



**Phytopharm plc Interim report
for the six months ended 28 February 2005**



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Inspired by nature

Phytopharm is a pharmaceutical company engaged principally in the research and development of pharmaceutical and functional food products based on clinical data generated from medicinal plant extracts. The Company is currently conducting research and development on novel pharmaceutical and functional food products within four disease areas:

Neurodegeneration

Obesity and metabolic disease

Dermatology

Inflammation

Mission

To develop 'first in class' products in categories of high unmet medical need.

Strategy

Phytopharm's strategy is to maximise shareholder value through the development of candidate products to a point where they may be licensed to multinational partners on attractive terms. This process would typically commence following 'proof of principle' (Phase IIa) clinical evaluation and would involve Phytopharm granting certain rights over a product (such as the right to sell a product in a particular territory) under licence to a partner in return for a revenue stream.

The Company keeps its core competencies in-house (such as pre-clinical and clinical strategy and management), while outsourcing all laboratory work and clinical testing to specialists, which enables the Company to control costs and to operate successfully, in spite of its small size.



Key events over the period

Completion of a Licence and Joint Development Agreement with Unilever for *Hoodia gordonii* extract

Successful interim data review for Phase II proof of principle study in Alzheimer's disease (Cogane™)

Receipt of £4 million milestone (£3.6 million net received in March 2005) from Yamanouchi following evaluation of interim Phase II Alzheimer's disease data (Cogane™)

Termination of licensing agreement with Yamanouchi in March 2005, following Yamanouchi's post-merger portfolio review

Revenues and milestone receipts of £6.3 million (H1 2004: £1.1 million) generate a profit for the period of £734,999 (H1 2004: loss of £1.9 million)

Placing of new shares in April raised £9.0 million after expenses



Pioneering a new route to market for pharmaceuticals

Phytopharm believes that its route to develop and market pharmaceuticals gives it a competitive advantage over certain other companies developing products for the same diseases. Rather than starting with a library of chemicals, the Company starts with an extract of a medicinal plant that has a history of clinical use, and either develops a medicine based on a controlled extract of the plant or isolates the active chemical in order to develop it as a prescription medicine.

Phytopharm performs a series of pre-clinical studies and/or a clinical trial and uses the effects of the product on the pre-clinical models and/or patients to guide it to a hypothesis of its mode of action. A screen is then developed, and where possible the active chemicals are isolated, and ideally a novel medicine is developed which can be licensed as a prescription product.

Classic route to market



Choose a library of potential products



Test a huge number



Proceed with the very few that appear to be active



Develop any that achieve proof of principle into a pharmaceutical

In addition to this development model, the Company subcontracts all laboratory work to specialists while retaining full control over the direction of its research. As a result, the Company has low fixed overheads, access to advanced research techniques and a lower development cost structure.

Phytopharm's development model contrasts with the typical pharmaceutical development model that starts with a biological target (for example, an enzyme or ion channel) and then screens a large number of chemicals until activity is found. This typical pharmaceutical development process can be time consuming and expensive.

Phytopharm's research and development can generate libraries of compounds, biological targets and associated clinical and pre-clinical data. This data creates development programmes aimed at target diseases, and ideally leads to multiple product licensing opportunities for specific compounds within those programmes.

The current status of the products within the four disease areas being developed by the Company, each at different stages of development, is considered in more detail in the following pages.

Phytopharm route to market



Start with plant remedies that work



Develop plant-based medicine or isolate the active chemical



Test for proof of principle, and develop into a pharmaceutical functional food

Four disease areas

Neurodegeneration

Incorporates the development of pharmaceutical prescription products based on striking clinical studies using a traditional Asian tonic.

