SkyePharma PLC

annual report 2000

making good drugs better

Contents

Our vision

The world's leading provider of drug delivery technologies, SkyePharma works with major pharmaceutical companies to develop controlled release versions of their products, and to provide assistance and expertise in clinical trial management, regulatory submission and manufacturing. Our service offer extends from drug development through to commercial launch.

SkyePharma's five platform technologies are the widest and broadest range available from a single company, giving it a presence in over 95% of the world's drug delivery market thus providing its customers with a one-stop shop for drug delivery solutions.

Through our patented and proven technologies, we help make good drugs better.

Corporate highlights

- Phase III trials of DepoMorphine successfully funded & commenced
- FDA approval of Solaraze
- Solaraze licensed to Bioglan for Europe & US
- SkyePharma & Sanofi-Synthelabo announce multiple launch of Xatral OD
- Xatral OD filed with US FDA
- DepoCyt licensed to Paladin for Canada
- FDA clearance to return DepoCyt to market
- European approval recommended for DepoCyt
- Key feasibility and development agreements with Amgen and Kirin utilising DepoFoam
- Phase III trials of Foradil commenced in Europe & US

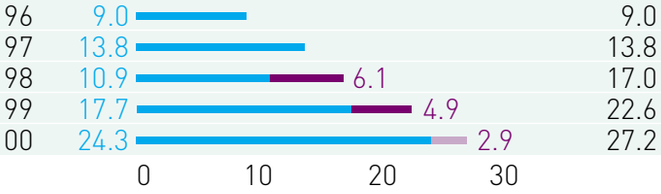
Financial highlights

		2000		1999
Financial highlights presented under UK GAAP	**£'000**	**$'000**	£'000	$'000
Turnover	**24,292**	**36,858**	17,739	26,915
Gross profit	**8,694**	**13,191**	2,885	4,377
Operating loss	**(17,984)**	**(27,287)**	(19,588)	(29,721)
Retained loss	**(19,690)**	**(29,876)**	(19,414)	(29,457)
Loss per Ordinary Share	**(3.9p)**	**(5.92c)**	(4.2p)	(6.37c)
Cash use	**(26,846)**	**(40,733)**	(29,731)	(45,111)

Cash use represents cash outflow from operations before the use of liquid resources and financing. US dollar value equivalents are shown for convenience and have been calculated for both periods using the current period – average rate of $1.5173 to the pound sterling.

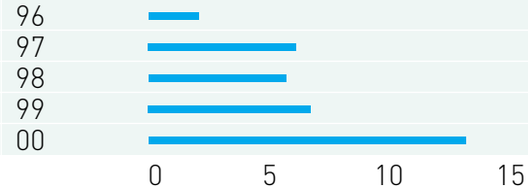
A reconciliation to US GAAP is included on pages 63 and 64 for the convenience of US readers.

Turnover (£ million)



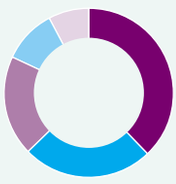
- Turnover
- Collaboration equity
- Other operating income

Research and development (£ million)



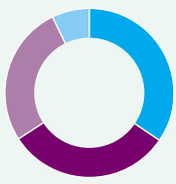
Capital expenditure

- Topical intellectual property £5.9m
- Novartis DPI equipment £3.9m
- Other equipment £3.0m
- Muttenz Building £1.6m
- Other intellectual property £1.2m



Cash use

- Operating activities £9.3m
- Property, plant and equipment £8.4m
- Intangible acquisitions £7.2m
- Interest £1.9m

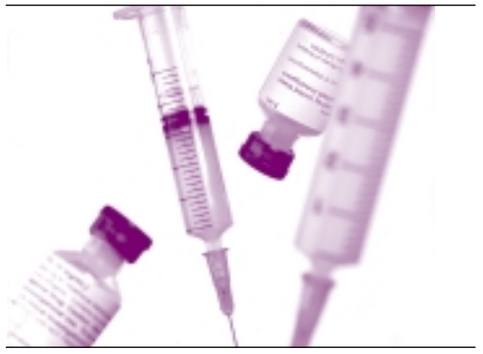


Overview of technologies

In 2000 SkyePharma emerged as the leading provider of drug delivery technologies and services in the world. SkyePharma now boasts five key technologies –

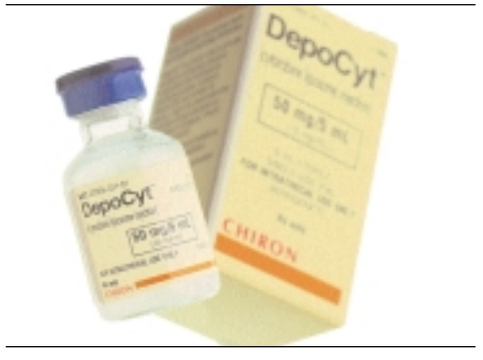
Injectable

SkyePharma's injectable technology is called DepoFoam, consisting of microscopic, spherical particles composed of hundreds to thousands of chambers separated from adjacent chambers by lipid membranes. Drugs can be released over a few hours, a few days or several weeks.



