arising on the acquisition of Quadrant is being amortised over 20 years.

Research and development

Research and development expenditure is written-off in the period in which it is incurred and includes all internal and external costs incurred in patenting, product development, developing manufacturing processes, manufacturing materials to be used in clinical trials, the cost of conducting those trials, external studies, analysis and consultants, the cost of obtaining regulatory approvals and the cost of third party licence fees.

Tangible fixed assets

Tangible fixed assets are stated at their purchase cost to the Group less depreciation. Depreciation is provided on a straight line basis to write-off the cost of the tangible fixed assets over their estimated useful lives at the following rates:

Leasehold	lesser of the period of the lease or 10% per annum
Plant and machinery	20-33% per annum
Computer and office equipment	20-25% per annum
Motor vehicles	33% per annum

Assets under construction are classified separately and depreciated from the date they are brought into use at appropriate rates.

Finance leases

Finance leases are defined as those which transfer the majority of the risks and rewards of ownership to the Group/Company. Tangible fixed assets include assets held under finance leases which are capitalised at their purchase cost with a corresponding amount treated as a liability. Interest is charged to the profit and loss account over the period of the lease agreements by reference to the capital balance outstanding.

Operating leases

Rentals payable in respect of operating leases are charged to the profit and loss account as incurred.

Principal accounting policies continued

Fixed asset investments (including investments in subsidiaries)

Investments are stated at cost, but are written down to their net realisable or recoverable value if the Directors consider that there has been an impairment of their value.

Stocks

Stocks are stated at the lower of cost and net realisable value. Cost is determined on a first in, first out basis.

Deferred taxation

Deferred tax is recognised, without discounting, in respect of all timing differences which have originated but not reversed by the balance sheet date, except as otherwise required by FRS 19, at rates expected to apply when they reverse, based on current tax rates and law. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

Pension costs

The Company makes defined contributions to money purchase pension schemes. Contributions are charged to the profit and loss account on an accruals basis.

Foreign currency translation

Foreign currency transactions are translated into sterling at the rate prevailing at the date of the transaction. Monetary assets and liabilities at the year end are translated into sterling at the rate prevailing at the balance sheet date. The resulting exchange differences are dealt with in the profit and loss account.

Turnover

Turnover, which excludes value added tax, comprises:

- Licensing and evaluation fees, which are recognised once it can be determined with reasonable certainty that such amounts will be received and that they are not returnable and are taken to turnover when the associated conditions are satisfied and/or substantive obligations met, pending which they are treated as deferred income. Licence fees which are returnable if contractually specified conditions are not met are treated as creditors until such conditions are fully satisfied.
- Development fees, which are recognised in the period in which the development is undertaken for third party licensees under the terms of licence agreements. Expenditure incurred in relation to development fees is treated as a cost of sale rather than classified as research and development expenditure.
- Royalties, which are recognised in the period in which the sales by third parties that give rise to the royalties take place.
- Product sales, which are recognised when the goods are despatched to customers.

Turnover does not include that proportion of the royalty and revenue streams arising from the Group's products which is receivable by Paul Royalty Fund under the transactions referred to in Note 5.

Other operating income

Other operating income comprises income which falls outside the definition of turnover.

Notes to the accounts

1. Acquisition, share issue and change of name

On the 15 July 2005 the Company acquired Quadrant Technologies Limited ("Quadrant"), together with its subsidiaries (together "the Quadrant Group") for a consideration of £48.5m, excluding expenses. This was satisfied as to £29m by the issue of 131,932,394 new Ordinary Shares in the Company and as to £19.5m in cash funded out of the proceeds of the Vendor Placing and Placing and Open Offer as explained below.

The Company also acquired the outstanding minority interest in its existing subsidiary, Innovata Biomed Limited, for a consideration of £1.9m, satisfied as to half by the issue of 4,484,848 new Ordinary Shares in the Company, and as to half by cash from the proceeds of the Placing and Open Offer.

In order to fund the cash element of the consideration for the above transactions, to cover the related expenses amounting to £2.7m, and to raise additional working capital of £3.0m, the Company issued for cash 91,758,315 new Ordinary Shares by way of a Vendor Placing and 45,741,683 new Ordinary Shares by way of a Placing and Open Offer at 19p per share.

At the same time the Company changed its name from M L Laboratories PLC to Innovata plc.

The purchase of Quadrant has been accounted for using acquisition accounting, after taking into account the fair value of the shares issued by Innovata plc based on a fair value of 22p per share. On this basis the net assets acquired and the goodwill arising in respect of the acquisitions of Quadrant and the minority interest in Innovata Biomed Limited were:

Fair value of net assets of Quadrant:

	Book value £000	Accounting policy alignments £000	Fair value revaluation £000	Fair value £000
Tangible fixed assets	414	–	–	414
Cash	5,060	–	–	5,060
Debtors	3,036	–	(1,000)	2,036
Creditors	(1,278)	–	(100)	(1,378)
Deferred consideration	(6,634)	–	(2,251)	(8,885)
Deferred income	–	(500)	–	(500)
Provisions	(389)	–	117	(272)
Net liabilities acquired	209	(500)	(3,234)	(3,525)
Fair value of consideration for Quadrant				48,525
Fair value of consideration for minority interest in Innovata Biomed Limited*				1,912
Costs of acquisition				1,011
Goodwill				54,973

The adjustments made to book values in arriving at the fair value of the net assets of Quadrant comprise:

- (a) adjustments arising from the application of the accounting policies of Innovata plc where they differ from those of the Quadrant Group.
- (b) adjustments arising from a provisional assessment of the fair values of the assets and liabilities of the Quadrant Group.