Product	Programme	Mode of action	Development stage
Cogane™ (PYM50028)	Alzheimer's disease/dementia	Reverses decline in memory	Phase II in progress
Myogane™ (PYM50018)	Motor neurone disease (ALS)	Neuroregenerative	Phase Ia completed
PYM50028	Parkinson's disease	Neuroregenerative	Phase Ib completed

Metabolic disease

Based around a single South African plant extract with a long tradition of use as a bush food of last resort.

Product	Programme	Mode of action	Development stage
Hoodia gordonii extract	Dietary control of obesity	Reduces the desire to eat	Functional food in development
In development	Obesity and metabolic disease	Direct action on satiety centre	Pre-clinical studies in progress

Phytopharm glossary of pharmaceutical product development

Pre-clinical studies
Safety and toxicology studies conducted in the laboratory to ensure that the product is safe to be given to humans or animals.

Phase I
Safety studies conducted in healthy volunteers to determine the metabolic and pharmacological actions of the product in humans, the side-effects associated with increasing doses, and, if possible, gain early evidence of effectiveness.

Phase II
Controlled clinical studies conducted in a relatively small number of patients to evaluate the product's effectiveness for treating a particular disease or condition and to determine the short-term side-effects and risks associated with the product.

Phase III
Controlled clinical studies conducted in a larger number of patients in different clinical settings to determine the product's effectiveness, safety, and appropriate dosage for treating a particular disease or condition. Following completion of the studies, the product is submitted to the regulatory body (e.g. FDA in the USA, MHRA in Europe) for approval to market the product.

Dermatology

Arose from a traditional Chinese medicine for eczema. These products have a dual mode of action that targets both the allergic and inflammatory components of eczema.

Product	Programme	Mode of action	Development stage
In development	Eczema	Inhibits allergic and inflammatory cytokines	Pre-clinical studies in progress

Inflammation

Stems from the well recognised anti-inflammatory properties of an Asian spice that has a novel mode of action.

Product	Programme	Mode of action	Development stage
In development	Asthma and other inflammatory disorders	Anti-inflammatory and anti-spasmodic	Pre-clinical studies in progress

Veterinary portfolio

Product	Programme	Mode of action	Development stage
Phytopica™	Canine skin disorders	Helps maintain healthy immune system	Marketed in UK
Zanthofen™	Canine joint disorders	Supports normal white cell function	Marketed in UK

Chief Executive's statement



In our Annual Report 2004, we wrote that 2005 would be a year of transformation, following the year of delivery in 2004. In the first six months of the year, we started by announcing the licence and joint development agreement with Unilever plc for the *Hoodia gordonii* extract. This was followed by an interim data review of the first 60 patients in the Phase II proof of principle study of Cogane™ (PYM50028) in Alzheimer's disease, which concluded that the study medication was not associated with any safety concerns. Following receipt of this data, Yamanouchi Pharmaceutical Co. Ltd. paid us a £4 million milestone payment acknowledging that the data had fulfilled the criteria in the licence agreement. However, at the same time, Yamanouchi informed us of their intention to terminate the PYM50028 licence agreement. This news caused us to terminate at the last minute a £23.9 million Placing and Open Offer in February 2005 so that potential investors could make an informed decision. Following the announcement of termination by Yamanouchi we subsequently raised £10.1 million in a revised Placing and Open Offer in April 2005 after the end of this interim period.

Research and development and commercial progress remains satisfying, and we look forward to sustaining our corporate development and financial progress

A handwritten signature in black ink, which appears to read "Richard Dixey". The signature is written in a cursive style with a horizontal line underneath the name.

Dr Richard Dixey
Chief Executive Officer
10 May 2005

Operational review



Phytopharm is a small pharmaceutical company specialising in the discovery and development of novel pharmaceutical and functional food products for neurodegeneration, obesity and metabolic disease, dermatology and inflammation. The Company's strategy is to develop first-in-class products through 'proof of principle' clinical testing, and then secure pharmaceutical partners for late stage development, sales and marketing. The progress of our products over the first half of the year, each at different stages of development, is described on the following pages.

