

**Company Number 05375156**

**VERONA PHARMA PLC**  
**REPORT AND ACCOUNTS**  
**YEAR ENDED 31 DECEMBER 2010**



# VERONA PHARMA PLC

## CONTENTS

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	<b>Page</b>
Contents	1
Directors, secretary and advisers	2
Corporate statement	3
Chairman and Chief Executive Officer's joint statement	4-6
Directors' report	7-11
Corporate governance report	12
Independent auditors' report	13-14
Group statement of comprehensive income	15
Group and Company statements of financial position	16-17
Group and Company statements of cash flows	18-19
Group and Company statements of changes in equity	20-21
Notes to the financial statements	22-38

**VERONA PHARMA PLC**  
**DIRECTORS, SECRETARY AND ADVISERS**

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Directors	Michael Walker Clive Page Claire Poll Trevor Jones Stuart Bottomley Patrick Humphrey
Company Secretary	John Bottomley
Registered Office	One America Square Crosswall London EC3N 2SG
Company Number	05375156
Auditors	UHY Hacker Young Quadrant House 4 Thomas More Square London E1W 1YW
Nominated Adviser and Broker	Evolution Securities Limited 100 Wood Street London EC2V 7AN
Solicitors	Taylor Wessing LLP 5 New Street Square London EC4A 3TW
Principal Banker	Royal Bank of Scotland 1 <sup>st</sup> Floor Argyll House 246 Regent Street London W1B 3PB
Registrars	Computershare Investor Services plc PO Box 82, The Pavilions Bridgewater Road Bristol BS99 7NH

**VERONA PHARMA PLC**  
**CORPORATE STATEMENT**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

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Verona Pharma plc is a biotechnology company dedicated to discovering new drugs for the treatment of chronic respiratory diseases, such as asthma, allergic rhinitis (hay fever), chronic obstructive pulmonary disease (COPD) and cough. Today, the Company announces its audited results for the 12 months ended 31 December 2010.

**2010 OPERATIONAL HIGHLIGHTS**

- January - Filed four new patents related to novel compounds discovered under the Company's Novel Anti-Inflammatory Polysaccharides ("NAIPs") project.
- January - Received the final quality assured study report from the Centre for Human Drug Research ("CHDR") at Leiden University for the Phase I/IIa trial of Verona Pharma's lead product, RPL554, which confirmed the quality of the clinical trial and its associated analyses.
- October - Initiated the clinical trial of VRP700 in chronic cough patients at the University of Florence, Italy.
- November - Completed proof of concept experimental studies showing that RPL554 can be delivered via each of the main types of devices commonly available for inhalation therapy.
- November - Initiated the clinical trial of RPL554 at CHDR at Leiden University to evaluate the safety and bronchodilator effectiveness of higher doses of RPL554 in patients with mild asthma.

**2010 FINANCIAL HIGHLIGHTS**

- Loss after tax of £1.89 million or 0.79 pence per ordinary share.
- Low cash burn rate during the year and as at 31 December 2010 the Company had cash and cash equivalents of £2.00 million.

**SUBSEQUENT EVENT HIGHLIGHTS**

- January 2011 - Applied to the Medicines and Healthcare Products Regulatory Agency ("MHRA") for approval to conduct further clinical development of RPL554 in the UK.
- February 2011 - Successfully completed the clinical trial at CHDR at Leiden University of higher doses of RPL554 in patients with mild asthma.
- February 2011 - Received ethics approval from the Policlinico Tor Vergata, University of Rome, Italy to proceed with an exploratory Phase II trial of RPL554 in COPD patients.

**VERONA PHARMA PLC  
CHAIRMAN AND CHIEF EXECUTIVE OFFICER'S JOINT STATEMENT  
FOR THE YEAR ENDED 31 DECEMBER 2010**

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**INTRODUCTION**

2010 has been another busy year for Verona Pharma. The Company continues to vigorously pursue the licensing of its lead project, RPL554, to an appropriate pharmaceutical partner, as well as to achieve progress with its other programmes – VRP700 for the treatment of cough and NAIPs. The Company also continues to review potential new projects for inclusion in its pipeline in the future. The Board continues to maintain a firm control on the Company's finances and the Company operates a proven financial model which enables it to apply its resources to maximum effect.

**RPL554**

Discussions are ongoing for licensing out the Company's lead project, RPL554, a novel inhaled PDE3/4 inhibitor as a treatment for inflammatory diseases of the respiratory tract, including asthma, COPD and allergic rhinitis (hay fever). As the Company has stated previously, it is seeking the most compatible and appropriate licensing partner to develop RPL554 into a marketed medicine.

During 2010, the Company initiated further clinical trials in order to provide useful clinical data to add further value to the overall RPL554 package. The first clinical trial started in November and took place in Leiden, The Netherlands, at CHDR. The purpose of the trial was to evaluate the safety and bronchodilator effectiveness of higher doses of RPL554 in patients with mild asthma. Other objectives for this trial were to establish an appropriate dose for patients with respect to both effectiveness as a bronchodilator, and its safety. The trial was successfully completed in December 2010 and there were no withdrawals due to adverse effects. Both doses of RPL554 resulted in positive bronchodilation as assessed by the standard measure of FEV1 (Forced Expiratory Volume in 1 sec). Of particular note was the absence of any gastrointestinal symptoms related to the administration of the drug, since this is a limiting side effect for many PDE4 (phosphodiesterase type 4) inhibitors. At the highest dose given, limited cardiovascular effects were encountered. The results from this trial will allow the Company to be able to set appropriate doses for future studies. Additionally, the outcome of the trial provided further support for RPL554 as a novel treatment for patients with respiratory diseases and further strengthened the Company's data package for discussions with potential licensees.

The second clinical trial received approval from the appropriate ethical authority in Italy in January 2011 to proceed with an exploratory Phase II trial at the Policlinico Tor Vergata in Rome. This clinical trial has been designed to test the bronchodilator effects as well as safety of RPL554 in patients with established mild to moderate COPD. The incidence of COPD globally continues to grow and it is a disease which currently has significant unmet treatment needs. The Company currently believes that RPL554 will if successful be of significant clinical value in the treatment of this debilitating condition.

In January 2011, the Company applied to the MHRA, the governmental agency in the UK with responsibility for standards of safety, quality and performance of new drug treatments, to conduct a third clinical trial in the UK. This trial will examine the safety, duration and maintenance of bronchodilator action of RPL554 when it is given at repeated doses over several days. In addition there will be exploratory observations related to possible anti-inflammatory actions of RPL554.

**VERONA PHARMA PLC  
CHAIRMAN AND CHIEF EXECUTIVE OFFICER'S JOINT STATEMENT  
FOR THE YEAR ENDED 31 DECEMBER 2010**

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The Company has also been evaluating the various methods by which RPL554 can be administered to patients by oral inhalation using appropriate oral inhaler devices. Normally asthma and COPD drugs are delivered from a dry powder inhaler ("DPI") or a pressurized metered dose inhaler ("pMDI"), although nebulizers are used in a substantial number of patients. In both the currently planned and completed trials, RPL554 has been delivered using a nebulizer. In November, the Company completed a proof of concept experimental study that showed RPL554 can be delivered via a DPI as well as by a pMDI. These experiments will assist potential licensees in deciding the most suitable administration route and type of device for the commercialisation of RPL554. Such studies will obviously add value and strengthen the Company's position with respect to ongoing licensing discussions

### **VRP700**

During 2010, the Company received the necessary regulatory and ethical approvals for a clinical trial of VRP700 in patients who have intractable cough due to underlying severe lung disease. The study was initiated in late October 2010 and is continuing at the University of Florence, Italy. The trial has been specifically designed to demonstrate the anti-tussive (cough-suppressive) effects of VRP700 by inhalation. Progress of the trial is limited due to an unavoidable slow rate of patient recruitment. The Company currently hopes that the trial will be able to be completed in the second quarter of 2011.

