Interim Report 2004

for the six months ended 30 June 2004

Advanced Medical Solutions Group plc

Highlights for the year to date

- Group turnover increased 26% to £5.2 million (2003: £4.1 million) with underlying sales growth of 29%
- Pre-tax losses halved to £0.55 million (2003: £1.1 million)
- EBITDA at break-even (2003: £0.6 million loss)
- Cash of £2.7 million sufficient to take the Group through to profitability
- Johnson & Johnson Wound Management launches silver alginate range into US market
- Three year supply agreement signed with Cardinal Health for private label woundcare products in the US, after the half year end
- Initial sales of ActivHeal™ woundcare range into the NHS
- 510(k) clearance by FDA for sale of new range of silver alginate products in US
- Collaborative agreement signed with Nitto Medical for Japan

Overview

I am pleased to report that AMS has made significant progress during the period. The investments made in sales & marketing and R & D during 2003, resulting in the launch of new products and the signing of new partners, contributed to Group turnover in the period of £5.2 million, 26% up on the first half of last year. Growth was achieved across both business units, Advanced Woundcare and Wound Closure, and across all geographical regions. Net losses have been halved to £0.55 million and the Group reached EBITDA break-even at the half-year. This is a major milestone in moving the Group towards profitability.

Operating Review

The Group's core focus remains the development and manufacture of advanced woundcare and wound closure products for sale in hospitals and long-term care facilities.

Advanced woundcare products are marketed and distributed into the $1.5 billion global market, through either major woundcare companies, such as 3M, Johnson & Johnson, Smith & Nephew, Coloplast and Mölnlycke under their leading brands, or through private label distributors such as Cardinal Health. Products based upon superglue technology address the emerging tissue adhesives segment of the $5 billion wound closure market. This market is currently accessed through a direct sales force in the UK and through distribution partners in Europe. The direct UK sales force also carries a full range of standard advanced woundcare products for sale into the NHS hospital and community care markets under our ActivHeal™ brand.

The Group has made steady progress in reducing its dependence on the performance of its major branded partners for delivering revenue growth and profit. The strategy of broadening its routes to market by complementing these relationships with the provision of private label standard products to major distributors and expanding its direct sales presence in the UK home market is proving to be successful.

Advanced Woundcare

Advanced woundcare sales of £4.2 million were up 23%, which is more than double the current woundcare market growth rate. This growth was spread across partners in Europe and the US and provides a solid business base for the future.

The exclusive global licensing of our fibre based silver alginate technology, with subsequent 510(k) approval and launch into the US market by Johnson & Johnson Wound Management under its SilverCel™ brand in April, is a major milestone in upgrading our base advanced woundcare range. European regulatory approval is taking longer than anticipated due to uncertainty over the interpretation of clinical requirements for dressings containing silver; however, it is expected that the product will be CE marked before year-end.

Silver is a broad spectrum antimicrobial that helps to prevent infection. In combination with alginate, a biopolymer derived from seaweed, AMS can provide products ideally suited to treatment of a wide variety of chronic wounds.

In response to demand from existing partners for the addition of silver to their current alginate range, a new product has been developed utilising a different silver technology. 510(k) clearance by the Food and Drug Administration for the US market was obtained in August and this product is expected to be introduced by a number of partners by year end. The product will be progressed through European regulatory approval during 2005. With two distinct silver technologies, the Company is in a strong position to address the dynamic silver market.

The three year agreement with Cardinal Health announced in July is a major step forward in building our private label business. AMS will provide a full range of advanced woundcare products for Cardinal Health for US distribution under its Allegiance brand. With turnover of more than $50 billion, Cardinal Health is a leading provider to the healthcare industry and is ranked 17 on the Fortune 500 (2004).

A full range of standard advanced woundcare products are now being offered to the NHS through our direct UK sales and marketing infrastructure. Our efforts during 2004 are aimed at creating interest and obtaining user acceptance of our products, which offer performance equivalent to the branded products at a substantial saving to the NHS, prior to their being included in central contracts as they come up for renewal. In the meantime, sales are achievable through Hospital Trusts that buy off-contract and these are being targeted. The response to our offering from management, purchasing officers and pharmacists has been very positive and initial orders have been taken. Demand is also being created from prescribing nurses and GPs following listing of our products on the Drug Tariff. This is encouraging as it is building acceptance of our products at grass roots level in the large community care market.