DepoCyt®

DepoCyt is an injectable, sustained-release formulation of cytarabine, for the treatment of lymphomatous meningitis. Using SkyePharma's DepoFoam technology, DepoCyt gradually releases cytarabine into the cerebral spinal fluid and extends the dosing interval to once every two weeks as compared to the standard dosing of twice weekly.



Inhalation

SkyePharma's environmentally friendly inhalation technologies include both non-CFC propelled metered dose inhalers and dry powder inhalers. Our dry powder inhaler (shown below) is fully breath-actuated, easy to use and is capable of delivering uniform doses.

Foradil®

Foradil is a fast onset, long-acting bronchodilator for the treatment of asthma. SkyePharma has produced a new formulation of Foradil, for partner Novartis, in the Group's multi-dose dry powder inhaler (or 'SkyeHaler') and recently started Phase III clinical trials in both the US and Europe.

injectable, inhalation, oral, topical and nano-particulate (enhanced solubility). Together these technologies enable us to cover over 95% of the pharmaceutical industry's platform delivery demands.

Oral

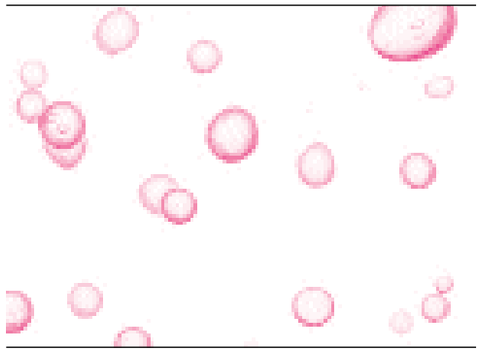
The GEOMATRIX tablet systems control the amount, timing and location of the release of drug compounds through the digestive tract. The combination of different chemical components in the core and barrier layers, each with different rates of swelling, gelling and erosion, allows the production of tablets with a wide range of release profiles.

Xatral® OD

Xatral OD contains alfuzosin, a compound used to treat the symptoms of benign prostatic hypertrophy, a common disorder in men over the age of 50 years. Launched in Europe by marketing partner Sanofi-Synthelabo in 2000, the new GEOMATRIX 'once daily' formulation provides greater patient convenience with equal efficacy.

Topical

SkyePharma's topical delivery systems are aimed at the delivery of drugs through or to the skin. Skyepharma now offers four drug delivery technologies in the topical area: Hyaluronan Induced Targeting (HIT), Crystalip, DermaStick and ES-Gel, providing a range of solutions to topical drug delivery issues.



Solaraze®

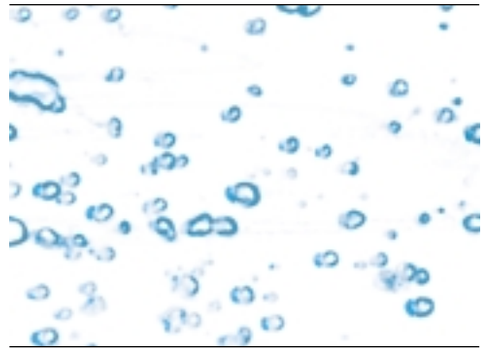
Solaraze is a topical gel for the treatment of actinic keratosis, a pre-cancerous skin condition caused by over-exposure to the sun. Solaraze received FDA approval in October 2000. It is currently also approved in five member states of the EU and in Canada. During the year Solaraze was licensed to Bioglan for Europe, US, Canada and Mexico.

Nano-particulate

SkyePharma has three technologies for the production of nano-sized drug or drug/carrier particles based on a simple clean and economic process. The technologies may be used to improve solubility of poorly soluble drugs either in stand-alone applications or in conjunction with SkyePharma's other drug delivery technologies.

Nano-particles

Nano-particles (shown below) are ten to fifteen times smaller than a red blood cell (shown above). Many drugs, when reduced to this size, show a dramatic increase in solubility and a consequent improvement in their ability to be absorbed by the human body, a fundamental requirement for all drugs and drug delivery systems.