### **NAIPs**

Verona Pharma's NAIPs project has progressed to the point that the Company has submitted four new 'composition of matter' patents for fractions that have been discovered as a result of the collaboration with Glycomar Ltd. These novel fractions have been identified from a number of marine sources and have shown anti-inflammatory actions that are of potential clinical value in a range of inflammatory diseases. The Company continues to seek other novel NAIPs from other sources via its collaboration with Glycores SpA.

### **FINANCIALS**

The loss for the current year increased by 18% or £0.29m to £1.89m (2009: £1.6m).

Total research and development expenditure, which was expensed as incurred, was £1.15m (2009: £0.94m). The increase in research and development expenditure was primarily due to an increase in expenditures for the RPL554 programme by £0.15m to £0.97m (2009: £0.82m), and an increase in expenditure on the Cough programme by £0.07m to £0.11m (2009: £0.04m). These increases were offset by a decrease in expenditure in the NAIPs programme by £0.01 to £0.07m (2009: £0.08m).

The increase in expenditure on the RPL554 programme was primarily due to costs incurred in connection with continuing to develop the RPL554 series and the experimental studies of various inhaler devices for administering RPL554. The increase in expenditure in the Cough programme was due to the progression from the clinical trial planning phase in 2009 to a clinical trial implementation phase in 2010.

Administrative expenses for the year were £0.75m (2009: £0.66m). The increase of £0.09m over the previous period was primarily due to an increase in investor relations activities and costs involved with the licensing efforts for RPL554.

**VERONA PHARMA PLC  
CHAIRMAN AND CHIEF EXECUTIVE OFFICER'S JOINT STATEMENT  
FOR THE YEAR ENDED 31 DECEMBER 2010**

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The income tax expense of £4,532 was capital gains tax paid by Rhinopharma Limited, during the year.

As at 31 December 2010, the Company had approximately £2 million in cash and cash equivalents.

**OUTLOOK**

All current evidence indicates that RPL554 has the potential to be a significant new respiratory drug that could capture a significant market share. Verona Pharma is optimistic that we will find a suitable partner to assist us in taking the drug to market. In the meantime, the higher dose trial which was successfully completed in December 2010, and the other two trials which are expected to be underway shortly, are designed to take the drug through to the next development stage and add value to our licensing package.

Progress with the VRP700 project clinical trial has been slower than we had hoped due to delays in patient recruitment, however, the Company expects that the trial will be completed in the second quarter of 2011.

Verona Pharma is pleased to report that it has continued to maintain a low cash burn rate. Furthermore, the Company is very positive about its progress to date and looks forward to updating the market on further developments in due course.

Professor Clive P. Page  
Chairman

Professor Michael J. A. Walker  
Chief Executive Officer

**VERONA PHARMA PLC  
DIRECTORS' REPORT  
FOR THE YEAR ENDED 31 DECEMBER 2010**

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The Directors present their annual report together with the audited financial statements and auditors' report for the year ended 31 December 2010.

**Principal activity**

The Company was incorporated on 24 February 2005. On 18 September 2006 the Company successfully acquired all the shares of Rhinopharma Limited, a private company incorporated in Canada, and changed its name to Verona Pharma plc (the "Company" or the "Parent"). The Parent and Rhinopharma Limited are collectively referred to as the "Group".

The principal activity of the Group is research and development of new drugs for the treatment of chronic respiratory diseases, such as asthma, allergic rhinitis (hay fever), chronic obstructive pulmonary disease (COPD) and cough.

**Review of the business and future prospects**

The Chairman and Chief Executive Officer's joint statement describes the Group's activities and future prospects.

**Results and dividends**

The Group results for the year are set out on page 15. There was a loss for the year after taxation amounting to £1.89 million (2009: loss of £1.6 million). In view of the loss, the Directors cannot recommend the payment of a dividend.

**Key performance indicators ("KPIs")**

The key performance indicators for the Group are as follows:

- Development milestones – This operational KPI is used by the Board to monitor the performance of the Group's drug candidates through the planned clinical studies. Key development milestones achieved in 2010 include:
  1. Initiated the clinical trial of VRP700 in chronic cough patients at the University of Florence, Italy.
  2. Completed proof of concept experimental studies showing that RPL554 can be delivered via each of the main types of devices commonly available for inhalation therapy.
  3. Initiated the clinical trial of RPL554 at CHDR at Leiden University to evaluate the safety and bronchodilator effectiveness of higher doses of RPL554 in patients with mild asthma.
- Cash life – This financial KPI is used by the Board to monitor the Group's burn rate and the timing and requirement for future funding. The average monthly operating cash outflow in 2010 was £138,000 and the net cash position at 31 December 2010 was £2 million. Estimated cash life was greater than 12 months as at 31 December 2010 assuming no acquisition of new intellectual properties and based on current cost expectations and level of operations.

**VERONA PHARMA PLC**  
**DIRECTORS' REPORT**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

Following is a clinical development chart showing the stage of development of the Group's drug candidates as at 31 December 2010:

Stage Development Drug Candidate	Lead Identity	Cellular Assays	Animal Studies	Phase I Trials	Phase II Trials
RPL554					
Cough					
NAIPs					

The Group's strategy is to enter into a licensing or-partnership arrangement for the further development and commercialisation of its drug candidates at the end of clinical proof of concept. The timeline for entering into such arrangements is uncertain and depends on the Company's ability to find a suitable partner and successfully complete the due diligence and negotiation process.

**Principal risks and uncertainties**

There is a high level of risk in drug development. The Group's current drug development programmes are at an early stage. The RPL554 programme has completed Phase I and IIa human clinical trials. The Cough programme has initiated a proof of concept clinical trial in October 2010, the NAIPs programme is at the research and development stage, and these two drugs' safety and effectiveness have not yet been established. In addition, there are numerous regulatory approvals that must be obtained to test, manufacture and commercialise the proposed drug treatments. Even if such approvals are obtained, there is no certainty that the Group will be able to commercialise the drug treatments on commercially acceptable terms. The Group may require access to additional funding in the future. If it fails to obtain such funding the Group may need to delay or scale back some of its research and development programmes.

The following Directors held office during the year:

Michael Walker  
 Clive Page  
 Trevor Jones  
 Claire Poll  
 Stuart Bottomley  
 Patrick Humphrey

**Directors' interests**

The beneficial and non-beneficial interests in the Company's shares of the Directors and their families were as follows:

<b>Name</b>	<b>Held at 31 December 2010</b>	<b>Held at 31 December 2009</b>
Stuart Bottomley	10,700,000	10,700,000
Clive Page	5,773,928	5,773,928
Michael Walker*	6,055,691	5,705,691
Claire Poll	3,500,000	3,500,000
Trevor Jones	38,461	Nil
Patrick Humphrey	Nil	Nil

\* includes 350,000 ordinary shares held by Magic Bullets Enterprises Limited, a company controlled by Mr. Walker.