Neurodegeneration

The neurodegeneration programmes include Alzheimer's disease, Parkinson's disease and amyotrophic lateral sclerosis, a motor neurone disease.

Our lead product, Cogane™ (coded PYM50028) is being developed for Alzheimer's and Parkinson's disease. In pre-clinical studies, PYM50028 is neuro-protective and reverses both the decrease of neuronal growth factors and the neuronal degeneration observed in the ageing brain. Importantly, this product has also been shown to restore levels of proteins that are altered in the ageing brain, returning them to levels observed in the young, causing beneficial outgrowth and branching of neurites.

In January 2005, we announced the successful outcome of a scheduled interim data review for the ongoing Phase II 'proof of principle' clinical study in Alzheimer's disease of PYM50028. This study is being conducted under a clinical trial authorisation (CTA) from the UK Medicines and Healthcare Products Regulatory Agency (MHRA). The Phase II study utilises a randomised, double-blind, placebo-controlled design to evaluate the safety, efficacy and pharmacokinetic profile of PYM50028 after once daily oral administration over three months. The effects of PYM50028 on memory, concentration and executive function will be evaluated during the study. In accordance with the protocol, an interim review was conducted after the first 60 subjects completed the study. The objectives of this review were to evaluate the emergent safety profile of the study and to re-estimate the total number of subjects required to measure the efficacy of PYM50028 on cognitive performance.

Operational review continued

The safety review was conducted by an independent consultant physician, who was provided with blinded data for each of the two treatment groups. He concluded that “the data obtained to date indicated that the study medication is not associated with any safety concerns.” Therefore, the study will continue with no changes to the safety monitoring.

The sample size reassessment was conducted by an independent statistician, who reported that the sample size for the study should be increased from 200 to 238 subjects. Phytopharm subsequently received regulatory and ethics approval for this amendment.

Recruitment into this study is now complete. We therefore anticipate the completion of the phase II trial at the end of 2005 and, following analysis of the results, will be seeking further licensing partners for this product.

In February 2005, we received confirmation of a milestone payment of £4 million (£3.6 million net received in March 2005) from Yamanouchi Pharmaceutical Co. Ltd (‘Yamanouchi’) following receipt by Yamanouchi of the safety data in relation to the first 60 patients treated with PYM50028 in the ongoing phase II proof of principle study in patients with Alzheimer’s disease. The study confirmed that the data met the criteria set out in the licensing agreement.

In March 2005, Phytopharm also received confirmation from Yamanouchi that as a result of a portfolio review arising out of the merger of Yamanouchi with Fujisawa Pharmaceutical Co, Yamanouchi was terminating the licensing agreement, covering Japan and some other Asian countries, in connection with PYM50028. Phytopharm had previously announced in February 2005 that it had been informed by Yamanouchi that it was likely to terminate this agreement.

Our second neurodegeneration product Myogane™ (coded PYM50018) is being developed for amyotrophic lateral sclerosis (ALS; also known as Lou Gehrig’s disease). ALS is the most common motor neurone disease and results from progressive degeneration of both upper and lower motor neurones.

In pre-clinical models, PYM50018 protects against neuronal damage, increases neurite outgrowth, reverses oxidative damage and reverses neuronal apoptosis *in vitro*. When administered orally to a transgenic pre-clinical model of ALS, PYM50018 delays the loss of muscle strength and extends survival time.

Last year, we successfully completed a Phase Ia clinical study to evaluate the safety, tolerability and pharmacokinetic profile of PYM50018. This residential clinical study was conducted under an investigational new drug (IND) application filed with the United States Food and Drug Administration (FDA) and confirmed that the product was well absorbed with a good safety profile. We also announced last year that the FDA had granted Orphan Drug and Fast Track designation to PYM50018 for the treatment of ALS. Building on this success we are now progressing the development package to support further clinical studies with PYM50018 for ALS.