Chairman's statement

Ian Gowrie-Smith
Executive Chairman

2000 was a year in which SkyePharma's position as the world's leading drug delivery company was endorsed internationally by the pharmaceutical industry. The attractiveness of being a key player in the market became increasingly apparent as the Company moved into a new, forceful phase in its development.

Our dual strategy – to provide value-added service to our pharmaceutical clients in exchange for high returns and to pursue selective internal projects to a later stage of development thereby providing a platform of future high value licensing partnerships, has started to set us apart from our competitors.

Having widened our technology base to a formidable portfolio of five proven drug delivery systems, three of which are FDA approved, SkyePharma became poised to offer the most comprehensive range of drug delivery solutions worldwide. Consequently, the Company is gaining an increasing number of multiple technology deals with the same clients. The transition to this important vantage point resulted from our decision to adopt an aggressive expansion of the Company, adding value, at comparatively low risk, to our activities. I am happy to report that it also put us firmly on track to profitability by the end of 2001.

During 2000 we successfully completed a Convertible Bond Issue raising approximately £60 million. The rationale was to retain leadership and realise maximum value by investing heavily in our technologies. Additionally, an important agreement with Paul Capital Royalty Acquisition Fund to contribute $30 million over two years to fund DepoMorphine through clinical trials and regulatory submission – in return for a share of potential future royalties and revenues from four SkyePharma products – strengthened our commitment to continued investment without delaying our move into profitability. Both transactions should enable us to increase dramatically our share of future profits.

The year was marked particularly by our success in driving products to launch or near-launch stage. Among key examples are our injectable proprietary products: DepoMorphine™ for pain management, DepoCyt for lymphomatous meningitis and the new topical formulation Solaraze for actinic keratosis. Deals and partnerships in late stage or near-launch development have borne fruit in the non-proprietary sector as well: highlights include Novartis' Foradil (asthma) and Sanofi-Synthelabo's Xatral OD (benign prostatic hypertrophy). There have also been clearer indications of the intentions of GlaxoSmithKline (GSK) regarding Paxil® CR (depression).

Key to our strategy is to gain high margins by taking our own proprietary

In 2000 SkyePharma emerged as the leading provider of drug delivery technologies and services in the world. SkyePharma now boasts five key technologies – injectable, inhalation, oral, topical and nano-particulate (enhanced solubility).

Together these technologies enable us to cover over 95% of the pharmaceutical industry's platform delivery demands.

products through to late stage development prior to out-licensing. We demonstrated during the year how financially beneficial that strategy should prove, with DepoCyt and Solaraze having the potential to generate growing revenues from 2001. Our aim is to clinch more high value marketing and distribution deals by increasing our share of profits with marketing partners, such as those established with Chiron in the US (DepoCyt) and Bioglan (Solaraze) and Novartis (Foradil) in North America and Europe.

Never has there been such demand for drug delivery. SkyePharma's unique service offer has attracted a surge of interest and new deals for the business at a time when the global drug delivery market continues to have a healthy annual growth rate of 15-20%. Our strength in this field is built on solid foundations, namely an unrivalled range of stand-alone yet complementary technologies in the injectable, inhalation, oral, topical and improved drug solubility fields. These enable us to cover over 95% of the drug delivery spectrum.

We have also demonstrated our capacity to take on rewarding support functions, from feasibility and development, clinical trial management and regulatory submission to manufacturing. With GSK's anti-Parkinson's drug Requip®, for example, we have undertaken a full service role through to regulatory filing.

Expertise in each of our technologies has been recognised and endorsed by numerous large clients: with Amgen, Pfizer and Kirin of Japan in the injectables sector, Novartis in inhalation, Sanofi-Synthelabo, GSK and Pfizer in oral technology and with Bioglan in the field of dermatology. In addition we have undertaken carefully selected partnerships, such as with Merck KGaA in the development of an important undisclosed oral product, Meditech for the commercialisation of Solaraze in Australia and the Pacific through its licensee, Bioglan with three proprietary topical technologies and Kowa of Japan in the development of Statin NK-104 for the treatment of high cholesterol. We are now poised to capitalise on the increased level of business by tapping into the highest echelons of the value chain.

Turning to the composition of the Board, I would like to thank former Non-executive Directors Nigel Wray and Dr Thomas Rinderknecht – who have served on the Board since 1995 and 1996 respectively – for their unstinting work on behalf of SkyePharma. Both announced their intentions to step down in 2000. May I also warmly welcome our two new non-executive appointees, Tamar Howson, former senior vice president and director of worldwide business development at SmithKline Beecham, and Dr Jerry Karabelas, formerly chief executive officer of Novartis Pharma AG. I am confident that their expertise and experience in the industry will have important implications for SkyePharma's future.