*No net assets were acquired in respect of Innovata Biomed Limited.

Notes to the accounts continued

1. Acquisition, share issue and change of name continued

The results of the Quadrant Group for the period since acquisition are disclosed within the consolidated profit and loss account under the heading "Acquisition". The results of Quadrant for the year ended 31 December 2004 and for the period 1 January 2005 to the date of acquisition on 15 July 2005 were:

	Unaudited 1 January 2005 to 15 July 2005 £000	Audited Year ended 31 December 2004 £000
Turnover	3,423	5,662
Operating profit	196	1,331
Profit on ordinary activities before taxation	360	1,334
Taxation	(1,000)	1,000
(Loss)/profit on ordinary activities after taxation	(640)	2,334

The cash flow effect of the purchase of Quadrant is set out in Note 31.

2. Discontinued activities

On 6 February 2004 the Group completed the disposal of its subsidiary, Healthcare Education Services Limited.

The results of this business have been included in the Group's consolidated profit and loss account for the year ended 30 September 2004 up until the date of disposal as a discontinued activity.

3. Exceptional items 2005

During the year the Group incurred an exceptional charge in relation to the restructuring of its business following the appointment of Ian Kent and Kieran Murphy as Chairman and Chief Executive Officer respectively in March 2005 and the acquisition of Quadrant in July 2005. The exceptional charge includes amounts relating to the cost of redundancies, the closure of sites, the write-off of tangible fixed assets and the write-off of goodwill relating to the UCOE activity. The charge is stated net of the proceeds from the sales of the UCOE gene expression technology and MATS, the Group's material analysis business.

The restructuring was conducted in two phases. On 25 April 2005, the Company announced a restructuring to consolidate the Group's then existing operations into one site at St Albans. This restructuring was part of a strategic review to reduce costs and improve efficiency and followed the appointment of the new management team on 2 March 2005, as explained above. This restructuring reflected the intent to place greater focus on the Group's respiratory business, and the intention therefore to divest or partner, as appropriate, certain of the Group's other assets, including Devacade®, the gene therapy products CTL102 and CTL901 and the UCOE gene expression technology. On 16 June 2005, the Company announced the proposed acquisition of Quadrant which was completed on 15 July 2005, and subsequently consolidated the Group's operations into one site at Quadrant's premises in Ruddington, Nottingham. This led to further reorganisation costs with the closure of the St Albans site, and further redundancies.

In July 2005 the Group sold the MATS business for a net consideration of £148,000 in cash. The results of the MATS business have not been separately disclosed as a discontinued activity on the grounds of immateriality.

On 30 September 2005, the Group sold the UCOE gene expression technology to Celliance Corporation for an undisclosed cash consideration.

2004

An exceptional profit arose during 2004 on the sale of the Group's remaining holding of one million Cobra Biomanufacturing PLC ("CBM") shares at a price of £1.25 per share, generating net proceeds, after expenses, of £1,231,000 and a profit for the Group of £755,000.

The disposal of Healthcare Education Services Limited during the year gave rise to neither a profit nor a loss as the consideration received in the form of shares in Bridgehead International Limited ("Bridgehead") has a fair value in the balance sheet equal to the net assets divested.

There was no taxation impact of the exceptional item in either year.

4. Segmental analysis by class of business

The analysis by class of business of the Group's turnover, research and development expenditure, other expenses, other operating income, loss before taxation and net assets is set out below:

Segmental reporting – All activities

	Turnover £000	Research and development expenditure £000	Other expenses £000	Other operating income £000	Loss before taxation £000	Net assets £000
2005						
Licensing and evaluation fees	6,507					
Development fees	3,864					
Royalties	3,567					
Product sales	1,369					
Total pharmaceutical activities	15,307	(10,344)	(16,932)	2,738	(9,231)	58,564
Other activities	391	(22)	(3)	–	366	(67)
Total	15,698	(10,366)	(16,935)	2,738	(8,865)	58,497
	Turnover £000	Research and development expenditure £000	Other expenses £000	Other operating income £000	Loss before taxation £000	Net assets £000
2004						
Licensing and evaluation fees	2,738					
Development fees	1,558					
Royalties	2,540					
Product sales	602					
Total pharmaceutical activities	7,438	(12,890)	(6,753)	508	(10,665)	12,780
Other activities	456	(13)	(728)	–	(240)	152
Total	7,894	(12,903)	(7,481)	508	(10,905)	12,932

Notes to the accounts continued

4. Segmental analysis by class of business continued Geographical segments – All activities

2005	Turnover by destination £000	Turnover by origin £000	Loss before taxation £000	Net assets £000
United Kingdom	10,130	15,698	(8,865)	58,497
North America	1,385			
Rest of Europe	2,293			
Rest of the World	1,890			
Total	15,698	15,698	(8,865)	58,497

2004	Turnover by destination £000	Turnover by origin £000	Loss before taxation £000	Net assets £000
United Kingdom	3,853	7,894	(10,905)	12,932
North America	222			
Rest of Europe	3,173			
Rest of the World	646			
Total	7,894	7,894	(10,905)	12,932

Segmental reporting – Acquisition

2005	Turnover £000	Research and development expenditure £000	Other expenses £000
Development fees	738		
Royalties	766		
Total pharmaceutical activities	1,504	(407)	(627)
Other activities	-	-	-
	1,504	(407)	(627)

Segmental reporting – Discontinued activities

2004	Turnover £000	Other expenses £000
Other activities	198	(352)
	198	(352)

4. Segmental analysis by class of business continued
Geographical segments – Acquisitions

2005	Turnover by destination £000	Turnover by origin £000
United Kingdom	660	1,504
North America	781	–
Rest of Europe	63	–
Rest of the World	–	–
Total	1,504	1,504

Geographical segments – Discontinued activities

2004	Turnover by destination £000	Turnover by origin £000
United Kingdom	131	198
North America	38	–
Rest of Europe	52	–
Rest of the World	(23)	–
Total	198	198

5. Other operating income

Other operating income for 2005 comprises monies received on the settlement of a dispute.