Obesity and metabolic disease

Our obesity programme includes an extract of *Hoodia gordonii* for the dietary control of obesity, which contains a novel appetite suppressant that reduces caloric intake in overweight subjects, as demonstrated in our double-blind, placebo-controlled clinical study announced in December 2001.

In December 2004, we announced that we had granted an exclusive global licence for our *Hoodia gordonii* extract to Unilever plc. As part of the agreement, Unilever committed to initial payments totalling approximately £6.5 million (\$12.5 million) out of a potential total of £21 million (\$40 million) in payments to us. In addition, we will receive a royalty on sales of all products, including globally recognised brands, containing the extract. We are collaborating with Unilever on a five stage research and development programme of safety and efficacy studies with a view to bringing new products to market. Unilever will manage the agronomy programme and will support the international patent programme for the products. Phytopharm has also developed screens that are predictive of appetite suppressant activity to evaluate pharmaceutical development candidates in our obesity and metabolic disease programme.

Dermatology

The dermatology programmes include products for canine skin disorders and human eczema. These products have a dual mode of action that targets both the allergic and inflammatory components of skin disorders.

Following the success last year of the three-plant product, coded PYM00217 in our European multi-centre study in canine atopic dermatitis, we launched PYM00217 with the brand name Phytopica™. Following the successful UK launch to registered veterinary practitioners, Phytopharm is now seeking global partners to market Phytopica™ in other territories.

Inflammation

Finally, the inflammation programmes include products for canine joint disorders and human inflammatory disorders, including asthma. These products are characterised by their inhibition of a wide range of enzymes central to chronic inflammation.

Last year, we announced the launch of Zanthofen™ (coded PYM50014) for the maintenance of canine joint mobility. Pre-clinical studies have demonstrated that the components of Zanthofen™ maintain normal white cell function and have antioxidant properties that help maintain joint mobility. Zanthofen™ is available to veterinary practitioners across the UK and is marketed by Phytopharm's marketing partner, Genitrix Ltd, a UK based veterinary product company.

Steady progress has been made in developing novel synthetic molecules intended to result in a pharmaceutical prescription medicine for the treatment of asthma and other inflammatory disorders. Pre-clinical studies have demonstrated anti-inflammatory and anti-spasmodic activity in several models of asthma and inflammation. We anticipate that further proof of concept studies will be investigated during the year using these compounds in pre-clinical models of asthma.



Dr Daryl Rees
Chief Operating Officer
10 May 2005

Financial review



Summary

The financial performance for the first six months to 28 February 2005 has been influenced by two main events: the income from Unilever for *Hoodia gordonii* extract after the agreement was signed in December 2004 and the third milestone payment due from Yamanouchi for PYM50028 in February 2005. The Company's investment in research and development continues to grow in line principally with the continuing progress of our programmes for Alzheimer's disease, amyotrophic lateral sclerosis and the dietary control of obesity.

Turnover

Revenues of £6.34 million for the first six months (H1 2004: £1.05 million, H2 2004: £0.02 million) comprised principally £2.27 million in payments received from Unilever, for the exclusive licence to develop, manufacture and market *Hoodia gordonii* extract for the dietary control of obesity on a global basis, and a £4 million (£3.6 million net of Japanese withholding tax) milestone payment from Yamanouchi, following acknowledgement by Yamanouchi that the safety data in relation to 60 patients treated with PYM50028 had fulfilled the criteria in the licensing agreement. The significant increase in revenues for the period reflects the intermittent timing of milestone payments.

Expenses

Research and development remained our most significant investment, totalling £4.11 million or 78% of total operating costs, an increase of 58% (H1 2004: £2.60 million, H2 2004: £3.75 million). This is largely due to the successful progress of the Alzheimer's disease and amyotrophic lateral sclerosis programmes, which are in clinical trials, and also the dietary control of obesity programme, which is now fully funded by Unilever. The research and development activity required administrative support of £1.15 million (H1 2004: £0.59 million, H2 2004: £1.12 million), due to the additional one-off costs of an aborted £23.9 million fundraising, US financial compliance costs and the share option compensation charge. This period's total operating expenses were £5.26 million, an increase of 65% (H1 2004: £3.18 million, H2 2004: £4.87 million).