**VERONA PHARMA PLC**  
**DIRECTORS' REPORT**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

**Share options**

Share options held by directors at 31 December 2010 were as follows:

	<b>At beginning of period</b>	<b>Granted/ exercised or expired in Period</b>	<b>At end of period</b>	<b>Exercise price (£)</b>	<b>Exercisable at end of period</b>
M Walker	2,000,000	Nil	2,000,000	0.05	2,000,000
C Page	2,000,000	Nil	2,000,000	0.05	2,000,000
C Poll	2,000,000	Nil	2,000,000	0.05	2,000,000
T Jones	2,000,000	Nil	2,000,000	0.05	2,000,000
S Bottomley	2,000,000	Nil	2,000,000	0.05	2,000,000
P Humphrey	1,000,000	Nil	1,000,000	0.175	500,000
P Humphrey	Nil	500,000	500,000	0.09	Nil

**Report on Directors' remuneration and service contracts**

The Remuneration Committee, consisting of two Non-Executive Directors, and chaired by Prof. Trevor Jones, meets at least once a year (or more frequently as required). The Committee is responsible for the remuneration of the Executive Directors, including their benefits in kind, terms of employment and share options. The Executive Directors also consult the Committee in relation to the remuneration of senior employees and staff share option schemes. The Committee takes account of remuneration paid by other companies of a similar size and comparable industry sector in the UK. The remuneration of the Non-Executive Directors is determined by the Board as a whole, based on a review of current practices in other companies. The service contracts of the Directors for director services are subject to a three month termination period. There are separate contracts in place for the provision of consulting services by Prof. Michael Walker, Prof. Clive Page and Claire Poll. The contract for the provision of the services of Michael Walker is with Magic Bullets Enterprises Limited and the contract for the provision of the services of Clive Page is with Gryon Consulting Limited. Both of these contracts specify a termination period of twelve months. The consulting contract with Claire Poll is in her own name and specifies a termination period of three months. Details of the Directors' emoluments for the year for director and consulting services are as follows:

	<b>Fees/basic salary £</b>	<b>Employer's NI £</b>	<b>Share based payment £</b>	<b>2010 Total £</b>	<b>2009 Total £</b>
<b>Executive</b>					
Michael Walker	60,291	359	-	60,650	60,346
Claire Poll	35,292	-	-	35,292	35,000
<b>Non-Executive</b>					
Clive Page	40,292	970	-	41,262	40,932
Trevor Jones	13,292	970	-	14,262	14,147
Stuart Bottomley	13,292	970	-	14,262	55,175
Patrick Humphrey	14,050	970	38,824	53,844	17,457
	<b>176,509</b>	<b>4,239</b>	<b>38,824</b>	<b>219,572</b>	<b>223,057</b>

**VERONA PHARMA PLC  
DIRECTORS' REPORT  
FOR THE YEAR ENDED 31 DECEMBER 2010**

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**Pensions**

The Group does not operate a money purchase/defined benefit pension scheme for Directors or employees.

**Substantial share holders**

The Company has been notified, in accordance with Chapter 5 of the FSA's Disclosure and Transparency Rules, of the under noted interests in its ordinary shares as at 31 March 2011 of 3% shareholders and above:

	<b>Number of Ordinary shares</b>	<b>% of Share Capital</b>
William de Broe	23,635,300	9.85%
TD Waterhouse Nominees (Europe) Limited	14,663,162	6.11%
Fidelity	12,949,579	5.40%
Henderson New Star	11,483,037	4.79%
Stuart Bottomley	10,700,000	4.46%
Craig Burton	10,000,000	4.17%
Barclayshare Nominees Limited	8,802,241	3.67%
HSDL Nominees Limited	8,228,988	3.43%

**Supplier payment policy**

The Company's policy is that payments to suppliers are made in accordance with those terms and conditions agreed between the Company and its suppliers, providing that all trading terms and conditions have been complied with.

**Political and charitable contributions**

There were no political or charitable contributions made by the Company during the year ended 31 December 2010.

**Statement of Directors' responsibilities**

The Directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and International Financial Reporting Standards ("IFRSs").

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

**VERONA PHARMA PLC  
DIRECTORS' REPORT  
FOR THE YEAR ENDED 31 DECEMBER 2010**

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The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

So far as the Directors are aware:

1. there is no relevant audit information of which the Company's auditors are unaware; and
2. the Directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

**Auditors**

In accordance with Section 489 of the Companies Act 2006, a resolution proposing that UHY Hacker Young be re-appointed as auditors of the Company and that the Directors be authorised to fix their remuneration will be proposed at the Annual General Meeting.

**Annual General Meeting**

Accompanying this report is the notice of Annual General Meeting of the Company which sets out the resolutions relating to the business which the Company proposes to conduct at the meeting. The meeting will be held at 11:30 am on 3 June 2011 at One America Square, Crosswall, London EC3N 2SG.

By order of the Board.

**Stuart Bottomley  
Director**

**Dated 14 April 2011**

**VERONA PHARMA PLC  
CORPORATE GOVERNANCE REPORT  
FOR THE YEAR ENDED 31 DECEMBER 2010**

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**Board of Directors**

The Board meets at regular intervals, normally no less than four times a year. The Board is responsible for approving company policy and strategy. The Board consists of six members, with Prof. Michael Walker and Claire Poll as executive directors and Prof. Clive Page, Prof. Trevor Jones, Stuart Bottomley and Prof. Patrick Humphrey as non-executive directors. The Chairman of the Board is Prof. Clive Page and the Company's business is run by Prof. Michael Walker (CEO), Danny Lowe (CFO) and Dr. Lui Franciosi (COO). Prof. Trevor Jones, Stuart Bottomley and Claire Poll are members of the Audit Committee, Prof. Clive Page, Prof. Trevor Jones and Stuart Bottomley are members of the Nomination and Corporate Governance Committee and Prof. Trevor Jones and Stuart Bottomley are members of the Remuneration Committee.

**Internal Control**

The Board is responsible for maintaining a strong system of internal control to safeguard shareholders' investment and the Group's assets and to review its effectiveness. The system of internal control is designed to provide reasonable, but not absolute, assurance against material misstatement or loss and to mitigate operational risks.

An Audit Committee has been established, chaired by Stuart Bottomley, which will meet at least twice a year and is responsible for ensuring that the financial performance of the Group is properly monitored and reported on, as well as meeting the auditors and reviewing any reports prepared by auditors.

At the present time, the size of the Group does not justify an internal audit function. The key features of the Group's system of internal control are as follows:

- the Company is headed by an effective Board, which leads and controls the Group;
- there is a clear division of responsibilities in running the Board and running the Group's business;
- the Board includes a balance of executive and non-executive directors; and
- the Board receives and reviews on a timely basis financial and operating information appropriate to being able to discharge its duties.

The Company has also established a Remuneration Committee, chaired by Prof. Trevor Jones, and a Nomination and Corporate Governance Committee, chaired by Prof. Clive Page. Both of these Committees meet at least once a year. The Nomination and Corporate Governance Committee is responsible for overseeing the Company's corporate governance capability, including evaluating the structure, size and composition of the Board and succession planning of Board members and senior management.

**Going Concern**

The Board has a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. The Board will continue to monitor the progress of the development of its programmes and the financial position in order to ensure that the Group continues to have sufficient funding to continue in business. For this reason, the Board continues to adopt the going concern basis in preparing the financial statements.

**Communication with shareholders**

The Board has a strong commitment to the maintenance of good investor relations with its shareholders, and the Directors will make themselves available to answer questions at the Annual General Meeting. Shareholders are encouraged to contact the Company via email or telephone if they have any questions.

**INDEPENDENT AUDITORS' REPORT  
TO THE SHAREHOLDERS OF VERONA PHARMA PLC  
FOR THE YEAR ENDED 31 DECEMBER 2010**

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We have audited the financial statements of Verona Pharma plc for the year ended 31 December 2010 which comprise the Group Statement of Comprehensive Income, the Group and Parent Company Statements of Financial Position, the Group and Parent Company Statements of Cash Flows, the Group and Parent Company Statement of Changes in Equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

**Respective responsibilities of directors and auditors**

As explained more fully in the Statement of Directors' Responsibility set out on pages 10 - 11, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

**Scope of the audit of the financial statements**

A description of the scope of an audit of financial statements is provided on the APB's website at [www.frc.org.uk/apb/scope/private.cfm](http://www.frc.org.uk/apb/scope/private.cfm).