Good progress has been made in accessing the Far East market. A collaboration agreement signed with Nitto Medical has allowed us to move through market evaluation and regulatory approval for a number of woundcare products for introduction into Japan from 2005 onwards. New marketing and distribution agreements were signed with InterPharma for Australia and Diethelm Keller Siber Hegner for Malaysia, Hong Kong, Vietnam and Pakistan.

We continue to develop our technology pipeline to support new and existing partners and move to higher value products. New alginate and foam technologies have been developed that provide superior absorbency and the ability to lock away excess wound fluid. Discussions are in progress for commercialising these technologies in 2005.

Wound Closure

The tissue adhesives business continues to show strong growth with sales up 40% in the period to £1 million maintaining our market leadership position in the use of adhesives in the UK Accident and Emergency (A & E) arena. Adhesives are routinely used for closing facial and scalp wounds, particularly children's, and our LiquiBand™ product is being used to close around 30,000 wounds per month in the UK.

The launch of LiquiBand Surgical™ for closure of surgical incisions in the Operating Room has taken the technology into the largest segment of the $5 billion wound closure market. This product comprises a fast-setting adhesive for closing the incision and a liquid bandage which is painted over the wound to protect it against moisture and infection. Clear benefits over stitches and staples have been demonstrated to the surgeon, post-operative nursing staff and patients, particularly with large incisions such as Caesarean sections, breast surgery and total hip replacement where prevention of infection and cosmetic outcome are key considerations. Two dedicated sales specialists have been added to the UK direct team to focus on this opportunity and we have partnered with EndoPlus UK, a specialist orthopaedic company whose sales team are selling the product into Orthopaedic theatres alongside their joint replacement products.

LiquiBand™ and LiquiBand Surgical™ products continue to be rolled out in Europe. A distribution deal was signed with Resorba Clinica GmbH, who launched into the German market in June, and regular business is now being achieved from distributors in Italy, Denmark and Norway. Further deals are under discussion with distributors in other European countries. Opportunities for collaborating with strategic partners for approval and introduction of these products into the US and Japanese markets are under discussion.

A number of product upgrades are under development to broaden the applications for tissue adhesives in topical and surgical non-invasive wound closure. These involve tailoring the properties of the adhesive and the design of the applicator to suit the particular use. Products are expected to come to market over the next 18 months that will address the majority of such wounds currently closed by stitches, sutures and adhesive strips.

Development of products for protecting skin from breakdown and for treating minor cuts and grazes continues to progress, with potential partners and launch plans identified for 2004/2005 subject to regulatory approvals.

Financial Review

Turnover increased 26% to £5.2 million (2003: £4.1 million) for the six months ended 30 June 2004. Sales into the US were affected by the weak dollar which depreciated 13% against sterling year on year. Adjusting for this effect, underlying sales growth was 29%. The advanced woundcare business grew by 23% to £4.2 million (2003: £3.4 million) or 27% on an underlying basis while the wound closure business increased by 40% to £1 million (2003: £0.7 million).

The gross margin for the Group was 37%, which was 1% less than the previous half year but 1% better than the margin for the full year. Adjusting for the exchange effect, the gross margin would have shown an improvement to 39%.

Net operating expenses decreased by £0.3 million to £2.5 million, reflecting the reduction of sales and marketing expense supporting the Consumer business and reduced patent spend. As a result, the operating loss for the six months was £0.6 million, 49% of the previous year (2003: £1.2 million) and the Group was EBITDA neutral (2003: £0.6 million loss). The overall loss for the Group was £0.55 million (2003: £1.1 million).

Working capital increased to £3.0 million from £2.2 million. Stock increased by £0.2 million to £1.5 million to meet increased demand. There will be a need to hold buffer stock to supply Cardinal in the US; however, it is not anticipated that stock will increase above its present level in the current year. Trade debtors increased to £2.2 million (2003: £1.7 million) with 64 debtor days outstanding (2003: 55 days).