	28 February 2005	Six months ended 31 August 2004	Six months ended 29 February 2004	Year ended 31 August 2004
	£m	£m	£m	£m
Turnover	7.10	0.02	1.05	1.07
Research and development	4.87	3.76	2.59	6.35
Administrative costs	1.15	1.12	0.59	1.71
Interest income	0.09	0.17	0.07	0.24
Net tax recoverable	(0.07)	0.21	0.21	0.76
Loss for period	0.74	(4.37)	(1.86)	(6.23)
Loss per share (pence)	1.9	(10.0)	(4.8)	(15.3)
Working capital	6.08	5.11	9.45	5.11

Interest and Tax

Interest income of £0.09 million was higher this period (H1 2004: £0.07 million, H2 2004: £0.17 million), due to a combination of changing cash balances and higher interest rates, and represents an average return of 2.04% on the cash balances throughout the period. There was a net tax charge of £0.07 million instead of net tax recoverable in previous periods (H1 2004: £0.21 million, H2 2004: £0.33 million), despite a similar research and development corporation tax credit to the previous period, due to the payment of a 10% Japanese withholding tax deducted from the Yamanouchi income.

Liquidity and capital resources

At 28 February 2005 the Group had cash and liquid resources of £3.67 million, £1.76 million lower than at the start of the financial year. Cash and liquid resources were strengthened by a placing and open offer of £9.0 million net, post the period end.

The fixed asset base remained low at £0.16 million since the start of the six month period as research and development activities are contracted out so that the Group does not need to finance its own laboratory facilities. Debtors of £6.33 million are 297% higher than at the start of the period, comprising principally the Yamanouchi milestone payment and to a lesser extent, research and development tax credits. Creditors of £4.27 million are 89% higher than at the start of the period, comprising mainly trade creditors and accruals.

Working capital at 28 February 2005 was £6.07 million, an increase of £0.96 million during the period and is a manifestation of the sporadic nature of milestone payments. The underlying utilisation of working capital in FY2005 is anticipated to be similar to previous periods.

During the period, Phytopharm reported an operating profit of £0.71 million, compared with a loss of £2.1 million in H1 2004. At a pre-tax level, profits were £0.81 million, compared with a loss of £2.1m in H1 2004.

Phytopharm has raised a net total of £43 million since the IPO in 1996 (including the £9.0 million fundraising in April 2005). As at 28 February 2005, a net total of £29 million has been invested by shareholders in developing Phytopharm and its product opportunities.



Dr Wang Chong
Chief Financial Officer
10 May 2005

Independent review report to Phytopharm plc

Introduction

We have been instructed by the Company to review the financial information which comprises the consolidated profit and loss account, the reconciliation of movements in Group shareholders' funds, the consolidated balance sheet and the consolidated cash flow statement and the related notes. We have read the other information contained in the interim report and considered whether it contains any apparent misstatements or material inconsistencies with the financial information.

Directors' responsibilities

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

Review work performed

We conducted our review in accordance with guidance contained in Bulletin 1999/4 issued by the Auditing Practices Board for use in the United Kingdom. A review consists principally of making enquiries of company management and applying analytical procedures to the financial information and underlying financial data and, based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed.

A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit performed in accordance with United Kingdom Auditing Standards and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the financial information. This report, including the conclusion, has been prepared for and only for the Company for the purpose of the Listing Rules of the Financial Services Authority and for no other purpose. We do not, in producing this report, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial information as presented for the six months ended 28 February 2005.