Dr Jacques Gonella has also decided not to seek re-election at the upcoming Annual General Meeting. Dr Gonella was responsible for starting and building Jago, subsequently taken public as SkyePharma. Although he has not had an executive role with the Company since then, we wish to formally convey our thanks for his assistance in the sensitive transition from a private Swiss company.

Significant activity in the pipeline will continue in 2001 and beyond. We should see Solaraze launched in North America and Europe and Xatral OD – already on the market in six European countries – in the US. Following the recent return of DepoCyt to the US market we were also able to announce its European approval recommendation in April 2001 and now look forward to its launch in Europe and Japan. Foradil and Requip will move into Phase III clinical trials and we expect to announce critical licensing deals for DepoMorphine worldwide and DepoCyt in Europe. We also expect additional news on Paxil CR. The short and long-term prospects for SkyePharma are extremely bright.

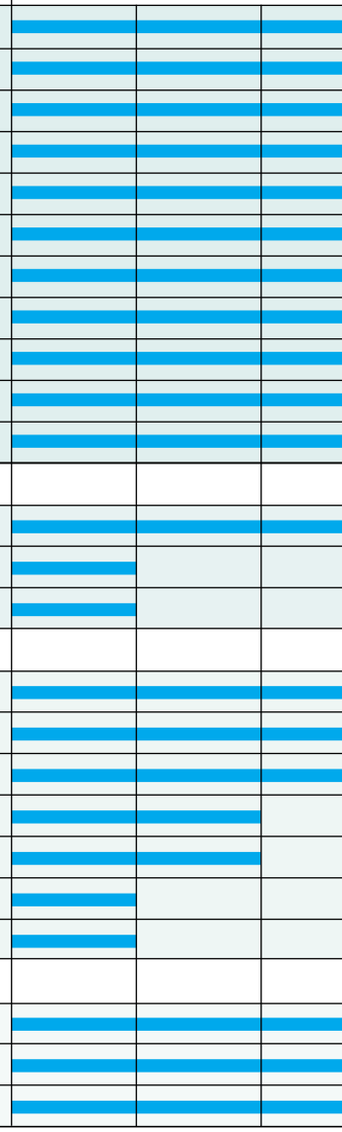
My thanks go to all our staff for the many achievements of 2000 and to our shareholders for their continued support.

Ian Gowrie-Smith
Executive Chairman

Key product pipeline

Technology platform	Client	Drug	Therapeutic category
Oral	Mundipharma	Nifedipine	Hypertension
	Ratiopharm	Diclofenac	Arthritis
	Watson	Dilacor XR	Cardiovascular
	Roche	Madopar DR	Parkinson's Disease
	GlaxoSmithKline	Paxil CR	CNS
	Sanofi-Synthelabo	Xatral OD	Genito-Urinary
	SkyePharma	Naproxen	Arthritis
	Undisclosed	Undisclosed	Undisclosed
	GlaxoSmithKline	Requip	Parkinson's Disease
	Pfizer	Undisclosed	Undisclosed
	Merck KGaA	Undisclosed	Undisclosed
Inhalation	Novartis	Foradil	Asthma
	Sepracor	Undisclosed	Asthma
	Undisclosed	Undisclosed	Asthma
Injectable	Chiron	DepoCyt	Oncology
	SkyePharma	DepoMorphine	Acute Pain
	SkyePharma	DepoAmikacin	Infection
	Amgen	Undisclosed	Undisclosed
	Kirin	Undisclosed	Undisclosed
	SkyePharma	DepoBupivacaine	Regional Pain
	SkyePharma	Cardi-clear	Restenosis
Topical	Bioglan	Solaraze	Actinic Keratosis
	Shire	Hyclinda	Acne
	SkyePharma	Oralase	Oral Pain

Feasibility In vitro (laboratory) feasibility study to determine whether, under laboratory conditions, the formulation of the product candidate can be achieved.



In addition there are a number of early stage and internal development projects for each of the technology platforms which are shown in the table below:

Oral	**7**	Injectable	**6**
Inhalation	**5**	Topical	**4**

	Phase I Also called Pre-clinical, where batches are manufactured for in vivo studies (in humans) in healthy volunteers.	**Phase II** Additional in vivo testing may be performed (also called pre-pivotal trials) involving a small patient population.	**Phase III** Trials in an expanded patient population, typically at dispersed sites. All of the improved outcome or new products under development require a Phase III trial. Also called pivotal trials.	**Filed** SkyePharma's partners file for regulatory approval in the jurisdictions in which it is intended that the product will be marketed. For example, in the US, this will require filing with the FDA.	**Approved** Approved by the relevant regulatory authority.