Other operating income for 2004 comprises the release to the consolidated profit and loss account of the remaining portion of monies received from Paul Royalty Fund ("PRF") in earlier years and carried in the balance sheet as deferred income, in order to match its release with associated spending obligations.

A total of £22.5m was received from PRF under two transactions in 2001 and 2002 as a result of which PRF is entitled to receive until 30 September 2010 a proportion of the royalties and revenue streams arising from Adept® and Extraneal®. As at 30 September 2004, the amounts received from PRF had been released in full to the consolidated profit and loss account.

While the risk relating to that proportion of the future royalty and revenue streams receivable by PRF has effectively been transferred to PRF, under certain specified circumstances (including change of control of innovata plc, certain major corporate transactions, and events of default material in the context of the PRF transaction) PRF has the right to require the Group to re-purchase PRF's interests in the royalty and revenue streams concerned for a consideration calculated to give PRF an agreed minimum rate of return.

Notes to the accounts continued

6. Interest receivable and payable

(a) Interest receivable

	2005 £000	2004 £000
Bank interest receivable	438	390
	438	390

(b) Interest payable

	2005 £000	2004 £000
On bank overdraft – repayable within five years	9	4
On unsecured loans	2	17
On finance leases	143	47
	154	68

7. Loss on ordinary activities before taxation

	2005 £000	2004 £000
Loss on ordinary activities before taxation is stated after charging:		
Depreciation – tangible owned fixed assets	429	328
– tangible fixed assets held under finance leases	336	439
Amortisation of intangible fixed assets	689	200
Auditors' remuneration for:		
– audit (Company £44,600) (2004: £20,000)	88	45
Operating leases – hire of other assets	–	1
– hire of plant and machinery	29	20
– rental of premises	984*	410
Loss on disposal of tangible fixed assets	59	–
And after crediting:		
Profit on disposal of tangible fixed assets	84	50

Remuneration of the Company's Auditors for the provision of non-audit services to the Company and its subsidiary undertaking was £360,000 (2004: £147,000). This comprised of fees in respect of taxation compliance £25,000 (2004: £27,000) and transaction assistance fees £335,000 (2004: £120,000).

*This figure includes rental costs included within the exceptional item as explained in Note 3.

8. Taxation

The current year tax credit represents refundable R&D tax credits less withholding taxes suffered. There is no charge to corporation tax during the year nor is there any provision required for deferred taxation. Accumulated tax losses have not been recognised as deferred tax assets as there is insufficient certainty as to their future recoverability.

As at 30 September 2005, the total tax losses in Group companies amounted to £106m (2004: £54m). These losses are available for offset against future profits in the companies concerned, subject to agreement with the Inland Revenue.

(a) Analysis of (charge)/credit in year

	2005 £000	2004 £000
R&D tax (charge)/credit Current year	315	1,414
Prior years	(77)	629
Withholding taxes	(270)	(184)
	(32)	1,859

(b) Factors affecting the tax (charge)/credit for the year

	£000	£000
Loss on ordinary activities before taxation	8,865	10,905
Loss on ordinary activities at 30%	2,660	3,271
Adjustments to tax credit in respect of prior periods	(77)	629
Carry forward of tax losses	(572)	(1,783)
Other timing differences	(151)	15
Amortisation of goodwill	(1,094)	(60)
Expenses not deductible for tax purposes	(143)	6
Non-taxable income arising on consolidation	(77)	226
Adjustment in respect of R&D tax credits	(308)	(261)
Withholding tax suffered	(270)	(184)
Total current tax (charge)/credit	(32)	1,859

Notes to the accounts continued

9. Directors and employees

	2005 Number	2004 Number
Employees		
Average weekly number of persons (including Directors) employed by the Group during the year		
Research and development	89	78
Administration and marketing	28	31
Educational training	-	6
	117	115
	2005 £000	2004 £000
Staff costs (for the above persons)		
Wages and salaries	6,554*	5,800
Social security costs	679	623
Other pension costs (Note 29)	340	412
	7,573	6,835
Directors' remuneration	£000	£000
Remuneration paid to the Directors of the holding company		
Aggregate emoluments	1,477	1,004
Contributions to money pension schemes	126	119
	1,603	1,123
Emoluments payable to the highest paid Director	£000	£000
Aggregate emoluments	536	364
Contributions to money purchase pension scheme	21	48
	557	412

Five Directors (2004: five) have benefits accruing under money purchase pension schemes.

No Director waived emoluments in respect of the year ended 30 September 2005 (2004: None).

Further details of the remuneration and Share Options of Directors are given in the Remuneration Report on pages 31 to 37.

*This figure includes staff costs included within the exceptional item as explained in Note 3.

10. Goodwill

Goodwill arising during the year relates to the acquisitions of Quadrant and the minority interest in Innovata Biomed, being the excess of cost of acquisitions over the fair value of net assets at the date of acquisition, and is capitalised and amortised over 20 years, this being the Directors' estimate of its useful economic life.

