developing
and providing
innovative technology

Advanced Medical Solutions Group plc

Interim Report 2006

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Highlights for the year to date

- Group turnover up 11% to £6.5 million (2005: £5.9 million), with underlying growth up 28%
- Gross margin improved to 40% from 37%
- Pre-tax losses reduced 61% to £0.2 million
- EBITDA increased 65% to £0.3 million
- Positive total cash flow resulting in cash of £3.6 million at half-year (2005: £2.9 million)
- Continued progress on key organic growth drivers:
  - Ionic silver alginate dressings approved for sale in Europe
  - LiquiBand® approval progressing in US
  - Product approvals on track in Far East
  - NHS business building steadily

Overview

I am pleased to report that AMS further strengthened its financial position and continued to progress key future growth opportunities during the period. Turnover grew 11% with gross margins improved to 40%. Pre-tax losses reduced 61% to £0.2 million with EBITDA positive at £0.3 million. The Group continued to generate cash and has adequate funds to meet ongoing needs and to accelerate growth.

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 $2.6 billion global market through either major woundcare companies under their leading brands or through private label distributors. Products based upon cyanoacrylate technology address the emerging tissue adhesives segment of the $5 billion wound closure market. This market, valued at more than $100 million, 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 the ActivHeal® brand.

Independent technical and clinical evaluations have shown that the ActivHeal® generic woundcare range offers equivalent performance to branded products but at a significantly reduced cost thereby delivering real and immediate savings to the NHS. These potential savings are estimated to be of the order of £25 million per year based on the current relevant spend of £60 million.

Progress continues to be made in reducing the Group's dependence on the performance of its major branded partners for delivering revenue growth and profit. The Group's strategy of broadening its routes to market by complementing these relationships with the provision of private label standard products to major distributors, and by the expansion of its direct sales presence in the UK home market, continues to be successful.

Advanced Woundcare

Advanced woundcare sales of £5.2 million were up 9% on the prior half year. Although this growth rate was in line with the overall advanced woundcare market, it masks a much stronger underlying performance as an element of partner business reported in 2005 will not reoccur in 2006. This relates to the loss of non-strategic business due to a downgrade in specification which no longer made the product commercially viable for AMS. Taking these sales into account, the underlying growth was 30% driven primarily by the continued success of the silver alginate business.

The Group further strengthened its position in the dynamic silver market with the European approval of a range of calcium alginate woundcare dressings containing ionic silver technology. These products have already been approved by the Food and Drug Administration (FDA) for sale in the US and were launched by a number of AMS' US partners during 2005. This has been instrumental in AMS' strengthening its position in the silver woundcare dressings market following the introduction of its initial fibre-based silver alginate technology into the US in 2004 and Europe in 2005 under an exclusive, global agreement with a leading brand.

Silver is a broad spectrum anti-microbial that helps to prevent infections such as MRSA. In combination with alginate, a biopolymer derived from seaweed, AMS can provide products ideally suited to the treatment of a wide variety of chronic wounds.

The ionic silver technology allows AMS to provide selected partners an entry into the expanding silver woundcare market, which is currently estimated at $100 million worldwide and growing in excess of 20% per year. In parallel with the European approval process, AMS has been working with a number of key partners on product launch plans. Initial market introductions are now expected to follow during the second half of 2006.

Steady progress continues to be made with the Company's direct ActivHeal® offering to the NHS. Fourteen NHS Hospital and Primary Care Trusts across England and Scotland have now adopted the ActivHeal® range of advanced woundcare products allowing them to achieve substantial cost savings at a time of severe funding pressures without compromising patient care. Many more centres are currently evaluating the product offering.

The addition of the Oxford Radcliffe Hospital NHS Trust at the end of March is a major step forward for the business. This Trust, which comprises four hospitals — the John Radcliffe and Churchill Hospitals, Headington, the Radcliffe Infirmary, Oxford, and the Horton Hospital in Banbury is now using the ActivHeal® range as its first choice dressings. Significant changes to the Trust's formulae for woundcare dressings were introduced under the direction of the Chief Nurse working in conjunction with Pharmacy to implement the ActivHeal® range.

The move to ten Strategic Health Authorities within the NHS should be a positive development for the business as this should result in a more streamlined, centralised approach being adopted for product evaluation and selection. Under the present system each Trust independently evaluates the product range being offered, which delays the process of introducing generic substitutes or replacement new products.

