NeuronZ Limited

Annual Report & Financial Statements

For the Year Ended 31 December 2001

NeuronZ Limited

Annual Report & Financial Statements

For the Year Ended 31 December 2001

Contents

NeuronZ Limited

Annual Report

For the Year Ended 31 December 2001

The Board of Directors is pleased to present the annual report of NeuronZ Limited which includes all information required to be disclosed under the Companies Act 1993, incorporating the financial statements and auditors' report, for the year ended 31 December 2001.

The annual report presented on pages 1 to 3 and the financial statements presented on pages 6 to 18 are signed for and on behalf of the Board and were authorised for issue on the date below.

....
Robin L Congreve - Chairman

....
Patrick Strange - Director

....
Date

NeuronZ Limited

Annual Report

For the Year Ended 31 December 2001

Principal Activities

NeuronZ Limited is a bioscience company operating solely within New Zealand whose principal business activity is the discovery and development of medicines and devices for the preservation, treatment and monitoring of neuronal function, following acute ischemic and traumatic injury and in neurodegenerative disease.

Performance Overview

During the year, the company has significantly developed its scientific and commercial operations employing additional staff and completing its move into The Liggins Institute.

The operating deficit of $8,600,000 (2000: deficit of $3,040,000) for the year reflects the increased level of scientific research activity during the year. The detailed financial statements are presented on pages 6 to 18.

The deficit per share of $3.13 (2000: deficit of $1.45) is based on 2,500,000 (2000: 1,935,854) weighted average number of shares outstanding.

No dividends were paid in the year.

Interests Register

The company is required to maintain an interests register in which particulars of certain transactions and matters involving directors must be recorded. Details of the entries in this register for each of the directors are as follows:

<u>Mr J Balter</u>

Mr Balter has a relevant interest in 1,200,000 Series A Preference Shares in his capacity as a director.

Mr Balter has acted in advisory capacities to the New Zealand Seed Fund which is a shareholder in NeuronZ Limited. He has also provided consultancy services directly to NeuronZ Limited during the year.

<u>Mr R L Congreve</u>

Mr Congreve has a relevant interest in 1,400,000 Series A Preference Shares as at 31 December 2001 in his capacity as director.

<u>Prof P D Gluckman</u>

Professor Gluckman holds 110,000 Ordinary Shares as at 31 December 2001.

Professor Gluckman resigned as a director of Auckland UniServices Limited on 15 October 2001. Auckland UniServices Limited has significant supply contracts with NeuronZ Limited. These are disclosed in note 10 to the financial statements.

NeuronZ Limited

Annual Report

For the Year Ended 31 December 2001

Mr J McLay

Mr McLay has a relevant interest in 1,600,000 Series A Preference Shares as at 31 December 2001 in his capacity as director.

Dr P C Strange

Dr Strange has a relevant interest in 2,254,000 Ordinary Shares as at 31 December 2001 in his capacity as director.

There are no other matters registered by the directors which are considered to cause any potential conflict of interests as at 31 December 2001.

Directors and remuneration

	Other Remuneration 2001 $'000	Other Remuneration 2000 $'000
RL Congreve (Chairman)	-	-
JJ Egan (Resigned June 2001)	209	212
K Kociuba (Resigned July 2001)	-	-
J Balter	647	528
PD Gluckman	158	230
PC Strange	-	-
J McLay (Appointed December 2001)	-	-

No directors received any fees for holding office.

Employees and remuneration

The number of employees in the company receiving remuneration and benefits above $100,000 per annum are as follows:

	2001	2000
$120,000 – 129,999	1	-
$130,000 – 139,999	-	1
$150,000 – 159,999	1	-

Donations

The company made no donations (2000: none) during the year.

Auditors

PricewaterhouseCoopers are the auditors of the company. Audit fees are $10,000 (2000: $5,000). Also during 2001 PricewaterhouseCoopers received $9,000 (2000: $12,000) in relation to other financial advice.