Goodwill at 1 October 2004 related to the research and development activities originally acquired by the Group on its acquisition of Cobra Therapeutics Limited ("Cobra") which were transferred into the direct ownership of the Company when Cobra left the Group as a result of the flotation on AIM of Cobra Biomanufacturing PLC. As a result of the restructuring of the Group's business referred to in Note 3 above, this goodwill is considered to have been impaired and has been written-off in full as part of the exceptional charge for restructuring costs.

Group	Goodwill £000
Cost	
At 1 October 2004	4,000
Additions	54,973
Impairment	(4,000)
At 30 September 2005	54,973
Aggregate amortisation	
At 1 October 2004	900
Charge for the year	689
Impairment	(1,017)
At 30 September 2005	572
Net book value at 30 September 2005	54,401
Net book value at 30 September 2004	3,100

Company	Goodwill £000
Cost	
At 1 October 2004	3,550
Impairment	(3,550)
At 30 September 2005	-
Aggregate amortisation	
At 1 October 2004	450
Charge for the year	118
Impairment	(568)
At 30 September 2005	-
Net book value at 30 September 2005	-
Net book value at 30 September 2004	3,100

Notes to the accounts continued

II. Tangible fixed assets

	Plant and machinery £000	Computer and office equipment £000	Motor vehicles £000	Assets under construction £000	Total £000
Group					
Cost					
At 1 October 2004	3,667	1,515	988	1,199	7,369
Acquisition	1,207	3,492	–	–	4,699
Additions	64	131	357	1,326	1,878
Disposal of subsidiary	22	(22)	–	–	–
impaired as a result of restructuring	(3,654)	(1,381)	–	–	(5,035)
Disposals	(96)	–	(593)	–	(689)
At 30 September 2005	1,210	3,735	752	2,525	8,222
Depreciation					
At 1 October 2004	2,787	1,249	475	–	4,511
Charge for year	333	134	298	–	765
Acquisition	1,032	3,254	–	–	4,286
Disposal of subsidiary	22	(22)	–	–	–
Impaired as a result of restructuring	(3,033)	(1,245)	–	–	(4,278)
Disposals	(90)	–	(415)	–	(505)
At 30 September 2005	1,051	3,370	358	–	4,779
Net book value					
At 30 September 2005	159	365	394	2,525	3,443
At 30 September 2004	880	266	513	1,199	2,858

The net book value of tangible fixed assets includes £1,827,000 (2004: £1,038,000) in respect of assets held under finance leases.

11. Tangible fixed assets continued

	Plant and machinery £000	Computer and office equipment £000	Motor vehicles £000	Assets under construction £000	Total £000
Company					
Cost					
At 1 October 2004	1,384	941	666	–	2,991
Additions	12	76	134	–	222
Transfer to subsidiaries	–	–	–	–	–
Impaired as a result of restructuring	(1,396)	(906)	–	–	(2,302)
Disposals	–	–	(507)	–	(507)
At 30 September 2005	–	111	293	–	404
Depreciation					
At 1 October 2004	853	779	363	–	1,995
Charge for year	146	73	178	–	397
Transfer to subsidiaries	–	–	–	–	–
Impaired as a result of restructuring	(999)	(803)	–	–	(1,802)
Disposals	–	–	(378)	–	(378)
At 30 September 2005	–	49	163	–	212
Net book value					
At 30 September 2005	–	62	130	–	192
At 30 September 2004	531	162	303	–	996

The net book value of tangible fixed assets includes £129,000 (2004: £611,000) in respect of assets held under finance leases.

Notes to the accounts continued

12. Fixed asset investments

Group	Investment £000
Cost and book value	
At 1 October 2004	250
Movement	–
At 30 September 2005	250

The Group's investment in Bridgehead International Limited, an unquoted company, represents 12% of its issued shared Capital.

Company	Investments £000	Subsidiaries £000	Total £000
Cost and book value			
At 1 October 2004	250	4,178	4,428
Acquisition of Quadrant (including expenses)	–	49,535	49,535
Acquisition of minority interest in Innovata Biomed	–	1,912	1,912
At 30 September 2005	250	55,625	55,875

Principal subsidiary companies	Country of incorporation	Description of holding	Proportion held %	Nature of business
Innovata Biomed Limited	Scotland	Ordinary Shares Preference Shares	100 100	Research, development and commercialisation of respiratory drug delivery technologies
Quadrant Technologies Limited	England	Ordinary Shares	100	Research, development of drug formulation and delivery systems
Quadrant Drug Delivery Limited	England	Ordinary Shares	100	Research, development of drug formulation and delivery systems
Quadrant Healthcare Limited	England	Ordinary Shares	100	Research, development of drug formulation and delivery systems together with the provision of management services to other Group companies

In addition the Group has a number of subsidiaries which are dormant or whose residual activities are not material to the results of the Group.

Principal subsidiary companies	Country of incorporation	Description of holding	Proportion held %	Nature of business
Joint venture				
QDose Limited	England	Ordinary Shares	50	Research, development of drug formulation and delivery systems

13. Stocks

	Group		Company	
	2005	2004	2005	2004
	£000	£000	£000	£000
Raw materials and consumables	320	329	–	10
	320	329	–	10

14. Debtors

	Group		Company	
	2005	2004	2005	2004
	£000	£000	£000	£000
(a) Amounts falling due within one year:				
Trade debtors	5,597	1,609	218	242
Other debtors	183	356	153	221
Corporation tax	315	2,561	315	1,656
Prepayments and accrued income	2,460	1,008	1,697	900
	8,555	5,534	2,383	3,019
(b) Amounts falling due after more than one year:				
Amounts owed by subsidiary undertakings	–	–	2,735	170
	8,555	5,534	5,118	3,189

The amounts due from subsidiary undertakings are unsecured and interest free.