We remain confident that our strategy of delivering both innovation to the NHS through our R&D activities with major branded companies, and offering real cost savings through the ActivHeal® range, will be successful, enabling us to capture a significant share of the £100 million UK advanced woundcare market.

The Group continues to fund the development of new differentiated products for licensing to its branded partners for sale worldwide.

Good progress continues to be made in accessing the Far East market with the first product launch into the $300 million Japanese advanced woundcare market expected by the end of 2006.

Wound Closure

The wound closure business grew 19% to £1.3 million in the period as the Group maintained its strong market leadership position in the UK Accident & Emergency arena and strengthened its European partner business.

The LiquiBand® tissue adhesives product portfolio has been broadened by the addition of a 0.25g mini version for closure of small topical skin wounds. Based on cyanoacrylate medical adhesive technology, the LiquiBand® range now covers products for closure of small cuts and trauma wounds particularly to the face and scalp, through to large surgical incisions such as caesarean sections and hip replacements. These products are approved and on sale throughout Europe for use in Accident and Emergency (A&E) and in Operating Rooms. A number of NHS Ambulance Trusts in the UK have also now adopted LiquiBand® to close trauma wounds at the scene of injury, thus potentially reducing the number of A&E admissions.

The Intellectual Property protection around these products has been strengthened by the granting of a European patent covering the Laparoscopic wound closure device. LiquiBand Laparoscopic™ offers real clinical and patient benefits in infection control and cosmetic outcomes that supports the growing trend to conduct surgical procedures by keyhole surgery. The patent covers a multi-tipped device used to initially close and seal the wound and then used to apply a secondary liquid bandage. The liquid bandage is used to protect the wound from bacteria, dirt and moisture during healing without the need for secondary dressings. A patent covering this device has previously been granted in the US.

Approval of the LiquiBand® product range continues on track in the US and Far East for 2007, areas which we believe will be of significant value creation in the future. The US tissue adhesives market is currently estimated to be around $70 million. The Group is anticipating entry into this market in 2008.

Development activity to extend the cyanoacrylate adhesive technology into new areas has resulted in an exciting strategic partnership with Kimberly-Clark for a novel surgical skin sealant to help control the risk of skin flora contamination throughout a surgical procedure, a key factor in the development of surgical site infections. These occur in 2–5% of all surgical procedures and can lead to serious complications and increased morbidity to the patient with significant incremental costs to health care providers. It is generally accepted that contamination by the patient's endogenous skin flora is a key factor in the development of surgical site infection and despite standard preventative steps, these remain an area of concern.

AMS has developed an innovative film-forming solution that bonds to the skin sealing off the spaces where bacteria can grow. Based upon patented cyanoacrylate technology, the product immobilises endogenous pathogens thereby reducing the risk of skin flora contamination. A novel applicator has been developed that allows the solution to be effectively applied even on irregular and contoured areas of the body, such as shoulders and knees, which are generally difficult to drape.

AMS has entered into an exclusive global agreement with Kimberly-Clark Health Care for the marketing and distribution of the product under the Kimberly-Clark* InteguSeal Microbial Sealant brand. The product has now been launched into Europe, cleared for sale in other geographies and is currently under review for market clearance in the United States.

Financial Review
Group sales increased 11% to £6.5 million (2005: £5.9 million) for the six months ended 30 June 2006. Due to consolidation in the healthcare industry and a change in direction in one of its partners, the Group experienced a loss of business for one of its non-core products in its advanced woundcare sector in 2006. This business will not be recurring. Adjusting for this, the Group's underlying growth was 28%.

The advanced woundcare sector grew 9% to £5.2 million (2005: £4.8 million) and on an underlying basis at 30%. The wound closure business grew at 19% to £1.3 million (2005: £1.1 million).

Turnover continued to grow in the UK through both branded partners and directly to the NHS with sales increasing by 27% to £2.0 million (2005: £1.5 million). Sales to the US also grew strongly to £1.5 million, reflecting the continued success of silver alginate, an increase of 46% over the prior year (2005: £1.0 million). Sales into Europe through branded partners declined by 13% to £2.6 million but on an underlying basis increased by 17%. We are anticipating continued growth with our ongoing partners.

The gross margin for the Group was 40% which was 3 percentage points better than the previous year. This margin improvement results from the Group selling higher value products and from continuing improvements in manufacturing efficiency.