Primarily due to the increase in working capital, operating cash flow, being the net of earnings before interest, tax, depreciation and amortisation and working capital movements, amounted to an outflow in the period of £1.0 million. This leaves the Group with £2.7 million of cash at 30 June 2004 (2003: £4.2 million) and net funds of £2.3 million (2003: £3.8 million).

Outlook

The outlook for the Group remains positive with the progress made during the first six months continuing into the second half of the year.

The new product pipeline is strong and partners continue to be signed which will continue to drive growth during 2004 and 2005.

Whilst the prime focus remains taking the Group through to profitability within current cash, the Board continues to review all corporate options to increase shareholder value.

Dr Geoffrey N. Vernon
Chairman

CONSOLIDATED PROFIT AND LOSS ACCOUNT

	Note	**Unaudited six months ended 30 June 2004 £'000**	Unaudited six months ended 30 June 2003 £'000	Audited twelve months ended 31 December 2003 £'000
Turnover	2	**5,206**	4,134	9,015
Cost of sales		**(3,294)**	(2,555)	(5,809)
Gross profit		**1,912**	1,579	3,206
Distribution costs		**(51)**	(32)	(86)
Administration costs		**(2,599)**	(2,819)	(5,859)
Other operating income		**154**	90	304
Operating loss		**(584)**	(1,182)	(2,435)
Interest receivable and similar income		**52**	82	152
Interest payable and similar charges		**(16)**	(18)	(35)
Loss on ordinary activities before taxation		**(548)**	(1,118)	(2,318)
Taxation		**—**	—	234
Loss sustained for the period		**(548)**	(1,118)	(2,084)
Basic and fully diluted loss per share	3	**(0.39)p**	(0.79)p	(1.5)p

	Unaudited six months ended 30 June 2004 £'000	Unaudited six months ended 30 June 2003 £'000	Audited twelve months ended 31 December 2003 £'000
Loss for the financial period	**(548)**	(1,118)	(2,084)
Currency translation differences on foreign currency net investments	**(7)**	3	(19)
Total recognised losses relating to the period	**(555)**	(1,115)	(2,103)

RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	Unaudited six months ended 30 June 2004 £'000	Unaudited six months ended 30 June 2003 £'000	Audited twelve months ended 31 December 2003 £'000
Opening shareholders' funds	**12,004**	14,107	14,107
Loss for the period	**(548)**	(1,118)	(2,084)
Currency translation differences on foreign currency net investments	**(7)**	3	(19)
Closing shareholders' funds	**11,449**	12,992	12,004

	Unaudited six months ended 30 June 2004 £'000	Unaudited six months ended 30 June 2003 £'000	Audited twelve months ended 31 December 2003 £'000
Fixed assets			
Intangible assets			
— other intangibles	**2,154**	2,322	2,238
Tangible assets	**4,030**	4,624	4,373
	6,184	6,946	6,611
Current assets			
Stocks	**1,536**	1,313	1,279
Debtors			
— due within one year	**3,189**	2,589	2,793
— due after more than one year	**200**	200	200
Cash at bank and in hand	**2,665**	4,218	3,608
	7,590	8,320	7,880
Creditors: amounts falling due within one year	**(1,973)**	(1,934)	(2,139)
Net current assets	**5,617**	6,386	5,741
Total assets less current liabilities	**11,801**	13,332	12,352
Creditors: amounts falling due after more than one year	**(352)**	(340)	(348)
	11,449	12,992	12,004
Capital and reserves			
Called up share capital	**11,782**	11,782	11,782
Share premium account	**37,978**	37,978	37,978
Other reserve	**1,531**	1,531	1,531
Profit and loss account	**(39,842)**	(38,299)	(39,287)
Equity shareholders' funds	**11,449**	12,992	12,004