15. Current asset investments

Group and Company	2005	2004
	£000	£000
Investments quoted on a recognised stock exchange, at cost	–	39
Sale of current asset investment	–	(1)
Provision for impairment of value	–	(38)
At 30 September	–	–
Aggregate market value of quoted investments	–	–

Current asset investments include holdings in certain US based companies to which the Directors have determined that no value should be attributed.

Notes to the accounts continued

16. Cash and short-term deposits

Cash and short-term deposits of £13,935,000 (2004: £10,868,000) include short-term deposits amounting to £8,865,000 (2004: £10,452,000), including £500,000 held as security for an overdraft facility of that amount from Barclays Bank PLC.

Cash and short-term deposits in the Company of £34,566,000 (2004: £36,440,000) include short-term deposits amounting to £8,865,000 (2004: £10,452,000), including £500,000 held as security for an overdraft facility of that amount from Barclays Bank PLC.

The Company has provided unlimited multilateral guarantees in respect of the bank overdrafts of certain of its subsidiaries, which at 30 September 2005 amounted to £25,569,000 (2004: £25,573,000).

17. Creditors

	Group		Company	
	2005 £000	2004 £000	2005 £000	2004 £000
(a) Amounts falling due within a year:				
Obligations under finance leases	694	310	84	177
Unsecured loans	–	478	–	5
Trade creditors	892	2,640	167	1,332
Taxation and social security	676	220	145	166
Other creditors	4,000	4,004	–	3
Accruals	5,123	1,360	3,325	775
	11,385	9,012	3,721	2,458
(b) Amounts falling due after more than one year:				
Obligations under finance leases	848	322	115	210
Amounts owed to subsidiary undertakings	–	–	201	201
	848	322	316	411

18. Provisions

	2005 £000	2004 £000
Deferred consideration	8,756	–
Investment in QDose	72	–
Other	200	–
	9,028	–

Quadrant Drug Delivery Limited was acquired by Quadrant from a subsidiary of Elan Corporation PLC ("Elan") on 10 July 2003. The consideration was £1 plus deferred contingent consideration payable based upon the level of cash receipts by the business relating to specified intellectual property and commercial agreements owned by Quadrant Drug Delivery Limited at that date. The amount included in the financial statements in respect of this deferred consideration represents the estimated net present value of future payments to Elan. The actual amount of deferred consideration ultimately payable may be greater or less than the amount recognised in the financial statements.

The deferred consideration is secured by a charge over certain income streams of the business.

19. Deferred income

Deferred income at 30 September 2005 and 30 September 2004 comprised licensing fees received but not yet credited to the consolidated profit and loss account, in accordance with our accounting policy on turnover.

Group	2005 £000	2004 £000
Licensing fees not yet credited	1,146	673
	1,146	673
Company	£000	£000
Licensing fees not yet credited	–	4
	–	4

20. Called-up share capital

	2005 £000	2004 £000
Authorised		
670,000,000 Ordinary Shares of 1p each (2004: 350,000,000)	6,700	3,500
Allotted, called-up and fully paid 502,627,943 Ordinary Shares of 1p each (2004: 228,710,703 Ordinary Shares)	5,026	2,287

As explained in Note 1, the following Ordinary Share issues were made during the year:

	Number of shares	Issue price per share £	Share capital £000	Share premium £000	Merger reserve £000
Issues for cash:					
Vendor Placing	91,758,315	0.19	918	16,516	
Placing and Open offer	45,741,683	0.19	457	8,234	
Issues for shares:					
Acquisition of Quadrant	131,932,394	0.22	1,319	–	27,706
Acquisition of minority interest in Innovata Biomed Limited	4,484,848	0.22	45	–	942
	273,917,240		2,739	24,750	28,648

Notes to the accounts continued

20. Called-up share capital continued

Contingent rights to the allotment of shares:

Under the 1989 M L Laboratories PLC Executive Share Option Scheme, options which have been granted to Directors and Executives to subscribe for Ordinary Shares and which remain unexercised as at the date of this report are as follows:

	Number of shares	Subscription price	Exercise date	Expiry date
	32,507	£3.69	23/07/99	23/07/06
	212,316	£2.27	06/01/00	06/01/07
	990,862	£1.24	09/02/01	09/02/08
	68,722	£1.19	18/03/01	18/03/08
	490,575	£0.88	06/07/01	06/07/08
	227,907	£1.06	08/03/02	08/03/09
	2,022,889			

Under the Innovata plc 1999 Executive Share Option Scheme, options which have been granted to Directors, Executives and employees to subscribe for Ordinary Shares and which remain unexercised as at the date of this report are as follows:

	Number of shares	Subscription price	Exercise date	Expiry date
	141,499	£1.39	20/08/02	20/08/09
	204,674	£1.39	20/08/04	20/08/09
	390,020	£1.40	10/11/03	10/11/10
	3,257,277	£0.37	02/11/04	02/11/11
	6,602,559	£0.15	17/04/06	17/04/13
	6,129,475	£0.19	19/04/07	19/04/14
	3,000,000	£0.22	03/03/08	03/03/15
	4,000,000	£0.22	15/07/08	15/07/15
	9,000,000	£0.26	14/09/08	14/09/15
	400,000	£0.26	10/10/08	10/10/15
	33,125,504			

Options granted to Directors of the Company by resolution of the shareholders in general meeting and which remain unexercised at the date of this Report:

	Number of shares	Subscription price	Exercise date	Expiry date
	3,000,000	0.22	14/07/05	14/07/15
	3,000,000			

21. Movements in capital and reserves and equity shareholders' funds

The movements in capital and reserves during the year were:

	Called-up share capital £000	Share premium account £000	Merger reserve £000	Profit and loss account £000	Equity shareholders' funds £000
(a) Group					
At 1 October 2004	2,287	50,155	8,336	(47,846)	12,932
Loss for financial year	–	–	–	(8,897)	(8,897)
Issue of Ordinary Shares (as set out in Note 20)	2,739	24,750	28,648	–	56,137
Expenses paid in connection with the issue of Ordinary Share capital	–	(1,675)	–	–	(1,675)
At 30 September 2005	5,026	73,230	36,984	(56,743)	58,497

	Called-up share capital £000	Share premium account £000	Special reserve £000	Merger reserve £000	Profit and loss account £000	Equity shareholders' funds £000
(b) Company						
At 1 October 2004	2,287	50,155	4,049	8,336	(19,537)	45,290
Loss for financial year	–	–	–	–	(8,038)	(8,038)
Issue of Ordinary Shares (as set out in Note 20)	2,739	24,750	–	28,648	–	56,137
Expenses paid in connection with the issue of Ordinary Share capital	–	(1,675)	–	–	–	(1,675)
At 30 September 2005	5,026	73,230	4,049	36,984	(27,575)	91,714

The special reserve was created in 1999 following a reduction of the share premium account. In the Group accounts, the goodwill which had arisen on consolidation up to 30 September 1998 of £4,049,000 has been offset against the special reserve rather than against the profit and loss account.

Notes to the accounts continued

22. Finance lease obligations and unsecured loans

	Group		Company	
	2005 £000	2004 £000	2005 £000	2004 £000
At 30 September 2005 the Group and Company had obligations under finance leases as follows:				
Payable within one year	694	310	84	177
Payable between one and two years	710	227	109	136
Payable between two and five years	138	95	6	74
	1,542	632	199	387

	Group		Company	
	2005 £000	2004 £000	2005 £000	2004 £000
At 30 September 2005 the Group and Company had obligations under unsecured loans as follows:				
Payable within one year	-	478	-	5
	-	478	-	5

23. Financial instruments

The Group has taken advantage of the exemption available under FRS 13 in respect of short-term debtors and creditors and accordingly, where permitted by the FRS, details in respect of such debtors and creditors are excluded from the disclosures dealt with in this Note.

Primary financial instruments employed by the Group, other than short-term debtors and creditors, comprise cash, short-term deposits, unsecured loans, current asset investments and finance leases. The Group's activities include some currency exposure arising from the fact that certain royalties are calculated and/or paid in US dollars and that certain operating costs are incurred in currencies other than sterling, principally US dollars. The Group's general policy is to convert dollar revenues to sterling when received and to convert sterling to foreign currencies at the transaction date. The Group does not trade in financial instruments.

The Group's policy during the year ended 30 September 2005 was to place the majority of its cash on short-term deposits with its bankers and to finance the purchase of tangible fixed assets through finance leases, where possible, for cash flow purposes.

The Group's exposure to interest rate risk is limited to its finance leases and unsecured loans which are typically fixed rate and its cash and short-term deposits which are typically floating rate.

The interest rate profile of financial assets was:

	Floating rate financial assets and overdraft		
	Cash and current bank accounts £000	Short-term bank deposits £000	Total £000
Currency			
Sterling	4,793	8,865	13,658
US Dollars	277	-	277
At 30 September 2005	5,070	8,865	13,935
Currency			
Sterling	(105)	10,452	10,347
US Dollars	521	-	521
At 30 September 2004	416	10,452	10,868

The fair value of short-term deposits approximates to the book value reported in the balance sheet because of the short-term maturity dates of these deposits.

23. Financial instruments continued

The interest rate profile of financial liabilities was:

	Financial liabilities			
	Fixed rate		Floating rate	
	2005 £000	2004 £000	2005 £000	2004 £000
Sterling				
Finance leases	1,542	632	-	-
Unsecured loans	-	478	-	-
	1,542	1,110	-	-

The weighted average interest rate on finance leases at 30 September 2005 was 8.33% (2004: 7.3%).

	Group		Company	
	2005 Months	2004 Months	2005 Months	2004 Months
The weighted average period to maturity of finance leases was:	17	25	18	26

The weighted average interest rate on the unsecured loans at 30 September 2004 was 5.5% and the period to maturity was two months.

The fair value of finance leases at 30 September 2005, calculated by discounting cash flows at prevailing interest rates was £982,000 (2004: £704,000).

The currency analysis of the Group's net monetary assets and liabilities (including short-term debtors and creditors) at 30 September was:

	2005 £000	2004 £000
Sterling	5,248	6,695
Other currencies, principally US dollars	1,061	373
	6,309	7,068

As at 30 September 2005 the Group had committed undrawn overdraft facilities amounting to £500,000 (2004: £500,000).

24. Loss for the financial year

As permitted by Section 230 of the Companies Act 1985, the parent company's profit and loss account has not been included in these financial statements. The parent company's loss for the financial year was £8,038,000 (2004: £5,781,000).

25. Loss per Ordinary Share

The calculation of basic earnings per share is based on the loss on ordinary activities after taxation and on 286,495,980 (2004: 201,948,984) Ordinary Shares, being the weighted average, calculated on a time basis, of the number of Ordinary Shares in issue.