PricewaterhouseCoopers LLP

Chartered Accountants

Cambridge

10 May 2005

- (a) The maintenance and integrity of the Phytopharm 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 interim report since it was initially presented on the website.
- (b) Legislation in the United Kingdom governing the preparation and dissemination of financial information may differ from legislation in other jurisdictions.

Unaudited consolidated profit and loss account for six months ended 28 February 2005

	Notes	Unaudited Six months ended 28 February 2005 £	Unaudited Six months ended 29 February 2004 £	Audited Year ended 31 August 2004 £
Turnover	2	6,340,644	1,052,360	1,072,082
Cost of sales		(371,054)	–	(10,136)
Gross profit		5,969,590	1,052,360	1,061,946
Net operating expenses	3	(5,255,859)	(3,184,923)	(8,057,945)
Operating profit/(loss)		713,731	(2,132,563)	(6,995,999)
Interest receivable and similar income		93,356	69,693	239,235
Interest payable and similar charges		(296)	–	(312)
Profit/(loss) on ordinary activities before taxation		806,791	(2,062,870)	(6,757,076)
Tax on profit/(loss) on ordinary activities	4	(71,792)	205,434	530,946
Profit/(loss) for the period	7	734,999	(1,857,436)	(6,226,130)
Basic earnings/(loss) per share (pence)	5	1.7	(4.8)	(15.3)
Diluted earnings per share	5	1.7	–	–

Unaudited reconciliation of movements in Group shareholders' funds for the six months ended 28 February 2005

	Unaudited Six months ended 28 February 2005 £	Unaudited Six months ended 29 February 2004 £	Audited Year ended 31 August 2004 £
Profit/(loss) for the period	734,999	(1,857,436)	(6,226,130)
New share capital issued	157,893	6,517,429	6,519,929
Expenses of share capital issued	–	(163,721)	(154,035)
Share option compensation charge	44,250	27,340	55,400
Net increase in shareholders' funds	937,142	4,523,612	195,164
Opening shareholders' funds	5,292,048	5,096,884	5,096,884
Closing shareholders' funds	6,229,190	9,620,496	5,292,048

Unaudited consolidated balance sheet at 28 February 2005

	Notes	Unaudited At 28 February 2005 £	Unaudited At 29 February 2004 £	Audited At 31 August 2004 £
Fixed assets				
Tangible assets		154,628	171,675	177,817
		154,628	171,675	177,817
Current assets				
Stocks		347,574	195,820	350,534
Debtors amounts falling due after one year	6	–	–	613,929
Debtors amounts falling due within one year		6,325,063	1,122,908	977,837
Cash held on deposit as short-term investments		3,524,233	2,541,243	5,237,452
Cash at bank and in hand		147,269	6,526,875	193,708
		10,344,139	10,386,846	7,373,460
Creditors: amounts falling due within one year		(4,269,577)	(938,025)	(2,259,229)
Net current assets		6,074,562	9,448,821	5,114,231
Total assets less current liabilities		6,229,190	9,620,496	5,292,048
Net assets		6,229,190	9,620,496	5,292,048
Capital and reserves				
Called up share capital		430,997	427,433	427,488
Share premium account	7	38,289,041	38,122,526	38,134,657
Merger reserve	7	(204,211)	(204,211)	(204,211)
Profit and loss account	7	(32,286,637)	(28,725,252)	(33,065,886)
Equity shareholders' funds		6,229,190	9,620,496	5,292,048

Unaudited consolidated cash flow statement for the six months ended 28 February 2005