NeuronZ Limited

Statement of Financial Performance

For the Year Ended 31 December 2001

	Notes	2001 $'000	2000 $'000
Revenue from continuing activities:			
Research revenues		178	253
Interest income		93	93
Total revenue for continuing activities		271	346
Operating expenses:			
Research		5,072	1,281
Finance and administration		3,799	2,105
		8,871	3,386
Operating Deficit from continuing activities before taxation	2	(8,600)	(3,040)
Provision for income taxes	3	-	-
Net Deficit		(8,600)	(3,040)
Net Deficit per share:			
Basic	1	($3.13)	($1.45)
Diluted	1	($3.13)	($1.45)
Weighted average number of shares outstanding:			
Basic	1	2,500,000	1,935,854
Diluted	1	2,500,000	1,935,854

NeuronZ Limited

Statement of Movements in Equity

For the Year Ended 31 December 2001

	Paid-in capital					
	Shares	Amount	Accum Deficit	Unearned share-based compensation	Total	Recognised revenues and expenses
Shareholders' equity as at 1 January 2000		$'000	$'000	$'000	$'000	$'000
Ordinary Shares	18,667	186		-		
Preference Shares	1,333	1,333		-		
Total Equity	20,000	1,519	(1,511)	-	(1,511)	(1,511)
Conversion of Preference Shares to Ordinary Shares	(1,333)	-		-	-	-
	13,330	-		-	-	-
Total number of Ordinary Shares before split	31,997	-		-	-	-
Issue of Ordinary Shares due to share split	2,468,003	-		-		-
Net deficit 2000			(3,040)	-	(3,040)	(3,040)
Shareholders' equity as at 31 December 2000						
Total Shareholders' Equity	2,500,000	1,519	(4,551)	-	(4,551)	(4,551)
Shareholders' equity as at 1 January 2001		$'000	$'000	$'000	$'000	$'000
Total Shareholders' Equity	2,500,000	1,519	(4,551)	-	(4,551)	(4,551)
Net deficit 2001			(8,600)	-	(8,600)	(8,600)
Shareholders' equity as at 31 December 2001						
Total Shareholders' Equity	2,500,000	1,519	(13,151)	-	(13,151)	(13,151)

NeuronZ Limited

Statement of Financial Position

As at 31 December 2001

	Notes	2001 $'000	2000 $'000
ASSETS			
Current assets:			
Cash and cash equivalents	5	3,773	4,109
Other current assets		491	146
Total current assets		4,264	4,255
Non-current assets:			
Plant and equipment, net	6	885	329
Total non current assets		885	329
Total assets		5,149	4,584
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Accounts payable and accrued liabilities	7	1,476	614
Total current liabilities		1,476	614
Non-current liabilities:			
Long term debt	8	15,305	7,002
Total liabilities		16,781	7,616
SHAREHOLDERS' EQUITY			
Paid in capital	4	1,519	1,519
Accumulated deficit		(13,151)	(4,551)
Total shareholders' deficit		(11,632)	(3,032)
Total liabilities and shareholders' equity		5,149	4,584

NeuronZ Limited

Statement of Cashflows

For the Year Ended 31 December 2001

	2001 $'000	2000 $'000
Cashflows (to)/from operating activities:		
Receipts from grants/customers	178	507
Interest received	86	81
Net goods and services tax received / (paid)	81	(122)
Payments to suppliers	(4,939)	(1,790)
Payments to employees	(1,884)	(542)
Series A Preference Shares financing costs	(332)	(502)
Income taxes paid	-	-
Net cash used in operating activities	(6,810)	(2,368)
Cashflows to investing activities:		
Purchase of plant and equipment	(846)	(355)
Net cash used in investing activities	(846)	(355)
Cashflows from/(to) financing activities:		
Issue of Series A Preference Shares	7,243	6,665
Net cash provided from /(to) financing activities	7,243	6,665
Net (decrease)/increase in cash	(413)	3,942
Cash at the beginning of the year	4,109	121
Effect of exchange rate changes on cash	77	46
Cash at end of the year	3,773	4,109
Reconciliation with net deficit:		
Net deficit	(8,600)	(3,040)
Items requiring adjustment:		
Depreciation	289	26
Interest on Preference Shares	779	237
Foreign exchange loss	186	54
Changes in working capital:		
Accounts receivable	-	239
Other debtors & prepaid expenses	(326)	(144)
Accounts payable and accruals	862	260
Income taxes payable	-	-
Net cash used in operating activities	(6,810)	(2,368)