**Opinion on financial statements**

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2010 and of the Group's loss for the year then ended;
- the financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

**Opinion on other matters prescribed by the Companies Act 2006**

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

**INDEPENDENT AUDITORS' REPORT  
TO THE SHAREHOLDERS OF VERONA PHARMA PLC  
FOR THE YEAR ENDED 31 DECEMBER 2010**

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**Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

**Guy Swarbreck (Senior Statutory Auditor)  
for and on behalf of UHY Hacker Young, Statutory Auditor**

14 April 2011

Quadrant House  
4 Thomas More Square  
London E1W 1YW

**VERONA PHARMA PLC**  
**GROUP STATEMENT OF COMPREHENSIVE INCOME**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

	Notes	Year ended 31 December 2010 £	Year ended 31 December 2009 £
Revenue		-	-
Cost of sales		-	-
<b>Gross profit</b>		-	-
Research and development		(1,150,904)	(944,903)
Administration expenses	18	(745,256)	(660,872)
<b>Operating loss</b>	4	(1,896,160)	(1,605,775)
Finance revenue	6	7,898	7,243
<b>Loss before taxation</b>		(1,888,262)	(1,598,532)
Taxation	7	(4,532)	-
<b>Loss for the year</b>		(1,892,794)	(1,598,532)
Other comprehensive income		-	-
<b>Total comprehensive loss for the year</b>		(1,892,794)	(1,598,532)
Loss per ordinary share – basic and diluted	2	(0.79)p	(0.74)p

There are no recognised gains or losses other than those passing through the profit and loss account.

**VERONA PHARMA PLC**  
**GROUP STATEMENT OF FINANCIAL POSITION**  
**AS AT 31 DECEMBER 2010**

	Notes	31 December 2010 £	31 December 2009 £
<b>ASSETS</b>			
<b>Non current assets</b>			
Tangible assets	12	15,513	18,004
Intangible assets	13	100,452	70,570
Goodwill	14	1,469,112	1,469,112
		<u>1,585,077</u>	<u>1,557,686</u>
<b>Current assets</b>			
Trade and other receivables	9	68,808	381,259
Cash and cash equivalents	10	2,003,012	2,829,981
		<u>2,071,820</u>	<u>3,211,240</u>
<b>Total assets</b>		<u><u>3,656,897</u></u>	<u><u>4,768,926</u></u>
<b>EQUITY AND LIABILITIES</b>			
<b>Capital and reserves attributable to equity holders</b>			
Called up share capital	15	239,906	232,378
Option reserves		359,008	356,210
Share premium account		9,373,526	8,561,493
Retained losses		(6,521,891)	(4,668,057)
<b>Total equity</b>		<u>3,450,549</u>	<u>4,482,024</u>
<b>Current liabilities</b>			
Trade and other payables	11	206,348	286,902
<b>Total liabilities</b>		<u>206,348</u>	<u>286,902</u>
<b>Total equity and liabilities</b>		<u><u>3,656,897</u></u>	<u><u>4,768,926</u></u>

The financial statements were approved by the Board on 14 April 2011.

**Stuart Bottomley**  
**Director**

**Company Number: 05375156**

**VERONA PHARMA PLC**  
**COMPANY STATEMENT OF FINANCIAL POSITION**  
**AS AT 31 DECEMBER 2010**

	Notes	31 December 2010 £	31 December 2009 £
<b>ASSETS</b>			
<b>Non current assets</b>			
Tangible assets	12	15,513	18,004
Intangible assets	13	100,452	70,570
Goodwill	14	1,453,569	1,453,569
Investment	8	1	1
		1,569,535	1,542,144
<b>Current assets</b>			
Trade and other receivables	9	193,103	462,224
Cash and cash equivalents	10	1,995,538	2,826,869
		2,188,641	3,289,093
<b>Total assets</b>		3,758,176	4,831,237
<b>EQUITY AND LIABILITIES</b>			
<b>Capital and reserves attributable to equity holders</b>			
Called up share capital	15	239,906	232,378
Option reserves		359,008	356,210
Share premium account		9,373,526	8,561,493
Retained losses		(6,420,369)	(4,605,526)
<b>Total equity</b>		3,552,071	4,544,555
<b>Current liabilities</b>			
Trade and other payables	11	206,105	286,682
<b>Total liabilities</b>		206,105	286,682
<b>Total equity and liabilities</b>		3,758,176	4,831,237

The financial statements were approved by the Board on 14 April 2011.

**Stuart Bottomley**  
**Director**

**Company Number: 05375156**

**VERONA PHARMA PLC**  
**GROUP STATEMENT OF CASH FLOWS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

	Notes	Year ended 31 December 2010 £	Year ended 31 December 2009 £
<b>Net cash outflow from operating activities</b>	16	(1,655,540)	(1,620,382)
<b>Cash outflow from taxation</b>		(4,532)	-
<b>Cash flow from investing activities</b>			
Interest received		7,898	9,879
Purchase of tangible assets		(7,081)	(16,593)
Purchase of intangible assets		(41,640)	(8,070)
<b>Net cash (outflow) / inflow from investing activities</b>		(40,823)	(14,784)
<b>Cash flow from financing activities</b>			
Deferred financing cost		54,365	(54,365)
Net proceeds from issue of shares		819,561	2,064,630
<b>Net cash inflow from financing activities</b>		873,926	2,010,265
<b>Net (decrease) / increase in cash and cash equivalents</b>		(826,969)	375,099
Cash and cash equivalents at the beginning of the year		2,829,981	2,454,882
<b>Cash and cash equivalents at the end of the year</b>	10	2,003,012	2,829,981

**VERONA PHARMA PLC**  
**COMPANY STATEMENT OF CASH FLOWS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

	Notes	Year ended 31 December 2010 £	Year ended 31 December 2009 £
<b>Net cash outflow from operating activities</b>	16	(1,620,814)	(1,611,387)
<b>Cash outflow from taxation</b>		-	-
<b>Cash flow from investing activities</b>			
Interest received		7,898	9,879
Purchase of tangible assets		(7,081)	(16,593)
Purchase of intangible assets		(41,640)	(8,070)
Advance to subsidiary		(43,620)	10,726
<b>Net cash (outflow) / inflow from investing activities</b>		(84,443)	(4,058)
<b>Cash flow from financing activities</b>			
Deferred financing cost		54,365	(54,365)
Net proceeds from issue of shares		819,561	2,064,630
<b>Net cash inflow from financing activities</b>		873,926	2,010,265
<b>Net (decrease) / increase in cash and cash equivalents</b>		(831,331)	394,820
Cash and cash equivalents at the beginning of the year		2,826,869	2,432,049
<b>Cash and cash equivalents at the end of the year</b>	10	1,995,538	2,826,869

**VERONA PHARMA PLC**  
**GROUP STATEMENT OF CHANGES IN EQUITY**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

	Share capital £	Share premium £	Option reserve £	Retained earnings £	Total 2009 £
<b>Balance at 1 January 2009</b>	215,258	6,504,783	343,001	(3,069,525)	3,993,517
Loss for the year	-	-	-	(1,598,532)	(1,598,532)
Other comprehensive income	-	-	-	-	-
Total comprehensive loss for the year	-	-	-	(1,598,532)	(1,598,532)
Issue of shares	17,120	2,188,680	-	-	2,205,800
Issue costs	-	(131,970)	-	-	(131,970)
Share based payment	-	-	13,209	-	13,209
<b>Balance at 31 December 2009</b>	<b>232,378</b>	<b>8,561,493</b>	<b>356,210</b>	<b>(4,668,057)</b>	<b>4,482,024</b>
<b>Balance at 1 January 2010</b>	232,378	8,561,493	356,210	(4,668,057)	4,482,024
Loss for the year	-	-	-	(1,892,794)	(1,892,794)
Other comprehensive income	-	-	-	-	-
Total comprehensive loss for the year	-	-	-	(1,892,794)	(1,892,794)
Issue of shares	7,528	866,798	-	-	874,326
Issue costs	-	(54,765)	-	-	(54,765)
Share based payment	-	-	41,758	-	41,758
Transfer of previously expensed share based payment charge upon exercise of options	-	-	(38,960)	38,960	-
<b>Balance at 31 December 2010</b>	<b>239,906</b>	<b>9,373,526</b>	<b>359,008</b>	<b>(6,521,891)</b>	<b>3,450,549</b>