	Notes	Unaudited Six months ended 28 February 2005 £	Unaudited Six months ended 29 February 2004 £	Audited Year ended 31 August 2004 £
Net cash outflow from continuing operating activities		(2,604,414)	(3,095,843)	(6,826,047)
Returns on investment and servicing of finance				
Interest received		93,356	69,693	239,235
Other interest paid		(296)	–	(312)
Net cash inflow from returns on investment and servicing of finance		93,060	69,693	238,923
Taxation				
UK corporation tax credit received		–	277,600	855,699
Foreign taxation paid		–	(100,000)	(100,000)
Net cash (outflow)/inflow from taxation		–	177,600	755,699
Capital expenditure and financial investment				
Purchase of tangible fixed assets		(29,126)	(59,945)	(117,110)
Proceeds on sale of tangible fixed assets		9,000	9,750	14,575
Reimbursement of advances to/(advances to) suppliers	6	613,929	–	(613,929)
Net cash inflow/(outflow) for capital expenditure and financial investment		593,803	(50,195)	(716,464)
Cash outflow before use of liquid resources		(1,917,551)	(2,898,745)	(6,547,889)
Management of liquid resources				
Decrease/(increase) in cash held on short-term deposit		1,713,219	2,590,309	(105,900)
Financing				
Proceeds from exercise of share options		157,893	33,367	36,625
Proceeds from issue of share capital		–	6,484,062	6,483,304
Expenses of share capital issue		–	(163,721)	(154,035)
Net cash inflow from financing		157,893	6,353,708	6,365,894
(Decrease)/increase in cash		(46,439)	6,045,272	(287,895)

Reconciliation of operating loss to net cash outflow from operating activities

	Unaudited Six months ended 28 February 2005 £	Unaudited Six months ended 29 February 2004 £	Audited Year ended 31 August 2004 £
Continuing activities			
Operating profit/(loss)	713,731	(2,132,563)	(6,995,999)
Depreciation on tangible fixed assets	44,752	45,168	93,114
Gain on disposal of fixed assets	(1,437)	(4,723)	(6,471)
Decrease/(increase) in stocks	2,960	(153,069)	(307,783)
(Increase)/decrease in debtors	(5,019,018)	(525)	(108,041)
Increase/(decrease) in creditors	1,610,348	(877,471)	443,733
Share option compensation charge	44,250	27,340	55,400
Net cash outflow from continuing operating activities	(2,604,414)	(3,095,843)	(6,826,047)

Notes to the interim report

1. Preparation of interim statements

The interim results have been prepared in accordance with the accounting policies set out in the Group's 2004 annual report and are unaudited. The information set out in this interim report for the six months to 28 February 2005 does not comprise statutory accounts within the meaning of the Companies Act 1985.

The figures for the year ended 31 August 2004 are abridged from the Group's statutory accounts for that year, which received an unqualified auditors' report and have been filed with the Registrar of Companies.

2. Turnover

	Six months ended 28 February 2005 £	Six months ended 29 February 2004 £	Year ended 31 August 2004 £
By business activity			
Licensing and development	6,266,426	1,052,360	1,052,360
Product sales	74,218	–	19,722
	6,340,644	1,052,360	1,072,082

3. Net operating expenses

Net operating expenses comprise:

	Six months ended 28 February 2005 £	Six months ended 29 February 2004 £	Year ended 31 August 2004 £
Research and development expenditure	4,109,707	2,597,986	6,347,431
Administrative expenditure	1,146,152	586,937	1,710,514
	5,255,859	3,184,923	8,057,945

4. Tax on loss on ordinary activities

	Six months ended 28 February 2005 £	Six months ended 29 February 2004 £	Year ended 31 August 2004 £
Current tax			
UK corporation tax credit on loss for period	328,208	305,434	630,946
Foreign tax	(400,000)	(100,000)	(100,000)
Corporation tax (charge)/credit	(71,792)	205,434	530,946

Foreign tax related to 10% Japanese withholding tax.

The Group is forecasting tax losses for the full year. The Group has taken advantage of the Research and Development corporation tax credits introduced in the Finance Act 2000 whereby the Group may surrender corporation tax losses incurred on research and development expenditure for a corporation tax refund at the rate of 24 pence in the pound of actual spend.