The effect of dilutive share options outstanding and not yet exercised at 30 September 2005 would be to reduce the loss per Ordinary Share.

Notes to the accounts continued

26. Other financial commitments

At 30 September 2005 the Group had annual commitments under non-cancellable operating leases as follows:

	2005 Land and buildings £000	2005 Other £000	2004 Land and buildings £000	2004 Other £000
Expiring within one year	38	1	48	2
Expiring with one and two years	369	3	38	1
Expiring between two and five years	170	28	213	11
Expiring in over five years	214	-	214	-
	791	32	513	14

27. Capital commitments

	Group		Company	
	2005 £000	2004 £000	2005 £000	2004 £000
Capital expenditure on tangible fixed assets that had been contracted for but has not been provided for in the financial statements	600	1,400	-	43

28. Contingent liabilities

Group and Company

As explained in Note 5, under agreements entered into in July 2001 and February 2002, in certain circumstances the Group may be required to make payments to PRF to repurchase its interests in the royalty and revenue streams concerned.

As explained in Note 16, the Company has provided unlimited multilateral guarantees in respect of the bank overdrafts of certain of its subsidiaries.

A milestone payment of £1.5m was received in the year to 30 September 2004 which, while taken to income as turnover in accordance with our accounting policy, is potentially repayable in the event of termination of the relevant licensing agreement through the breach thereof by the Group, insolvency of the Group, or as a result of actions within the Group's control.

At 30 September 2005 the Group was engaged in disputes with Pall Corporation and Ineos Silicas Limited. However, no liability to the Group is expected to arise from these disputes. The Group's legal costs in connection with proceedings against Pall Corporation will amount to approximately £1m. Depending on the outcome of the litigation, the Group may recover a proportion of these costs from Pall Corporation. Pall Corporation have estimated that their legal costs will be approximately £1.5m and depending on the outcome of the litigation, it is possible the Group may be ordered to pay a proportion of these costs.

Quadrant Healthcare (UK) Limited (now Quadrant Holdings Cambridge Limited), a subsidiary of Quadrant, was established in 1994 pursuant to a management buy out. Under the terms of that acquisition agreement the consideration for the know-how transferred to Quadrant Healthcare (UK) Limited (now Quadrant Holdings Cambridge Limited) was capped at a maximum of £20m and was also deferred only becoming payable on the commercial success of products which incorporated the know-how acquired. This agreement was re-negotiated by Quadrant in the light of the acquisition of Quadrant Healthcare (UK) Limited and this consideration is now payable as a percentage of certain revenues and receipts generated by the enlarged Quadrant Group utilising any of the patents or patent applications owned by Quadrant Healthcare (UK) Limited prior to the acquisition.

At 30 September 2005 there were no other contingent liabilities other than those arising from the ordinary course of business in respect of which no material losses are expected to arise.

29. Pensions

The Group operates a number of defined contribution pension schemes. The assets of the schemes are held separately from those of the Group and are independently administered. The pension cost charge represents contributions payable by the Group under the schemes and amounted to £340,000 (2004: £412,000). Contributions totalling £Nil were payable at the year end.

30. Reconciliation of operating loss to net cash flow from operating activities

	2005 £000	2004 £000
Operating loss	(3,036)	(11,982)
Depreciation of tangible fixed assets	765	768
Amortisation of goodwill	689	200
Net profit on disposal of current asset investment	-	(1)
Net profit on disposal of tangible fixed assets	(25)	(50)
Decrease in stocks	9	408
(Increase) in debtors	(3,248)	(1,307)
(Decrease)/increase in creditors	(565)	1,304
(Decrease) in deferred income	(26)	(142)
Net cash outflow from operating activities	(5,437)	(10,802)

31. Working capital and cash effect of acquisitions**(a) Working capital effect of acquisition of Quadrant**

	2005 £000
Tangible fixed assets	414
Debtors	2,036
Creditors	(1,378)
Deferred consideration	(8,885)
Deferred income	(500)
Provisions	(272)
	(8,585)

(b) There was no working capital effect of the acquisition of the minority interest in Innovata Biomed Limited.

(c) Cash effect of acquisitions

	2005 £000
Cash acquired on acquisition of Quadrant	5,060
Cash element of purchase consideration of Quadrant	(19,500)
Cash element of purchase consideration of minority interest in Innovata Biomed Limited	(925)
Costs of acquisition	(1,011)
	(16,376)

Notes to the accounts continued

32. Reconciliation of net cash flow to movement in funds

	2005 £000	2004 £000
Increase in cash in year	4,654	79
Movement in short-term deposits	(1,587)	4,208
Movement in borrowings	(432)	(547)
Change in net funds resulting from cash flows	2,635	3,740
Opening net funds	9,758	6,018
Closing net funds	12,393	9,758

33. Analysis of net funds

	2004 £000	Cash flow £000	2005 £000
Cash at bank and in hand	416	4,654	5,070
Short-term deposits	10,452	(1,587)	8,865
Unsecured loans	(478)	478	-
Finance leases due within one year	(310)	(384)	(694)
Finance leases due in more than one year	(322)	(526)	(848)
	9,758	2,635	12,393

34. Related party transactions

As explained in Note 1, the Group acquired the outstanding minority interest in Innovata Biomed on 15 July 2005 from Dr R N Boyes, a former Director of the Company, for a consideration of £1.9m. This transaction was approved by the shareholders of the Company on 14 July 2005.

The Directors have taken advantage of the exemption conferred by Financial Reporting Standard 8 not to disclose transactions with other Group companies as they are eliminated on consolidation.