**VERONA PHARMA PLC**  
**COMPANY STATEMENT OF CHANGES IN EQUITY**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

	Share capital	Share premium	Option reserve	Retained earnings	Total
	£	£	£	£	£
<b>Balance at 1 January 2009</b>	215,258	6,504,783	343,001	(3,016,107)	4,046,935
Loss for the year	-	-	-	(1,589,419)	(1,589,419)
Other comprehensive income	-	-	-	-	-
Total comprehensive loss for the year	-	-	-	(1,589,419)	(1,589,419)
Issue of shares	17,120	2,188,680	-	-	2,205,800
Issue costs	-	(131,970)	-	-	(131,970)
Share based payment	-	-	13,209	-	13,209
<b>Balance at 31 December 2009</b>	<b>232,378</b>	<b>8,561,493</b>	<b>356,210</b>	<b>(4,605,526)</b>	<b>4,544,555</b>
<b>Balance at 1 January 2010</b>	232,378	8,561,493	356,210	(4,605,526)	4,544,555
Loss for the year	-	-	-	(1,853,803)	(1,853,803)
Other comprehensive income	-	-	-	-	-
Comprehensive loss for the year	-	-	-	(1,853,803)	(1,853,803)
Issue of shares	7,528	866,798	-	-	874,326
Issue costs	-	(54,765)	-	-	(54,765)
Share based payment	-	-	41,758	-	41,758
Transfer of previously expensed share based payment charge upon exercise of options	-	-	(38,960)	38,960	-
<b>Balance at 31 December 2010</b>	<b>239,906</b>	<b>9,373,526</b>	<b>359,008</b>	<b>(6,420,369)</b>	<b>3,552,071</b>

**VERONA PHARMA PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

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**1. Accounting policies**

A summary of the principal accounting policies, all of which have been applied consistently throughout the year, is set out below.

**1.1. Basis of preparation**

The financial statements have been prepared using the historical cost convention. In addition, the financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRSs”).

**1.2. Going concern**

During the year ended 31 December 2010 the Group made a loss of £1,892,794 (2009: a loss of £1,598,532). At the balance sheet date the Group had net assets of £3,450,549 (2009: £4,482,024) of which £2,003,012 was cash at bank. The operation of the Group is currently being financed from funds which the Company raised from private and public placings.

The Group's capital management policy is to only raise sufficient funding to finance the Group's near term research objectives. Upon completion of objectives, or identification of new projects, the Directors will seek new funding to finance the next stage of the research programme or the new projects. The Directors believe that the Group has sufficient funds for it to comply with its foreseeable commitments and, accordingly, are satisfied that the going concern basis remains appropriate for the preparation of these financial statements. The Group will need additional funding to support the next stage of its research programme.

**1.3. Basis of consolidation**

These group financial statements include the accounts of Verona Pharma plc and its wholly-owned subsidiary Rhinopharma Limited. The purchase method of accounting is used to account for the acquisition of Rhinopharma Limited.

The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. Goodwill arising on acquisitions is capitalised and subject to an impairment review, both annually and when there are indications that the carrying value may not be recoverable.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated.

Rhinopharma Limited adopts the same accounting policies as the Company.

**VERONA PHARMA PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

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**1.4. Foreign currency translation**

Items included in the Group's financial statements are measured using the currency of the primary economic environment in which the Group operates ("the functional currency"). The financial statements are presented in pounds sterling ("£"), which is the functional and presentational currency of the Company and the presentational currency of the Group.

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange ruling at the balance sheet date and the gains or losses on translation are included in the profit and loss account. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the original transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

The assets and liabilities of foreign operations are translated into sterling at the rate of exchange ruling at the balance sheet date. Income and expenses are translated at weighted average exchange rates for the period. The resulting exchange differences are recognised in other comprehensive income.

**1.5. Cash and cash equivalents**

The Company considers all highly liquid investments, with a maturity of 90 days or less to be cash equivalents, carried at the lower of cost or market value.

**1.6. Deferred taxation**

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and expected to apply when the related deferred tax is realised or the deferred liability is settled.

Deferred tax assets are recognised to the extent that it is probable that the future taxable profit will be available against which the temporary differences can be utilised.

**1.7. Research and development costs**

Research costs net of grants received are charged as an expense in the period in which they are incurred. Development costs are charged as an expense in the period incurred unless the Company believes a development project meets generally accepted accounting criteria for capitalisation and amortisation. At 31 December 2010 no development costs have been capitalised.

**1.8. Tangible assets**

Tangible assets are recorded at cost less accumulated depreciation. Depreciation is provided on a straight-line basis over the expected useful lives as follows:

Computer hardware	3 years
Computer software	2 years
Office furniture and equipment	5 years

**VERONA PHARMA PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

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**1.9. Intangible assets**

Patent costs associated with the preparation, filing, and obtaining of patents are capitalised and amortised on a straight-line basis over the estimated useful lives of the patents of ten years.

**1.10. Impairment of intellectual properties**

The carrying value of patents and goodwill do not necessarily reflect present or future values and the ultimate amount recoverable will be dependent upon the successful development and commercialisation of products based on these intellectual properties. Management reviews the intellectual properties for impairment whenever events or changes in circumstances indicate that full recoverability is questionable, and such review is performed on at least an annual basis. Management measures any potential impairment by comparing the carrying value to the discounted amounts of expected future cash flows.

**1.11. Share based payments**

The Company made share-based payments to certain directors and advisers by way of issue of share options. The fair value of these payments is calculated by the Company using the Black-Scholes option pricing model. The expense is recognised on a straight line basis over the period from the date of award to the date of vesting, based on the Company's best estimate of shares that will eventually vest.

**1.12. Critical accounting judgements and estimates**

The preparation of financial statements in conformity with International Financial Reporting Standards requires the use of accounting estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates. IFRSs also require management to exercise its judgement in the process of applying the Group's accounting policies.

The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are as follows:

(a) Impairment of intangible assets

Determining whether an intangible asset is impaired requires an estimation of whether there are any indications that its carrying value is not recoverable.

At each reporting date, the Company reviews the carrying value of its tangible and intangible assets to determine whether there is any indication that those assets have been impaired. If such an indication exists, the recoverable amount of the asset, being the higher of the asset's fair value less costs to sell and value in use, is compared to the asset's carrying value. Any excess of the asset's carrying value over its recoverable amount is expensed to the income statement.

(b) Valuation of goodwill

Management values goodwill after taking into account the results of research efforts and estimated future sales and costs. If the assumed factors vary from actual occurrence, this will impact on the amount of the asset which should be carried on the balance sheet. Further details of the Group's assessment of the carrying value of goodwill are disclosed in note 14.

**VERONA PHARMA PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

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(c) Share based payments

The Group records charges for share based payments. For option based share based payments management estimate certain factors used in the option pricing model, including volatility, exercise date of options and number of options likely to be exercised. If these estimates vary from actual occurrence, this will impact on the value of the equity carried in the reserves. Further details of the Group's estimation of share based payments are disclosed in note 18.

**1.13. New standards and interpretations**

The following new standards and amendments to standards are mandatory for the first time for financial periods commencing on or after 1 January 2010:

Amendments to IFRS 2 – Share based payment

The amendments clarify the scope of IFRS 2, as well as the accounting for Group cash-settled share-based payment transactions in the separate financial statements of an entity receiving the goods or services when another Group entity or shareholder has the obligation to settle the award. This standard does not have any impact on the results or net assets of the Group.

Amendments to IAS 7 – Statement of Cash Flows

The amendments to IAS 7 resulted from the Improvements to IFRSs issued in 2009 and specify that only expenditures that result in a recognised asset in the statement of financial position can be classified as investing activities in the statement of cash flows. This amendment has not affected the presentation of cash outflows in the Group or Company Statement of Cash Flows.