Review of operations

Michael Ashton
Chief Executive Officer

Since 1998 SkyePharma's strategy has been to become the world's foremost professional provider of drug delivery technologies. Our mission remains to be the drug delivery company of choice to the pharmaceutical and biopharmaceutical industry.

I am pleased to report that during 2000 – due to a combination of strategic acquisitions in 1999, technological, product and business development, together with carefully selected manufacturing, marketing and distribution partnerships – SkyePharma has emerged as the leading global provider of drug delivery technologies and services. I am confident that the Company is now becoming the most sought-after drug delivery partner worldwide.

Encouragingly, this comes at a time of unparalleled increase in the demand from international pharmaceutical and biopharmaceutical companies for outsourced drug delivery. We now boast among our expanding pharmaceutical client list such names as Novartis, Sanofi-Synthelabo, GlaxoSmithKline (GSK), Abbott, Sepracor, Pfizer, Roche, Bioglan, Amgen, Chiron and Kirin.

Our strategy is two-pronged: to act as a one-stop shop of drug delivery for the pharmaceutical industry in return for royalties and milestone payments; and to develop a proprietary pipeline using our own resources, subsequently to be partnered for marketing at a higher level of royalty payment. The progression of this strategy is relatively low risk.

All molecules currently in advanced development are already approved in some format and their efficacy is proven. Indeed, some of the largest pharmaceutical companies with whom we work are partners who have publicly endorsed SkyePharma's technology with up-front equity investments, Novartis and GSK among them.

Of particular significance has been the considerable progress made within our pipeline during 2000, across the range of our technologies. The combined estimated market for drugs now using SkyePharma delivery technology, either launched or at a late pre-launch stage, now amounts to some $8 billion.

Among the highlights are:
- DepoCyt (oncology/injectable)
- DepoMorphine (pain management/injectable)
- Foradil (respiratory/inhalation)
- Xatral OD (benign prostatic hypertrophy/oral)
- Paxil CR (depression/oral)
- Solaraze (pre-cancerous skin disorder/topical)

SkyePharma's strategy is to develop and expand its range of delivery technologies and to maintain a technology leadership position in its key fields. This allows the Company to leverage established relationships and to gain and nurture new ones, based on a proven track record. Often we do business with pharmaceutical companies who are interested in one of our technologies to find that they have need for others. Additionally, the technology mix enables us to exploit synergies between the delivery platforms and intellectual property we own, thus presenting the potential for multi-faceted drug delivery and added value for our clients.

Our platform technologies encompass five key areas. Following the acquisition of DepoTech's (now SkyePharma Inc) injectable technology, the former Canadian group Hyal's topical technology business and Medac GmbH's nano-particulate solubilisation technology in 1999, we now cover more than 95% of the drug delivery market and our technologies constitute the broadest range available from a single drug delivery supplier. The technologies are: **Injectable** – DepoFoam; **Inhalation** – metered dose inhaler (MDIs), dry powder inhalers (DPIs) and, recently developed, breath-actuated inhalers; **Oral** – GEOMATRIX™; **Topical** – Hyaluronan Induced Targeting (HIT); **Nano-particulate** – enhanced solubility.

Having achieved this technological breadth and scope, the main focus of 2000 was largely product-driven. Described in detail within this review is the steady stream of product development deals, approvals and launches that came to fruition throughout the year. These are set to progress the fortunes of SkyePharma in the coming years, as milestone and royalty payments begin to make a meaningful impact on our financial performance.

Research and development
SkyePharma operates from corporate headquarters in central London. The main research and development activity for inhalation, oral, solubilisation and topical technologies are located in Basel, Switzerland and Lyon, France. Our DepoFoam injectable technology is developed and manufactured at our San Diego facility in California. The Company's 150 research scientists, clinical affairs and regulatory personnel, of whom approximately half hold advanced degrees, are recognised as world class. The top 10 scientists from Basel, Lyon and San Diego meet regularly to optimise co-ordination and synergy, sharing ideas and innovations to ensure we maintain technological and scientific leadership and exploit new ideas.

A major goal we have set for ourselves is to become a 'one-stop shop' for clients and partners wishing to outsource their drug delivery needs, not only as a provider of the widest range of drug delivery technologies available but also as an expert in providing the clinical, regulatory and manufacturing expertise to minimise time to market.

DepoMorphine
SkyePharma's DepoMorphine has a unique profile, offering 48 hours of post-operative pain relief from a single pre-operative injection.

Review of operations continued

John Longnecker
Chief Executive Officer
SkyePharma Inc.