5. Earnings per share

The basic earnings per share is based on profits of £734,999 and 42,919,416 ordinary shares, being the weighted average number of shares in issue during the period.

For diluted earnings per share, the weighted average number of ordinary shares in issue is diluted to assume conversion of all dilutive potential ordinary shares. The Group has two classes of dilutive potential ordinary shares: these share options granted to employees where the exercise price is less than the average market price of the Company's ordinary shares during the period and the contingently issuable shares under the Group's long-term incentive plan.

At 28 February 2005, the performance criteria for the vesting of the awards under the incentive scheme had not been met and consequently the shares in question are excluded from the diluted EPS calculation.

Reconciliations of the earnings and weighted average number of shares used in the calculations for the period to 28 February 2005 are set out below. There is no calculation for the comparative period as the Group incurred a loss.

	Earnings £	Weighted average number of shares	Per share amount (pence)
Basic EPS			
Earnings attributable to ordinary shareholders	734,999	42,919,416	1.7
Effect of dilutive share options	–	769,570	–
Diluted EPS			
Adjusted earnings	734,999	43,688,986	1.7

6. Debtors

The Company was obliged to pay to the Inland Revenue £157,731.41 arising on the exercise by Dr Dixey of 288,889 share options on 3 December 2004, near the end of the exercise period. Dr Dixey is accordingly obliged to reimburse such amount to the Company including interest charges at a commercial rate. He intends to sell a sufficient number of his shares in the Company, as soon as he is reasonably and legally able, to raise sufficient funds net of tax and costs to enable him to reimburse the Company. This amount is included in debtors due within one year.

The Company has been reimbursed by Unilever N.V. as part of the Joint Development Agreement, for the advances made to suppliers shown as debtors due after one year at 31 August 2004.

Notes to the interim report continued

7. Share premium account and reserves

	Share premium account £	Merger reserve £	Profit and loss account £
At 1 September 2004	38,134,657	(204,211)	(33,065,886)
Premium on new share issue	154,384	–	–
Share option compensation charge	–	–	44,250
Loss for the period	–	–	734,999
At 28 February 2005	38,289,041	(204,211)	(32,286,637)

8. Performance share award

On 3 December 2004 the remuneration committee made a performance share award of 150,000 ordinary shares at par to Dr G W Chong. The remuneration committee considered that there was a considerable risk of Dr Chong leaving the Company as his existing share option awards were at option prices significantly in excess of the current share price and this performance share award was granted, as permitted by Chapter 13.13A of the Listing Rules to retain the services of Dr Chong. The award is subject to performance conditions and the benefits are not pensionable. The performance conditions are based on Total Shareholder Return (TSR) over a three year period (with no retesting opportunities) when compared to a peer group comprising 27 other listed UK biotech and pharmaceutical companies for 100,000 shares and compared to the FTSE SmallCap index for the remaining 50,000 shares. In each case 25% of the shares awarded will vest for median performance against the comparator group rising to 100% for upper decile and above performance. None of the shares awarded will vest for below median performance. TSR is considered by the remuneration committee to be the most robust method of measuring company performance over the period. The terms of the award will not be amended to the benefit of Dr Chong without seeking shareholder approval.

9. Post balance sheet events

Phytopharm announced on 29 March 2005 that it had received confirmation from Yamanouchi Pharmaceutical Co. Ltd ('Yamanouchi') that as a result of a portfolio review arising out of the merger of Yamanouchi with Fujisawa Pharmaceutical Co, Yamanouchi is to terminate the licensing agreement covering Japan and some other Asian countries in connection with Cogane™ (PYM50028), Phytopharm's candidate product for the treatment of Alzheimer's disease.

Phytopharm announced on 4 May 2005 the completion of a Placing and Open Offer raising approximately £10.1 million (£9.0 million net of expenses) comprising an aggregate of 8,091,193 new ordinary shares at the issue price of 125 pence per new ordinary share.

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