Amendments to IFRS 8 – Operating Segments

IFRS 8 has been amended as part of the Improvement to IFRSs issued in 2009 with regard to disclosures of segment assets. This amendment has not impacted on the information disclosed in note 3 to these financial statements.

Amendments to IAS 36 – Impairment of Assets

As part of the Improvement to IFRSs issued in 2009, IAS 36 has been amended in relation to units of accounting for goodwill impairment testing using segments under IFRS 8 before aggregation. The amendment to this standard does not have any impact on the Group's approach to its impairment review of goodwill or the results or net assets of the Group.

**1.14. New standards and interpretations not applied during the year**

During the year, the IASB and IFRIC have issued new standards, amendments and interpretations with an effective date after the date of these financial statements. Of these, only the following are expected to be relevant to the Group:

<b>Standard</b>	<b>Subject</b>	<b>Effective from</b>
IFRS 9	Financial Instruments – Classification and Measurement	1 January 2013
IAS 1	Presentation of Financial Statements – Amendments resulting from April 2010 Annual Improvements to IFRSs	1 January 2011
IAS 24	Related Party Disclosures – Revised definition of related parties	1 January 2011
IAS 32	Financial Instruments: Presentation – Amendments relating to the classification of rights issues	1 February 2010
IFRIC19	Extinguishing Financial Liabilities with Equity Instruments	1 July 2010

The Directors do not anticipate that the adoption of these standards will have a material impact on the Group's financial statements in the period of initial application.

**VERONA PHARMA PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

**2. Earnings per share**

Basic loss per share of (0.79p) (2009: loss of 0.74p) for the Group is calculated by dividing the loss for the period by the weighted average number of ordinary shares in issue of 238,761,092 (2009: 215,540,798).

Diluted loss per share for the current period has not been presented since the Company's share options are anti-dilutive.

**3. Segmental information**

The Group has determined that its operating segments be reported on a product pipeline basis as this best reflects the Group's activity cycle. Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker has been identified as the Board of Directors.

The Group's product pipeline is dedicated to the research, discovery and development of new therapeutic drugs for the treatment of chronic respiratory diseases. At present there are three products: RPL554, NAIP and Cough. RPL554 is in the clinical phase, having successfully completed a Phase I and IIa trial, NAIPs and Cough are in the basic research phase.

Segment information by operating segment is as follows:

	<b>Clinical 2010 £</b>	<b>Clinical 2009 £</b>	<b>Basic research 2010 £</b>	<b>Basic research 2009 £</b>
<b>Income statement information</b>				
Research and development	(962,453)	(817,815)	(188,452)	(127,088)
Amortisation of patent	(8,848)	(7,311)	(2,909)	(2,186)
Segment loss	<u>(971,301)</u>	<u>(825,126)</u>	<u>(191,361)</u>	<u>(129,274)</u>
<b>Balance sheet information</b>				
Patents	70,609	51,843	29,843	18,727
Goodwill	1,469,112	1,469,112	-	-
Segment assets	<u>1,539,721</u>	<u>1,520,955</u>	<u>29,843</u>	<u>18,727</u>

**VERONA PHARMA PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

**3. Segmental information (continued)**

	<b>2010</b>	<b>2009</b>
	<b>£</b>	<b>£</b>
<b>Reconciliation of segment result</b>		
Loss per reportable segment – Clinical	(971,301)	(825,126)
Loss per segment – Basic research	(191,361)	(129,274)
Total loss for reportable segments	<u>(1,162,662)</u>	<u>(954,400)</u>
Amortisation of non-segment assets	(9,572)	(12,677)
Unallocated administration expense	<u>(723,926)</u>	<u>(638,698)</u>
Group operating loss	<u>(1,896,160)</u>	<u>(1,605,775)</u>

At the end of the financial year, the Group was still in the early development stage and therefore had no turnover in either 2009 or 2010.

**Reconciliation of segment assets**

Assets per reportable segment – Clinical	1,539,721	1,520,955
Assets per reportable segment – Basic research	29,843	18,727
Total assets for reportable segments	<u>1,569,564</u>	<u>1,539,682</u>
Unallocated non-current assets	15,513	72,369
Unallocated current assets	<u>2,071,820</u>	<u>3,156,875</u>
Group total assets	<u>3,656,897</u>	<u>4,768,926</u>

**Segment information by geographical segment for 2010 is as follows:**

<b>Geographical segment (Group)</b>	<b>United Kingdom</b>	<b>Canada</b>	<b>Total</b>
	<b>£</b>	<b>£</b>	<b>£</b>
Research and development	(1,131,349)	(19,555)	(1,150,904)
Administration expenses	(730,352)	(14,904)	(745,256)
Finance revenue	7,898	-	7,898
Loss before taxation	<u>(1,853,803)</u>	<u>(34,459)</u>	<u>(1,888,262)</u>
Tangible assets	15,513	-	15,513
Intangible assets	100,452	-	100,452
Trade and other receivables	67,730	1,078	68,808
Cash and cash equivalents	1,995,538	7,474	2,003,012
Goodwill	1,469,112	-	1,469,112
Trade and other payables	<u>(206,105)</u>	<u>(243)</u>	<u>(206,348)</u>
Net assets	<u>3,442,240</u>	<u>8,309</u>	<u>3,450,549</u>

**VERONA PHARMA PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

**3. Segmental information (continued)**

Segment information by geographical segment for 2009 is as follows:

<b>Geographical segment (Group)</b>	<b>United Kingdom</b>	<b>Canada</b>	<b>Total</b>
	<b>£</b>	<b>£</b>	<b>£</b>
Research and development	(944,903)	-	(944,903)
Administration expenses	(651,759)	(9,113)	(660,872)
Finance revenue	7,243	-	7,243
Loss before taxation	<u>(1,589,419)</u>	<u>(9,113)</u>	<u>(1,598,532)</u>
Tangible assets	18,004	-	18,004
Intangible assets	70,570	-	70,570
Trade and other receivables	380,471	788	381,259
Cash and cash equivalents	2,826,869	3,112	2,829,981
Goodwill	1,469,112	-	1,469,112
Trade and other payables	<u>(286,682)</u>	<u>(220)</u>	<u>(286,902)</u>
Net assets	<u>4,478,344</u>	<u>3,680</u>	<u>4,482,024</u>

**4. Operating loss**

	<b>2010</b>	<b>2009</b>
	<b>£</b>	<b>£</b>
<b>Group</b>		
This is stated after charging:		
Foreign exchange loss	<u>13,586</u>	<u>6,258</u>
Auditors' remuneration for audit services		
- Group and Company audit	15,000	15,000
Auditors' remuneration for non audit services		
- Taxation consultancy	<u>3,400</u>	<u>3,000</u>
Total auditors' remuneration	<u>18,400</u>	<u>18,000</u>

**VERONA PHARMA PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

<b>5. Employee costs</b>	<b>2010</b>	<b>2009</b>
	<b>£</b>	<b>£</b>
<b>Group</b>		
Wages and salaries	199,010	181,878
Social security costs	12,551	22,854
	<u>211,561</u>	<u>204,732</u>

Remuneration of Directors is separately disclosed in the Report on Directors' remuneration.