NeuronZ Limited

Statement of Accounting Policies

For the Year Ended 31 December 2001

Nature of business

NeuronZ Limited is a bioscience company operating solely within New Zealand whose principal business activity is the discovery and development of medicines and devices for the preservation, treatment and monitoring of neuronal function, following acute ischemic and traumatic injury and in neurodegenerative disease.

The Company's development activities involve inherent risks. These risks include, among others: dependence on, and the Company's ability to retain key personnel; the Company's ability to protect its intellectual property and prevent other companies from using the technology; the Company's business is based on novel and unproven technology; the Company's ability to complete the clinical trial process to obtain regulatory approval and commercialise the products; technological developments by the Company's competitors may render its products obsolete; and future regulation could limit the amount the Company will be able to charge for its products. The realisable value of the Company's recognised assets is subject to these inherent risks.

In addition, the Company has developed a business plan, which will require a high level of expenditures until product revenue streams are established and therefore expects to continue to incur additional net losses through this time. In the future, the Company will need to raise additional financing through public or private equity financings, collaborations or other arrangements with corporate sources, or other sources of financing to fund operations. There can be no assurance that such additional financing, if available, can be obtained on terms reasonable to the company. In the event the Company is unable to raise additional capital, future operations will need to be curtailed or discontinued. These matters raise doubt about the Company's ability to continue as a going concern.

Summary of significant accounting policies

The accompanying financial statements of the Company are for the year ended 31 December 2001, and are based on the general principals of historical cost accounting. They are presented in accordance with the Companies Act 1993 and have been prepared in accordance with the Financial Reporting Act 1993, in conformity with generally accepted accounting practice in New Zealand.

Estimates

The preparation of financial statements in conformity with generally accepted accounting practice requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Goods and services tax (GST)

The statements of financial performance has been prepared so that all components are presented exclusive of GST. All items in the statement of financial position are presented net of GST, with the exception of receivables and payables, which include GST invoiced.

Translation of foreign currency

The financial statements are expressed in New Zealand dollars, the functional currency of the Company. Transactions denominated in a foreign currency are converted to New Zealand dollars at the exchange rates in effect at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies arising from operations are translated into New Zealand dollars using closing exchange rates in effect at period end. Gains and losses due to exchange rate fluctuations on these items are included in the statement of financial performance. An exchange rate of NZ$0.42 (2000: NZ$0.4435) was used to translate US dollar denominated monetary items at 31 December 2001.

NeuronZ Limited

Statement of Accounting Policies

For the Year Ended 31 December 2001

Research and development

Research expenses include direct and directly attributable overhead expenses for drug discovery and research and pre-clinical. Research costs are expensed as incurred.

When a project reaches the stage where it is reasonably certain that future expenditure can be recovered through the process or products produced, development expenditure is recognised as a development asset when :

- a product or process is clearly defined and the costs attributable to the product or process can be identified separately and measured reliably;
- the technical feasibility of the product or process can be demonstrated;
- the existence of a market for the product or process can be demonstrated and the company intends to produce and market the product or process;
- adequate resources exist, or their availability can be reasonably demonstrated to complete the project and market the product or process.

In such cases the asset is amortised from the commencement of commercial production of the product to which it relates on a straight line basis over the period of expected benefit. Research and development costs are otherwise expensed as incurred.

Taxation

The tax expense recognised for the year is based on the accounting surplus, adjusted for permanent differences between accounting and tax rules.