During the year we successfully achieved our aim to offer a full range of support from feasibility and development through to clinical trial management, regulatory submission and manufacturing. Our newly formed global clinical and regulatory group in San Diego has worked in tandem with the Basel-based research and regulatory team to drive the gamut of development activities on a number of collaborative ventures including the FDA approval of Solaraze and the drug development and clinical trial monitoring for GSK's anti-Parkinson's drug Requip (ropinirole). This infrastructure is the foundation upon which we now have the capacity to progress internally developed products to late stage development.

This and other innovative transactions are part of a strategic process designed to enable SkyePharma to capture the top end of the value chain in drug delivery partnering deals. It is a strategy that proved highly significant for the Company during the year and one that has helped pave the way for projected profitability from the second half of 2001.

Injectable technology
SkyePharma became a major presence in the new area of controlled release injectable technology with the acquisition of DepoTech, renamed SkyePharma Inc, in March 1999. Some 15% of the drug delivery market is for injectables. SkyePharma Inc is the developer of DepoFoam, a unique lipid based technology using a single injection to deliver a sustained drug release for up to weeks at a time.

DepoFoam technology is approved by the US Food and Drug Administration (FDA) via our launched drug DepoCyt.

DepoCyt is an injectable sustained release chemotherapeutic agent for the treatment of lymphomatous meningitis, a serious and potentially fatal complication of certain haematological malignancies. This injectable sustained-release formulation of cytarabine is the only FDA approved treatment for patients with this disease. It gradually releases cytarabine into the cerebral spinal fluid and extends dosing intervals to once every two weeks compared to the standard intrathecal dosing of twice or three times a week. Chiron Corporation markets the product in the US. SkyePharma and Chiron share profits on a 50/50 basis. In July 2000 SkyePharma granted exclusive Canadian marketing and distribution rights for DepoCyt to Paladin Labs Inc. The terms of the deal included a US$1 million up-front payment, together with additional milestone payments tied to future events and a significant share of future revenues.

In early March 2001 SkyePharma and Chiron Corporation received clearance from the FDA to return DepoCyt® to the market. Chiron and SkyePharma voluntarily withdrew DepoCyt from the market in October 1999. Upon routine stability testing, it was discovered that certain batches of DepoCyt, incorporating a raw material that had been developed using a different process, did not meet all regulatory specifications. There were no adverse events attributed to the recalled batches and the product was made

available to patients on a compassionate basis during the year. In April 2001 we were able to announce that we had obtained a recommendation for approval for DepoCyt in Europe, paving the way for its launch in Europe this year and Japan in the future.

A second key development for our injectable technology was the progression of DepoMorphine to Phase III trials and agreement with Paul Capital Royalty Acquisition Fund. The deal provides SkyePharma with $30 million over the next two years to fund clinical development and regulatory submission. This transaction enables us to fund and invest in the clinical development of DepoMorphine without the research and development cost affecting our timescale to profitability.

DepoMorphine has a unique profile in the management of moderate-to-severe post-operative pain, offering 48 hours of pain relief with a single pre-operative injection. In clinical trials the drug scored 'excellent ratings' compared with standard morphine and intravenous fentanyl. The market in the US for injectable hospital pain management products is estimated at $530 million: with fully funded clinical trials, we have greater flexibility in our licensing strategy and expect to license the product to a partner on very favourable terms.

We announced in early 2000 that the Company was in feasibility studies or scaling up for pre-clinical studies of seven new products with DepoFoam. During the year two important deals – for yet undisclosed compounds – were unveiled with Amgen Inc. and Kirin of Japan. Both these deals mark significant development milestones for DepoFoam and spearhead an accelerating deal flow for this promising platform technology.

Inhalation technologies

Inhaled pharmaceuticals are almost exclusively used for the treatment of asthma and bronchitis, attracting more than 50 million patients in the industrialised world. Annual sales of these products are about $5.8 billion and are growing at the rate of 10% per annum. The pulmonary drug market is on track to nearly double in size to approximately $10 billion by 2005.

SkyePharma is active in environmentally friendly non-CFC propelled metered dose inhalers, dry powder inhalers, under the brand name 'SkyeHaler' and – as a result of collaboration with PA Consulting – a breath-actuated inhaler device designed to deliver asthma drugs more efficiently. In this latter venture PA Consulting have provided their expertise in device development and SkyePharma has provided its expertise in non-CFC metered dose formulation.

Dry powder inhaler or 'SkyeHaler'
SkyePharma's SkyeHaler is small and easy to use. A new formulation of Foradil in the SkyeHaler, developed for Novartis, moved into Phase III clinical trials in 2000.