	<b>2010</b>	<b>2009</b>
	<b>Number</b>	<b>Number</b>
<b>Group</b>		
The average number of employees including directors during the year was:	<u>15</u>	<u>16</u>

<b>6. Finance revenue</b>	<b>2010</b>	<b>2009</b>
	<b>£</b>	<b>£</b>
<b>Group</b>		
Bank interest	<u>7,898</u>	<u>7,243</u>

**7. Taxation**

**Analysis of tax charge for the year**

Current tax:

UK corporation tax at 28% (2009: 28%)

Foreign taxation

-	-
<u>4,532</u>	<u>-</u>

**Current tax charge**

<u>4,532</u>	<u>-</u>
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**Factors affecting the tax charge for the year**

Loss on ordinary activities before taxation

<u>(1,888,262)</u>	<u>(1,598,532)</u>
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Multiplied by standard rate of corporation tax of 28.00% (28.00%)

<u>(528,713)</u>	<u>(447,589)</u>
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Effects of:

Non deductible expenses

Timing differences not recognised

Tax losses carried forward

Prior year adjustment

11,692	3,779
-	(102)
517,021	443,912
<u>4,532</u>	<u>-</u>

**Current tax charge**

<u>4,532</u>	<u>-</u>
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**VERONA PHARMA PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

**7. Taxation (continued)**

**Factors that may affect future tax charges**

At the balance sheet date, the Group has unused United Kingdom tax losses available for offset against suitable future profits in the United Kingdom. A deferred tax asset has not been recognised in respect of such losses due to uncertainty of future profit streams. The contingent deferred tax asset at 26% is estimated to be £1,765,000.

**8. Subsidiary entities**

The Company currently has one wholly owned subsidiary, Rhinopharma Limited. Rhinopharma Limited is incorporated under the laws of the Province of British Columbia, Canada. Rhinopharma Limited was a drug discovery and development company focused on developing proprietary drugs to treat allergic rhinitis and other respiratory diseases prior to its acquisition by the Company on 18 September 2006.

<b>9. Trade and other receivables</b>	<b>2010</b>	<b>2009</b>
	<b>£</b>	<b>£</b>
<b>Group</b>		
Other receivables	27,967	27,082
Deferred financing costs	-	54,365
Share subscription receivable	-	243,750
Prepayments and accrued income	40,841	56,062
	<u>68,808</u>	<u>381,259</u>
<b>Company</b>		
Other receivables	27,712	26,982
Deferred financing costs	-	54,365
Share subscription receivable	-	243,750
Prepayments and accrued income	40,018	55,374
Amounts due from subsidiary company	125,373	81,753
	<u>193,103</u>	<u>462,224</u>
<b>10. Cash and cash equivalents</b>		
<b>Group</b>		
Cash at bank and in hand	2,003,012	2,829,981
Cash equivalents	-	-
	<u>2,003,012</u>	<u>2,829,981</u>
<b>Company</b>		
Cash at bank and in hand	1,995,538	2,826,869
Cash equivalents	-	-
	<u>1,995,538</u>	<u>2,826,869</u>

**VERONA PHARMA PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

**11. Trade and other payables**

	<b>2010</b>	<b>2009</b>
	<b>£</b>	<b>£</b>
<b>Group</b>		
Trade payables	141,553	117,363
Other payables	6,376	2,446
Share subscription received	-	105,100
Accruals	58,419	61,993
	<u>206,348</u>	<u>286,902</u>

**Company**

Trade payables	141,310	117,143
Other payables	6,376	2,446
Share subscription received	-	105,100
Accruals	58,419	61,993
	<u>206,105</u>	<u>286,682</u>

**12. Tangible assets**

**Group and Company**

	<b>Computer hardware</b>	<b>Computer software</b>	<b>Office equipment</b>	<b>Total</b>
	<b>£</b>	<b>£</b>	<b>£</b>	<b>£</b>
<b>Cost</b>				
At 31 December 2008	25,362	5,288	1,341	31,991
Additions	9,718	6,875	-	16,593
At 31 December 2009	<u>35,080</u>	<u>12,163</u>	<u>1,341</u>	<u>48,584</u>
<b>Depreciation</b>				
At 31 December 2008	13,284	4,180	439	17,903
Charge for the year	9,117	3,292	268	12,677
At 31 December 2009	<u>22,401</u>	<u>7,472</u>	<u>707</u>	<u>30,580</u>
<b>Net book value</b>				
At 31 December 2009	<u>12,679</u>	<u>4,691</u>	<u>634</u>	<u>18,004</u>
<b>Net book value</b>				
At 31 December 2008	<u>12,078</u>	<u>1,108</u>	<u>902</u>	<u>14,088</u>

**VERONA PHARMA PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

**12. Tangible assets (continued)**

<b>Group and Company</b>	<b>Computer hardware</b>	<b>Computer software</b>	<b>Office equipment</b>	<b>Total</b>
	<b>£</b>	<b>£</b>	<b>£</b>	<b>£</b>
<b>Cost</b>				
At 31 December 2009	35,080	12,163	1,341	48,584
Additions	5,639	1,442	-	7,081
At 31 December 2010	<u>40,719</u>	<u>13,605</u>	<u>1,341</u>	<u>55,665</u>
<b>Depreciation</b>				
At 31 December 2009	22,401	7,472	707	30,580
Charge for the year	6,947	2,357	268	9,572
At 31 December 2010	<u>29,348</u>	<u>9,829</u>	<u>975</u>	<u>40,152</u>
<b>Net book value</b>				
At 31 December 2010	<u>11,371</u>	<u>3,776</u>	<u>366</u>	<u>15,513</u>
<b>Net book value</b>				
At 31 December 2009	<u>12,679</u>	<u>4,691</u>	<u>634</u>	<u>18,004</u>

**13. Intangible assets**

<b>Group and Company</b>	<b>Patents</b>
	<b>£</b>
<b>Cost</b>	
At 31 December 2008	88,621
Additions	8,071
At 31 December 2009	<u>96,692</u>
<b>Amortisation</b>	
At 31 December 2008	16,625
Charge for the year	9,497
Impairment during the year	-
At 31 December 2009	<u>26,122</u>
<b>Net book value</b>	
At 31 December 2009	<u>70,570</u>
<b>Net book value</b>	
At 31 December 2008	<u>71,996</u>

**VERONA PHARMA PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

**13. Intangible assets (continued)**

<b>Group and Company</b>	<b>Patents</b>
	<b>£</b>
<b>Cost</b>	
At 31 December 2009	96,692
Additions	41,640
At 31 December 2010	<u>138,332</u>
<b>Amortisation</b>	
At 31 December 2009	26,122
Charge for the year	11,758
Impairment during the year	-
At 31 December 2010	<u>37,880</u>
<b>Net book value</b>	
At 31 December 2010	<u>100,452</u>
<b>Net book value</b>	
At 31 December 2009	<u>70,570</u>

	<b>2010</b>	<b>2009</b>
	<b>£</b>	<b>£</b>
<b>14. Goodwill</b>		
<b>Group</b>		
Goodwill	<u>1,469,112</u>	<u>1,469,112</u>
<b>Company</b>		
Goodwill	<u>1,453,569</u>	<u>1,453,569</u>

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired in connection with the acquisition of Rhinopharma Limited in September 2006. Goodwill is capitalised and allocated to appropriate research projects, in Verona's case RPL554. They are deemed to have indefinite useful life and so are not amortised. Annual impairment test of the research projects ('RPs') is performed by comparing the expected recoverable amount of the RPs to the carrying amount of the RPs.

The recoverable amount of the RPs is based on value in use calculations. The use of this method requires the estimation of risk-adjusted future cash flows discounted using suitable pre-tax discount rate, and a pre-tax discount rate of 4.0% has been used. The key assumptions on which the cash flow projections were based include market size, market penetration, pre-tax discount rate, probability, estimated revenue and royalties. Sources of information for these key assumptions have been determined by using a combination of external market information, industry forecasts and management's expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

**VERONA PHARMA PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

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**14. Goodwill (continued)**

Management has performed sensitivity analysis on the key assumptions including doubling the discount rate to 8% and reducing the other key assumptions by 50% to 75%. However, the changes would not cause the carrying amount to exceed their recoverable amount. Hence, the Company concluded that no impairment was required as at 31 December 2010.