The impact of all timing differences between accounting and tax income is recognised as a deferred tax liability or asset. This is the comprehensive basis for the calculation of deferred tax under the liability method.

A deferred tax asset, or the effect of losses carried forward that exceed the deferred tax liability, is recognised in the financial statements only where there is virtual certainty that the benefit of the timing differences, or losses, will be utilised. No tax asset is recognised in the financial statements for the year to December 2001.

Impairment

The Company reviews long-lived assets, including intangible assets, whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. The carrying amount of a long lived asset is considered impaired when the estimated undiscounted cashflow from such asset is less than its carrying value. In that event, a loss is recognised in the statement of financial performance based on the amount by which the carrying amount exceeds the fair market value of the long lived asset. Fair market value is determined using the anticipated cashflows discounted at a rate commensurate with the risk involved.

Cash and cash equivalents

Cash and cash equivalents comprises cash and demand deposits held with established financial institutions and highly liquid investments, which are readily convertible into cash and have maturities of three months or less.

NeuronZ Limited

Statement of Accounting Policies

For the Year Ended 31 December 2001

Plant and equipment

Property, plant and equipment are recorded at cost. Depreciation is determined principally on a straight line basis for plant, equipment and office furniture and fittings, based upon the following estimated useful lives:

Scientific equipment	4 years
Computer equipment	2 years
Office furniture, fixtures & fittings	4 years
Leasehold Improvements	Term of lease

Repairs and maintenance and gains and losses on sale or disposal of assets are reflected in the statement of financial performance as incurred. Major renewals and betterments are capitalised.

Financing costs

Costs associated with the issue of shares which are recognised in shareholders' equity are treated as a reduction of the amount collected per share. Costs associated with the issue of shares which are recognised within non current liabilities on the balance sheet are expensed in the period accrued.

Financial instruments

Financial instruments recognised in the statement of financial position include cash and cash equivalents, accounts receivable, accounts payable and redeemable preference shares. With the exception of the redeemable preference shares, the Company believes that the amounts reported for financing instruments approximate fair value due to their short term nature (refer note 8 regarding redeemable convertible preference shares). There are no unrecognised financial instruments. The Company does not undertake hedging activities or utilise derivative financial instruments.

The company has no exposure to credit risk. The company is exposed to market fluctuations in the USD rate with respect to the Preference Share liabilities disclosed in note 8 to the accounts.

Statement of cashflows

Operating cashflows include all transactions and other events that are not investing or financing activities. Investing activities are those activities relating to the acquisition, holding and disposal of property, plant and equipment, and investments. Financing activities are those that result in changes in the size and composition of the capital structure disclosed within equity or long term debt.

Changes in accounting policies

There have been no changes in accounting policies during the year.

NeuronZ Limited

Notes to the Financial Statements

For the Year Ended 31 December 2001

1. Net deficit per share

Basic net deficit per share is based upon the weighted average number of outstanding Ordinary Shares. For the year ended 31 December 2001, the Company's potentially dilutive common share equivalents being the Series A Preference Shares (refer note 8) have an anti-dilutive effect on net deficit per share and, therefore, have not been used in determining the total weighted average number of common shares outstanding for the purpose of calculating diluted net deficit per share.

The following table sets forth the computation of basic and diluted net deficit per share:

Basic:	**2001 $'000**	2000 $'000
Unadjusted Net deficit	(8,600)	(3,040)
Add: Preference Share dividend	779	237
Net deficit in EPS	(7,821)	(2,803)
Weighted Average Shares Outstanding:	2,500,000	1,935,854
Net deficit per share	($3.13)	($1.45)
Diluted:		
Unadjusted Net deficit	(8,600)	(3,040)
Add: Preference Share dividend	779	237
Net deficit in EPS	(7,821)	(2,803)
Weighted Average Shares Outstanding:	2,500,000	1,935,854
Net deficit per share	($3.13)	($1.45)

2. Operating Deficit

Operating Deficit is stated after charging:	**2001 $'000**	2000 $'000
Directors fees	-	-
Audit fees	10	5
Other fees to auditor	9	12
Depreciation	289	26
Net loss on foreign currency translations	186	54
Rent expense	250	26

3. Income Tax

The company had unrecognised income tax losses carried forward from 2000 of $1,700,000 with a tax effect of $561,000.