Shareholder information

Investor relations

Innovata believes that two-way communication with its shareholders and potential shareholders is of great importance to enable them to develop a clear understanding of the Company's strategy, performance and growth potential, to build up long-term trust and to ensure compliance with all regulations regarding the conduct of a publicly owned company and dissemination of price-sensitive information. As a result, the Company aims to provide as much information as is practical and sensible to both existing and potential investors, acknowledging that transparency is the best way to develop understanding. Innovata welcomes any comments regarding its investor relations and will strive to build its IR practice over time.

Financial calendar

Preliminary announcement of 2005 results	11 January 2006
Annual General Meeting	15 March 2006
Announcement of 2006 Interim Results	June 2006
2006 year end	30 September 2006

Annual General Meeting

The AGM will be held on Wednesday 15 March 2006 at 11.00am at the offices of Jones Day, 21 Tudor Street, London, EC4Y 0DJ.

Annual Report and Accounts and corporate website (www.innovataplc.com)

Innovata's Annual Report is seen internally and externally as an important communications tool. The Company has a number of audiences and it seeks to provide as much information to these different audiences as is possible within a single document. The Annual Report is supported by the corporate website which will be updated with preliminary and interim results, press releases, regulatory announcements and other updates that the Company believes will be useful. The site also has an interactive share price graph which displays current and historic prices and traded volumes.

Electronic communications

Innovata will soon offer its shareholders and other interested parties the opportunity to receive electronic notification of the Company's latest press releases via email. To take advantage of this service, shareholders will be able to register online via the news alert form that will be found under the Investor Relations section.

Enquiries about shareholdings

Any administrative enquiries relating to shareholdings in Innovata should be addressed directly to the Registrar (contact details on following page). For further details of the shareholder services offered by the Company's Registrars, please visit www.capitaregistrars.com

Innovata plc's shares are traded on the Main Market of the London Stock Exchange, symbol IOV.

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Glossary

API: active pharmaceutical ingredient.

Asthma: a condition in which individuals suffer from a widespread narrowing of the bronchial airways, which changes in severity over short periods of time, leading to cough, wheezing and difficulty in breathing.

Beclomethasone: a steroid which is used to help prevent the symptoms of asthma.

Budesonide: a steroid which is used to help prevent the symptoms of asthma.

COPD: chronic obstructive pulmonary disease is an irreversible and chronic obstruction of the airways which is caused primarily by smoking. It principally includes chronic bronchitis and emphysema or both conditions, which slowly progress and eventually lead to a largely irreversible loss of lung function.

Cystic fibrosis: an inherited disease in which a thick mucus clogs the lungs and blocks the ducts of the pancreas.

Diabetes: a chronic health condition where the body is unable to produce or adequately use insulin. Symptoms include thirst, excessive urination, dehydration and weight loss. The treatment of diabetes may require daily insulin injections, proper nutrition and regular exercise.

DPI: dry powder inhaler.

Excipients: an inactive ingredient added to a drug (ie, in pill form) to dilute it or to give it form, consistency or stability.

FDA or US Food and Drug Administration: part of the US Department of Health and Human Services Agency responsible for ensuring the safety and effectiveness of all drugs, biologics, vaccines, and medical devices.

Fibrinogen: a protein involved in coagulation. It reacts with other molecules to produce blood clots.

Formoterol: belongs to the family of medicines known as beta-2 agonists. It is used to help treat or relieve the symptoms of asthma.

GMP or Good Manufacturing Practice: a quality assurance system required by authorities, for use in the manufacture of drugs.

Haemophilia A: a disorder of the blood in which it lacks an agent, known as Factor VIII, to make it clot.

Hyaluronic acid: a natural component of connective tissue, including the skin, which plays a critical role in providing volume to skin by retaining water. It may be derived by bacterial fermentation.

Icodextrin: a replacement for high-strength glucose solutions in peritoneal dialysis.

Iloprost: an inhalation solution for the treatment of pulmonary arterial hypertension, a debilitating disease characterised by severe constriction of the blood vessels of the lungs and very high pulmonary arterial pressure.

Lactose: a type of sugar found in milk and milk products.

Macromolecules: large molecules in biological systems namely proteins, nucleic acids, and polysaccharides.

Meptin™ (procaterol): a beta-2 agonist developed by Otsuka used to treat the symptoms of asthma, chronic bronchitis, emphysema, and other lung diseases.

NCE: a new chemical entity or new drug.

Nebulise: to form a mist of fine droplets from a liquid. To atomise.

Peptide: a molecule composed of two or more amino acids. Larger peptides are generally referred to as polypeptides or proteins. An amino acid is any of a class of 20 molecules that are combined to form proteins in living

things. The sequence of amino acids in a protein and hence protein function are determined by the genetic code.

Peritoneal: of the peritoneum which is the membrane that forms the lining of the abdominal cavity.

Protein: a molecule composed of a long chain of amino acids. Proteins are the principal constituents of cellular material and serve as enzymes, hormones, structural elements, and antibodies. The molar mass is usually above 100,000.

Pulmonary hypertension: high blood pressure in the blood vessels of the lungs which if left untreated may lead to heart failure.

Salbutamol: a beta-2 agonist used to treat wheezing, shortness of breath, and troubled breathing caused by asthma, chronic bronchitis, emphysema, and other lung diseases.

Thrombin: an enzyme that converts fibrinogen to fibrin.

Trehalose: a disaccharide or sugar found in invertebrates, bacteria, algae, plants and fungi that may be used to stabilise protein structures.

Disclaimer

This report includes statements that are forward-looking in nature. Forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of innovata plc to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements.

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