Net operating expenses increased by £0.2 million to £2.8 million compared with last year. Most of this increase was incurred in sales and marketing. Other operating income includes payments received from partners to cover clinical trials and other milestone payments. The Group reported an operating loss before tax for the half year of £0.2 million, an improvement of £0.2 million compared with the corresponding period in the prior year whilst EBITDA was £0.3 million (2005: £0.1 million). The overall loss for the Group reduced to £0.2 million (2005: £0.4 million).

Net working capital, excluding cash, increased by £0.1 million to £2.8 million. Stock remained at a similar level at £1.8 million while debtors reduced to £2.8 million (2005: £3.2 million), mainly as a result of an unexpected early payment by one of our customers which reduced trade debtors to £2.1 million (2005: £2.3 million) and trade debtor days to 54 (2005: 58 days). Creditors reduced to £1.9 million (2005: £2.5 million).

The Group generated a net cash inflow from operating activities of £0.4 million compared with an outflow in the prior half year of £0.1 million. Capital expenditure was at a similar level to the prior year at £0.1 million but is anticipated to increase in the second half of the year. The Group ended the six months with £3.6 million in cash (2005: £2.9 million) and net funds of £3.3 million (2005: £2.5 million).

Outlook
The outlook for the Group remains positive with trading continuing in line with full year market expectations.

A strong financial platform is being established to support a number of significant organic growth opportunities covering products, partners and territories. US approval of LiquiBand® allowing entry into this major market, anticipated in 2008, is expected to be a major driver of future growth.

The Group's cash position now allows it to consider self-funding acquisitions that fit its business and technology strategy.

Dr Geoffrey N Vernon
Chairman

CONSOLIDATED PROFIT AND LOSS ACCOUNT

	Note	**Unaudited six months ended 30 June 2006 £'000**	Unaudited six months ended 30 June 2005 £'000	Audited twelve months ended 31 December 2005 £'000
Turnover	2	**6,478**	5,857	12,892
Cost of sales		**(3,875)**	(3,675)	(7,753)
Gross profit		**2,603**	2,182	5,139
Distribution costs		**(53)**	(76)	(123)
Administration costs		**(2,969)**	(2,632)	(5,604)
Other operating income		**220**	78	546
Operating loss		**(199)**	(448)	(42)
Interest receivable and similar income		**55**	57	101
Interest payable and similar charges		**(14)**	(16)	(32)
(Loss)/profit on ordinary activities before taxation		**(158)**	(407)	27
Taxation		**—**	—	249
(Loss sustained)/profit retained for the period		**(158)**	(407)	276
(Loss)/earnings per share				
Basic	3	**(0.11)p**	(0.29)p	0.19p
Diluted		**(0.11)p**	(0.29)p	0.19p

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	Unaudited six months ended 30 June 2006 £'000	Unaudited six months ended 30 June 2005 £'000	Audited twelve months ended 31 December 2005 £'000
(Loss)/profit for the financial period	**(158)**	(407)	276
Currency translation differences on foreign currency net investments	**3**	(8)	(3)
Total recognised gains and losses relating to the period	**(155)**	(415)	273

RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	Unaudited six months ended 30 June 2006 £'000	Unaudited six months ended 30 June 2005 £'000	Audited twelve months ended 31 December 2005 £'000
Opening shareholders' funds	**11,847**	11,574	11,574
(Loss)/profit for the financial period	**(158)**	(407)	276
Currency translation differences on foreign currency net investments	**3**	(8)	(3)
Closing shareholders' funds	**11,692**	11,159	11,847

CONSOLIDATED BALANCE SHEETS

	Unaudited six months ended 30 June 2006 £'000	Unaudited six months ended 30 June 2005 £'000	Audited twelve months ended 31 December 2005 £'000
Fixed assets			
Intangible assets	**1,818**	1,986	1,902
Tangible assets	**3,123**	3,402	3,403
	4,941	5,388	5,305
Current assets			
Stocks	**1,837**	1,895	1,669
Debtors			
— due within one year	**2,764**	3,232	3,247
— due after more than one year	**747**	638	747
Cash at bank and in hand	**3,607**	2,859	3,388
	8,955	8,624	9,051
Creditors: amounts falling due within one year	**(1,898)**	(2,528)	(2,193)
Net current assets	**7,057**	6,096	6,858
Total assets less current liabilities	**11,998**	11,484	12,163
Creditors: amounts falling due after more than one year	**(306)**	(325)	(316)
	11,692	11,159	11,847
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	**(39,599)**	(40,132)	(39,444)
Equity shareholders' funds	**11,692**	11,159	11,847