The company has an estimated income tax loss of $7,300,000 in 2001 with a tax effect of $2,400,000 to be carried forward subject to the requirements of income tax legislation being met and the company maintaining shareholder continuity.

NeuronZ Limited

Notes to the Financial Statements

For the Year Ended 31 December 2001

4. Share capital

	2001 $'000	2000 $'000
Ordinary Shares		
Balance at beginning of year	1,519	186
Shares issued during the year	-	-
Converted from Preference Shares	-	1,333
Balance at end of year	1,519	1,519
Preference Shares		
Balance at beginning of year	-	1,333
Converted to Ordinary Shares	-	(1,333)
Balance at end of year	-	-
Total Share Capital	1,519	1,519

As at 31 December 2001 there were 2,500,000 (2000: 2,500,000) Ordinary Shares issued and fully paid. All Ordinary Shares rank equally as to dividends and liquidation with one vote each attached to each fully paid Ordinary Share.

5. Cash and cash equivalents

	2001 $'000	2000 $'000
Cash and cash equivalents consists of the following:		
Cash	2,409	2,873
Demand deposits	1,364	1,236
	3,773	4,109

A foreign exchange gain of $77,000 (2000: $46,000) on US dollar denominated bank accounts was recorded in the operating deficit for the year ended 31 December 2001.

NeuronZ Limited

Notes to the Financial Statements

For the Year Ended 31 December 2001

6. Plant and equipment

Plant and equipment consist of the following:	**2001 $'000**	2000 $'000
Cost:		
Scientific equipment	660	171
Computer equipment	366	122
Office furniture, fixtures & fittings	135	62
Leasehold improvements	40	-
	1,201	355
Less accumulated depreciation:		
Scientific equipment	125	9
Computer equipment	154	14
Office furniture, fixtures & fittings	28	3
Leasehold improvements	9	-
	316	26
Plant and equipment, net	885	329

7. Accounts payable and accrued liabilities

Accounts payable and accrued liabilities consist of the following:	**2001 $'000**	2000 $'000
Trade accounts payable	815	216
Employee related payables	33	10
Other accruals	628	388
	1,476	614

8. Long term debt

	2001 $'000	2000 $'000
Series A Preference Shares issued	14,286	6,314
Liability for Series A Preference Shares to be issued	-	451
Accrued Series A Preference Share dividend	1,019	237
	15,305	7,002

8. Long term debt (continued)

On 31 May 2001, 16 July 2001 and 24 December 2001 the company issued 200,000, 2,200,000 and 800,000 redeemable, convertible Series A Preference Shares (" Preference Shares ") respectively at a subscription price of US$1 per share.

The Preference Shares carry the right to receive a cumulative dividend of 8% of the issue price per annum, are convertible into the same number of Ordinary Shares at any time by the shareholder and also automatically on the occurrence of the closing of a Qualified Public Offering or by a majority resolution of the Preference Shareholders. Each Preference Share carries one vote and ranks ahead of Ordinary Shares for the amount paid up and any accrued and unpaid dividends if the company is wound up. Thereafter, each Preference Share ranks pari passu with the Ordinary Shares. Preference Shares must be redeemed six years after issue if they have not been converted to Ordinary Shares before that time. Accordingly, they are of the nature of debt rather than equity.

On issue the Preference Shares have been translated at the current NZ$ rate and have been classified within non current liabilities as disclosed above in accordance with current NZ and US GAAP. The US$ liability created has been retranslated as at December 2001 with the total foreign exchange loss of NZ$278,000 (2000: Loss of NZ$221,000) disclosed within the operating deficit for the year.