Breath-actuated inhaler
Developed in a collaboration with PA Consulting, the breath-actuated inhaler has been designed to deliver asthma drugs more efficiently.

Review of operations continued

Dr Francesco Patalano
President SkyePharma Europe

Among the major partners to have adopted SkyePharma's inhaler technologies are Novartis for Foradil, Sepracor and Boehringer Ingelheim. Significantly, Foradil moved into Phase III European trials in late 2000 and US Phase III trials have just commenced. We expect a US and a European launch in 2003.

Under the terms of the deal with Novartis, SkyePharma has produced a new formulation of Foradil within the Company's multi-dose SkyeHaler. Small and easy to use, SkyeHaler has unique interactive safety and monitoring functions and will be produced on a fully automated line from SkyePharma's Lyon factory at a comparable cost to other inhalers on the market. The worldwide sales potential for Foradil based on internal forecasts is estimated at up to $600 million. SkyePharma expects royalties and manufacturing revenues of over 10%.

International research underlines the potential of the SkyeHaler. Of four dry powder inhalers evaluated by patients in independent research, SkyeHaler was the most frequent first choice in all countries and in all age groups (up to 65 years old), among both males and females and both mild-to-moderate and severe asthma sufferers.

SkyePharma is at the forefront of the delivery of products to the lung for asthma, and anticipates that it will be able to expand its client base to make this a major contributor to our growth.

Oral technology
SkyePharma's oral capabilities are provided by the sophisticated tablet system within the GEOMATRIX family of technologies, which control the amount, timing and location of the release of drug compounds through the digestive tract. The combination of different chemical components in the core and barrier layers of a tablet, each with different rates of swelling, gelling and erosion, allows the production of tablets with a wide range of predictable and reproducible drug release profiles. Oral drug delivery accounts for 50% of the growing $45 billion global drug delivery market.

Currently six GEOMATRIX products have received regulatory and marketing approvals, two in the US and four in Europe. There are eight technologies within the GEOMATRIX family, enabling delivery of a wide range of difficult-to-formulate drugs. Protected by comprehensive, long-life patents, GEOMATRIX formulations can be manufactured at low cost and high volume, using standard raw materials and equipment. New coatings and polymers are being investigated continually to enable SkyePharma to respond precisely to changes in gastrointestinal tract conditions, such as pH and food effects. At the same time the Company is researching potential for a dual-technology approach to some applications by combining, for example, its oral and solubilisation technologies.

Xatral OD
Sanofi-Synthelabo's once-daily formulation of alfusozin, Xatral OD, was launched in six European countries and filed for marketing approval in the US in 2000.

During 2000 a second raft of European approvals for Sanofi-Synthelabo's once-daily formulation of alfuzosin, Xatral OD, was announced, closely followed by the drug's filing for marketing approval in the US where it is due to be introduced for the first time. Xatral is used for the treatment of functional symptoms of benign prostatic hypertrophy (BPH), a common disorder in men over the age of 50. It is available in more than 80 countries as a two or three-times daily formulation. In 2000, European sales were in the region of €120 million. Estimated global sales potential is $400 million. The once-a-day alternative, using SkyePharma's proprietary GEOMATRIX technology, is now launched in the UK, Denmark, France, Sweden, Switzerland and The Netherlands.

GSK's once-daily anti-Parkinson's drug Requip (ropinirole) entered Phase II trials during the year. SkyePharma is handling all development activities up to regulatory filing. The deal, concluded in September 1999, included an $8 million equity investment in SkyePharma by GSK and further cemented a fruitful, long-term relationship between the two companies.

Review of operations continued

GSK's GEOMATRIX-delivered Paxil CR – approved in 1999 in 12.5 mg and 25 mg strengths for depression – remains a significant potential revenue earner for SkyePharma. During 2001 GSK announced that it had received an approvable letter from the FDA for a second CR indication, panic disorder, and gave notification it was working on a third CR indication, pre-menstrual dysphoric disorder (PMDD), a severe form of pre-menstrual syndrome. Paxil in its current form is the seventh-largest pharmaceutical product in the world with revenues of some £1.6 billion in 2000, and growing at the rate of 17% year-on-year. We anticipate that Paxil CR will be a significant contributor to GSK's anti-depressant therapy franchise.

GEOMATRIX technology attracted two further development agreements during 2000. In March we signed a feasibility contract with Pfizer to formulate an undisclosed compound using our advanced oral delivery technology. A development with Merck KGaA, Darmstadt, has also commenced. Results of several prototype formulations demonstrated proof of concept, leading to agreement for SkyePharma to take responsibility for scaling up the process, providing materials for clinical trials and assisting Merck in the compilation of a regulatory dossier. The product will be manufactured on behalf of Merck from SkyePharma's FDA-approvable Lyon factory. Both projects are progressing to plan.