	Note	**Unaudited six months ended 30 June 2006 £'000**	Unaudited six months ended 30 June 2005 £'000	Audited twelve months ended 31 December 2005 £'000
Net cash inflow/(outflow) from operating activities	4	**336**	(122)	534
Returns on investments and servicing of finance				
Interest received		**37**	21	131
Interest element of finance lease rental and hire purchase payments		**(1)**	(1)	(2)
Interest paid		**(13)**	(15)	(30)
Net cash inflow from returns on investments and servicing of finance		**23**	5	99
Taxation		**—**	—	189
Capital expenditure and financial investment				
Purchase of tangible fixed assets		**(134)**	(168)	(575)
Net cash outflow for capital expenditure and financial investment		**(134)**	(168)	(575)
Cash inflow/(outflow) before use of liquid resources and financing		**225**	(285)	247
Management of liquid resources				
Sale/(purchase) of term deposits		**598**	297	(342)
Financing				
Repayment of secured loan	6	**(6)**	(6)	(13)
Net movement of capital element of finance lease rental and hire purchase payments	6	**(3)**	(2)	(3)
Net cash outflow from financing		**(9)**	(8)	(16)
Increase/(decrease) in cash	5	**814**	4	(111)

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 2005. The results for the six months ended 30 June 2006 and 30 June 2005 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 2005 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 2006 £'000	Unaudited six months ended 30 June 2005 £'000	Audited twelve months ended 31 December 2005 £'000
Turnover by geographical region:			
United States of America	**1,451**	993	2,288
Rest of Europe	**2,643**	3,042	6,098
United Kingdom	**1,967**	1,543	3,731
Rest of World	**417**	279	775
	6,478	5,857	12,892
Turnover by business unit:			
Advanced woundcare	**5,177**	4,766	10,535
Wound closure	**1,301**	1,091	2,357
	6,478	5,857	12,892

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

Turnover, (loss)/profit before tax and net assets by origin

	£'000	£'000	£'000
Turnover			
United Kingdom	**6,478**	5,857	12,892
United States	**—**	—	—
	6,478	5,857	12,892
(Loss)/profit before tax			
United Kingdom	**(112)**	(356)	137
United States	**(46)**	(51)	(110)
	(158)	(407)	27
Net assets			
United Kingdom	**11,691**	11,159	11,845
United States	**1**	—	2
	11,692	11,159	11,847

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

3. (Loss)/earnings 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 2006, namely 142,082,536 (2005: 142,082,536) and losses of £158k (2005: £407k).

4. Reconciliation of operating loss to net cash inflow/(outflow) from operating activities

	Unaudited six months ended 30 June 2006 £'000	Unaudited six months ended 30 June 2005 £'000	Audited twelve months ended 31 December 2005 £'000
Operating loss	**(199)**	(448)	(42)
Depreciation	**414**	472	877
Amortisation of intangible fixed assets	**84**	84	168
Loss on sale of fixed assets	**—**	—	1
Increase in stocks	**(168)**	(389)	(163)
Decrease/(increase) in debtors	**501**	(442)	(567)
(Decrease)/increase in creditors	**(296)**	601	260
Net cash inflow/(outflow) from operating activities	**336**	(122)	534

5. Reconciliation of net cash flow to movement in net funds (note 6)

	Unaudited six months ended 30 June 2006 £'000	Unaudited six months ended 30 June 2005 £'000	Audited twelve months ended 31 December 2005 £'000
Increase/(decrease) in cash during the period	**814**	4	(111)
Cash outflow to repay debt and finance leases	**9**	8	16
Cash (inflow)/outflow from (decrease)/increase in liquid resources	**(598)**	(297)	342
Change in net funds resulting from cash flows	**225**	(285)	247
Translation difference	**3**	(8)	(3)
Movement in net funds in the period	**228**	(293)	244
Net funds at 1 January 2006	**3,054**	2,810	2,810
Net funds at 30 June 2006	**3,282**	2,517	3,054

6. Analysis of net funds

	1 January 2006 £'000	Cash flows £'000	Exchange movements £'000	**30 June 2006 £'000**
Cash	402	814	3	**1,219**
Term deposits	2,986	(598)	—	**2,388**
Cash at bank and in hand	3,388	216	3	**3,607**
Debt due within one year	(13)	(1)	—	**(14)**
Debt due after one year	(309)	7	—	**(302)**
Finance leases	(12)	3	—	**(9)**
Total	3,054	225	3	**3,282**

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