**15. Called up share capital**

The movements in the share capital are summarised below:

	<b>Number of shares</b>	<b>£</b>
Authorised:		
10,000,000,000 Ordinary shares of 0.1p each	10,000,000,000	10,000,000
Allotted, called up and fully paid:		
<b>Ordinary shares as at 1 January 2009</b>	215,258,325	215,258
Ordinary shares issued during the year	17,119,953	17,120
<b>As at 31 December 2009</b>	232,378,278	232,378
Ordinary shares issued from share placement	6,368,761	6,369
Ordinary shares issued from exercise of options	1,159,666	1,159
<b>As at 31 December 2010</b>	239,906,705	239,906

The following issues of new shares took place during the year ended 31 December 2010:

As part of a share placement between 8 and 20 January 2010 6,368,761 new Ordinary shares of 0.1p each in the Company were issued fully paid for 13 pence per share.

As part of an exercise of share options on 11 November 2010 1,159,666 new ordinary shares of 0.1p each in the Company were issued fully paid for 4 pence per share.

**VERONA PHARMA PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

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**16. Net cash outflow from operating activities**

	<b>2010</b>	<b>2009</b>
	<b>£</b>	<b>£</b>
<b>Group</b>		
Operating loss	(1,896,160)	(1,605,775)
Cost of issuing share options	41,758	13,209
Decrease/ (increase) in trade and other receivables	258,086	(258,698)
(Decrease)/ increase in trade and other payables	(80,554)	202,709
Non-cash expense	-	6,000
Depreciation of tangible assets	9,572	12,676
Amortisation of intangible assets	11,758	9,497
	<hr/>	<hr/>
Net cash outflow from operating activities	<u>(1,655,540)</u>	<u>(1,620,382)</u>

**Company**

Operating loss	(1,861,701)	(1,596,662)
Cost of issuing share options	41,758	13,209
Decrease/ (increase) in trade and other receivables	258,376	(258,755)
(Decrease)/ increase in trade and other payables	(80,577)	202,648
Non-cash expense	-	6,000
Depreciation of tangible assets	9,572	12,676
Amortisation of intangible assets	11,758	9,497
	<hr/>	<hr/>
Net cash outflow from operating activities	<u>(1,620,814)</u>	<u>(1,611,387)</u>

**17. Related parties transactions**

The Company was charged £41,307 (2009: £41,562) by Magic Bullets Enterprises Limited, a company of which Prof. Michael Walker is a Director. At the year end the Company owed £Nil (2009: £Nil) to the related party.

The Company was charged £27,000 (2009: £27,000) by Gryon Consulting Limited, a company of which Prof. Clive Page is a Director. At the year end the Company owed £Nil (2009: £Nil) to the related party.

**VERONA PHARMA PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

**18. Cost of issuing share options**

Included within administration expenses is a charge of £41,758 (£2009: £13,209) for issuing share options. The share based payment charge represents the current year's allocation of the expense for relevant share options issued in 2010 and 2009. All options issued prior to 2009 were fully expensed prior to 2009.

The Company granted 850,000 (2009: 1,200,000) share options during the current year with fair value using the Black-Scholes option-pricing model of £25,353 (2009: £112,599).

Of the 850,000 share options granted in the year, all were granted to employees. The employees' options are exercisable at 9 pence per option and the expiry date of these share options is 15 June 2015.

The following assumptions were used for the Black-Scholes valuation of share options granted in 2010 and 2009.

Year/Type	Issued in 2010	Issued in 2009	
	Employees	Employees	Consultants
Options granted	850,000	1,000,000	200,000
Risk-free interest rate	2.75%	5.0%	4.75%
Expected life of options	5 years	5 years	5 years
Annualised volatility	37.35%	75.02%	155.20%
Dividend rate	0.00%	0.00%	0.00%

The Company had the following share options movements in the year:

Year of issue	Exercise price (pence)	At 1 January 2010	Number of options			At 31 December 2010	Expiry date
			Options granted	Options exercised	Options lapsed		
2006	5	11,000,000	-	-	-	11,000,000	18 September 2011
2006	6	2,885,500	-	-	-	2,885,500	19 September 2011
2007	4	1,280,000	-	-	-	1,280,000	4 July 2012
2008	4	1,159,666	-	(1,159,666)	-	-	8 January 2011
2009	4	200,000	-	-	-	200,000	8 January 2014
2009	17.5	1,000,000	-	-	-	1,000,000	11 September 2014
2010	9	-	850,000	-	-	850,000	15 June 2015
<b>Total</b>		<b>17,525,166</b>	<b>850,000</b>	<b>(1,159,666)</b>	<b>-</b>	<b>17,215,500</b>	

**VERONA PHARMA PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

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**18. Cost of issuing share options (continued)**

The weighted average exercise price of options at the year end is as follows:

	<b>Number of options</b>	<b>Weighted average exercise price (pence)</b>
<b>As at 1 January 2009</b>	16,325,166	5.0
Options granted in the year:		
Employees and consultants	200,000	4.0
Directors	1,000,000	17.5
	<hr/>	
<b>As at 31 December 2009</b>	17,525,166	5.7
Options granted in the year		
Employees and consultants	350,000	9.0
Directors	500,000	9.0
Options exercised in the year	(1,159,666)	4.0
	<hr/>	
<b>As at 31 December 2010</b>	17,215,500	6.0
	<hr/>	
<b>Exercisable at 31 December 2010</b>	15,765,500	5.8
	<hr/>	

**19. Profit of the parent company**

The Parent has taken advantage of the exemption permitted by Section 408 of the Companies Act 2006 not to present a profit and loss account for the year. The Parent's loss before tax for the year was £1,853,803 (2009: loss of £1,589,419).

**20. Control**

The Company is not under the control of any individual or group of connected parties.

**21. Financial commitments**

As at 31 December 2010 the Group and Company were committed to making the following payments under non-cancellable operating leases in the year to 31 December 2011.

	<b>Land and Buildings</b>	
	<b>2010</b>	<b>2009</b>
	<b>£</b>	<b>£</b>
Operating leases which expire:		
Within one year	47,720	44,020
	<hr/>	<hr/>

**VERONA PHARMA PLC**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2010**

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**22. Financial instruments**

(a) Fair values

The carrying amounts of cash and cash equivalents, short-term investments, receivables, and accounts payable and accrued liabilities, approximate to fair value due to their short-term nature.

(b) Credit risk

Credit risk reflects the risk that the Group may be unable to recover contractual receivables. The Group is still in the development stage; therefore, no policies are required at this time to mitigate this risk.

(c) Currency risk

Foreign currency risk reflects the risk that the Group's net assets will be negatively impacted due to fluctuations in exchange rates. The Group has not entered into foreign exchange contracts to hedge against gains or losses from foreign exchange fluctuations. At 31 December 2010, cash and cash equivalents include Euro €91,773, and accounts payable and accrued liabilities include balances of CAD\$20,003, Euro €107,112, and USD\$15,225.

(d) Financial risk management

The Directors recognise that this is an area in which they may need to develop specific policies should the Group become exposed to further financial risks as the business develops.

(e) Management of capital

The Group considers capital to be its equity reserves. At the current stage of the Group's life cycle the Group's objective in managing its capital is to ensure funds raised meet the research and operating requirements until the next development stage of the Group's suite of projects.

The Group ensures it is meeting its objectives by reviewing its Key Performance Indicators ("KPIs") to ensure its research activities are progressing in line with expectations, controlling costs and placing unused funds on deposit to conserve resources and increase returns on surplus cash held.

(f) Interest rate risk

At 31 December 2010, the Group had cash deposits of £2,003,012 (2009: £2,829,981). The Company's exposure to interest rate risk, which is the risk that a financial instrument's value will fluctuate as a result of changes in market interest rates on classes of financial assets and financial liabilities, was as follows:

<b>Financial Asset</b>	<b>Floating interest rate 2010 £</b>	<b>Non-interest bearing 2010 £</b>	<b>Floating interest rate 2009 £</b>	<b>Non-interest bearing 2009 £</b>
Cash deposits	2,003,012	-	2,829,981	-