	Note	**Unaudited six months ended 30 June 2004 £'000**	Unaudited six months ended 30 June 2003 £'000	Audited twelve months ended 31 December 2003 £'000
Net cash outflow from operating activities		**(967)**	(1,363)	(1,708)
Returns on investments and servicing of finance				
Interest received		**33**	99	158
Interest element of finance lease rental and hire purchase payments		**(1)**	(3)	(5)
Interest paid		**(15)**	(15)	(30)
Net cash inflow from returns on investments and servicing of finance		**17**	81	123
Taxation		**167**	137	153
Capital expenditure and financial investment				
Purchase of tangible fixed assets		**(146)**	(192)	(400)
Sale of tangible fixed assets		**1**	4	7
Net cash outflow for capital expenditure and financial investment		**(145)**	(188)	(393)
Cash outflow before use of liquid resources and financing		**(928)**	(1,333)	(1,825)
Management of liquid resources				
Sale of term deposits		**656**	1,471	2,249
Financing				
Repayment of secured loan	5	**(6)**	(5)	(10)
Net movement of capital element of finance lease rental and hire purchase payments	5	**(2)**	(55)	(94)
Net cash outflow from financing		**(8)**	(60)	(104)
(Decrease)/increase in cash	4	**(280)**	78	320

1. Basis of Preparation

The interim statements have been prepared in accordance with the accounting policies set out in the annual report for the year ended 31 December 2003. The results for the six months ended 30 June 2004 and 30 June 2003 have not been audited and do not constitute statutory accounts within the meaning of section 240 of the Companies Act 1985.

The results for the year ended 31 December 2003 are extracted from the audited annual financial statements on which the auditors reported without qualification. Full financial statements for that year have been filed with the Registrar of Companies.

2. Segmental information

	Unaudited six months ended 30 June 2004 £'000	Unaudited six months ended 30 June 2003 £'000	Audited twelve months ended 31 December 2003 £'000
Turnover by geographical region:			
United States of America	**1,014**	962	2,167
Rest of Europe	**2,863**	2,264	4,789
United Kingdom	**1,155**	880	1,918
Rest of World	**174**	28	141
	5,206	4,134	9,015
Turnover by business unit:			
Advanced woundcare	**4,245**	3,446	7,412
Wound closure	**961**	688	1,603
	5,206	4,134	9,015

It is not possible to identify loss before taxation and net assets by business unit because of the use of common services.

Turnover, loss before tax and net assets by origin	**£'000**	£'000	£'000
Turnover			
United Kingdom	**5,206**	4,134	9,015
United States	**—**	—	—
	5,206	4,134	9,015
Loss before tax			
United Kingdom	**(495)**	(1,026)	(2,217)
United States	**(53)**	(92)	(101)
	(548)	(1,118)	(2,318)
Net assets			
United Kingdom	**11,446**	12,976	11,996
United States	**3**	16	8
	11,449	12,992	12,004

The turnover and loss before taxation is wholly attributable to the principal activity of the Group.

3. Loss per share

The basic loss per share has been calculated on a weighted average number of shares in issue for the six months ended 30 June 2004, namely 142,082,536 (2003: 142,082,536) and losses of £548k (2003: £1,118k).

4. Reconciliation of net cash flow to movement in net funds (note 5)

	Unaudited six months ended 30 June 2004 £'000	Unaudited six months ended 30 June 2003 £'000	Audited twelve months ended 31 December 2003 £'000
(Decrease)/increase in cash during the period	**(280)**	78	320
Cash outflow to repay debt and finance leases	**8**	60	104
Cash inflow from decrease in liquid resources	**(656)**	(1,471)	(2,249)
Change in net funds resulting from cash flows	**(928)**	(1,333)	(1,825)
New finance leases	**—**	—	(19)
Translation difference	**(7)**	3	(19)
Movement in net funds in the period	**(935)**	(1,330)	(1,863)
Net funds at 1 January 2004	**3,246**	5,109	5,109
Net funds at 30 June 2004	**2,311**	3,779	3,246

5. Analysis of net funds

	1 January 2004 £'000	Cash flows £'000	Exchange Movements £'000	**30 June 2004 £'000**
Cash	761	(280)	(7)	**474**
Term deposits	2,847	(656)	—	**2,191**
Cash at bank and in hand	3,608	(936)	(7)	**2,665**
Debt due within one year	(11)	—	—	**(11)**
Debt due after one year	(334)	6	—	**(328)**
Finance leases	(17)	2	—	**(15)**
Total	3,246	(928)	(7)	**2,311**

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