The 8% Preference Share dividend has been accrued for up to December 2001 and is disclosed as Preference Share Interest within the operating deficit for the year.

The directors believe the monetary value of the Preference Shares and associated dividend to be a prudent estimate of the fair value of the financial instrument due to the intellectual property held by the company.

9. Commitments and contingencies

Operating leases

The following amounts for the lease of premises have been committed to by the company, but not recognised in the financial statements.

	2001 **$'000**	2000 $'000
Non cancellable operating lease commitments:		
Within one year	313	-
One to two years	313	-
Two to five years	912	-
Beyond five years	-	-
	1,538	-

NeuronZ Limited

Notes to the Financial Statements

For the Year Ended 31 December 2001

Legal claims

The Company has not entered into any collaborative arrangements and has no other significant legal contingencies as at 31 December 2001 (2000 : None)

The company actively protects its patent position and as at 31 December 2001 is enforcing this stance against a former consultant to the company.

Both the company directors and their legal advisors believe the company position in this matter to be extremely strong with no liabilities likely to arise. Furthermore, both the directors and their legal advisors believe that a degree of cost recovery is likely in this matter.

To date, this matter has not yet been fully resolved and therefore no direct amounts have been accrued in these financial statements.

Capital commitments

The company is committed to the purchase of scientific equipment to the value of $257,000 (2000: nil) as at 31 December 2001.

10. Related party transactions

Auckland UniServices Limited is a related party of NeuronZ Limited by virtue of its Ordinary shareholding. During the year goods and services were recharged to NeuronZ Limited at a net value of NZ$2.8M (2000: NZ$1.2M) on commercial, contractually agreed terms.

As at 31 December 2001 NZ$0.5M (2000: NZ$0.1M) was outstanding and included within trade accounts payable in note 7 to the accounts.

Professor P D Gluckman and Mr J Balter are related parties of NeuronZ Limited by virtue of their directorships, management influence and in the case of Professor P D Gluckman direct shareholding. During the year Professor P D Gluckman received consultancy fees of NZ$0.2M for science and management services provided. Fees for investment banking NZ$0.2M and strategic consulting of NZ$0.4M were paid to The Ulysses Group during the year, an entity in which Mr J Balter is a partner.

As at 31 December 2001 NZ$75,000 (2000: nil) was outstanding to Mr J Balter and NZ$32,000 (2000: nil) was outstanding to Professor P D Gluckman. Both these amounts are included within other accruals in note 7 to the accounts.

The company has had no other significant transactions with related parties during the year.

11. Going Concern

As stated in the Statement of Accounting Policies on page 10, the Company will need to raise additional financing through public or private equity financings, collaborations or other arrangements with corporate sources or other sources of financing to fund operations. The directors believe they will be successful in obtaining sufficient funding for the operations of the Company for the foreseeable future and for a period not less than twelve months from the date of them signing these financial statements.

12. Subsequent event

Subsequent to 31 December 2001, the company ratified a service agreement with BrainZ Instruments Limited to provide administrative, research and development resources in connection with their *Brain Monitor* technology. The agreement is effective from 1 October 2001 and the amount due to NeuronZ Limited in the period to 31 December 2001 is $272,000 which is disclosed within other current assets on the balance sheet on page 8.

13. Employee share ownership plans

The Board is committed in assisting employees to have an ownership stake in the company.

Up to 2,500,000 shares, which have yet to be issued and are of varying classes, have nominally been set aside to be allocated to staff under employee share ownership plans. Of this amount, 1,948,000 shares have been nominally allocated to certain staff.

As at 31 December 2001 the share option plans had not been formalised.

NeuronZ Limited

Directory

As at 31 December 2001

Registered office

Level 3
2-6 Park Avenue
Grafton
Auckland

Solicitors

Russell McVeagh
48 Shortland Street
PO Box 8
Auckland

Auditors

PricewaterhouseCoopers
188 Quay Street
Private Bag 92 162
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