Topical technology

The most recent addition to our platform portfolio was the acquisition of a superior topical technology in late 1999 – aimed at the topical delivery of drugs through or into the skin. The delivery technique's main constituent, hyaluronan (HA) has fundamental benefits for the localisation of drugs applied to the skin via Hyaluronan Induced Targeting (HIT). Drugs formulated in HA achieve prolonged dermal retention, a specific characteristic of the formulation. HA offers unique potential for the treatment of a variety of skin conditions such as psoriasis, eczema and acne. The technology is appropriate for dermal use of many drugs including corticosteroids, antibiotics, antifungals, antivirals and retinoids.

Solaraze, the first in SkyePharma's pipeline of proprietary topical formulations, gained approval in the US during 2000 and is approved in five European countries, with more pending. It is also approved in Canada. Solaraze is indicated for the treatment of actinic keratosis (AK), a pre-cancerous skin condition. Solaraze is expected to be launched in both Europe and the US in the first half of 2001. Age, sun exposure and fair skin are risk factors for the development of AK. Current treatment includes cryosurgery, the freezing off with liquid Nitrogen, which can result in scarring. However, most patients with AK do not currently seek treatment: increased awareness of skin cancer is likely to lead to real growth in the numbers who do in the future.

An agreement was signed in March with Bioglan Pharma PLC to undertake the European manufacture, marketing and distribution of Solaraze. They paid an up-front licensing fee and we will receive royalties on sales. We have also recently announced the licensing of Solaraze for the US, Canada and Mexico to Bioglan. The North American market is conservatively valued at some $250 million.

Having one dedicated company as our marketing partner for both the US and Europe will provide a unity of strength and commercial focus for this important new product. As a result of the US deal, SkyePharma received $14 million as an up-front payment. There will be future milestone payments with Solaraze's commercial launch and additional milestones if the product reaches certain sales targets, plus royalties on net sales. It is our belief that total milestone payments could reach $29 million over the next five years for the US alone.

Meanwhile, Solaraze is set to profit in the Asia Pacific market – where in Australia, for example, incidence of AK is reported in 40%-50% of people aged over 40 – following the grant of a licence to Meditech Research Limited to commercialise the product in Australia, New Zealand, Malaysia and Singapore through its licensee. SkyePharma will receive a 15% share of all revenues earned by Meditech in these territories with Solaraze and associated products. We are working closely with Meditech and its licensing partner to expedite Australian regulatory approval.

Our deal with Meditech also allowed us to commercialise a further part of the HA portfolio. We granted Meditech a non-exclusive license over the HIT Technology to enable it to exploit its anti-cancer HyACT™ project worldwide. SkyePharma will receive 10% of all net revenue from the HyACT project.

Our leadership in this topical delivery sector was further cemented at the turn of 2000/01 when SkyePharma gained certain licensing rights to three of Bioglan's topical drug delivery technologies – Crystalip, DermaStick and two products utilising the ES-Gel system – for $9 million. Crystalip enhances stability of drugs by embedding them in lipid crystals. DermaStick presents the active ingredient in a wax stick, enabling controlled application to affected skin. ES-Gel is a semi-solid formulation producing enhanced solubility of drugs. We are entitled to retain the first $9 million of all new income generated by SkyePharma from the three technologies and, thereafter, all other income will be split 50:50 between Bioglan and SkyePharma.

Solaraze
Licensed to Bioglan for US, Canada, Mexico and Europe during 2000, Solaraze is indicated for the treatment of actinic keratosis, a pre-cancerous skin condition.

Review of operations continued

Nano-particulate technology
Nano-particulate technology or enhanced solubilisation – is an exciting fifth dimension to SkyePharma's technology portfolio. Solubility problems lead to an estimated 40% of newly synthesised compounds being abandoned at the research and development stage.

Solubility is an essential factor for effectiveness in all drugs, independent of the administration route. SkyePharma has two patented approaches: nano-suspensions and solid lipid nano-particles. Crucial to SkyePharma's service offer is that, using nano-particulate technology, we are now able to produce drugs that would not otherwise be suitable for formulation in conventional formats. Our double technology approach is providing drug delivery solutions for many compounds to be delivered via the inhaled, oral, injectable and topical routes.

SkyePharma's ability to make drug particles nano-sized for improved solubility has enormous implications for both stand-alone and dual technology applications across our platform technologies. We saw the start of this in 2000 when we signed two early stage feasibility studies for this technology and started work on improvements to several internal compounds prior to partnering.

Business development and partnership
SkyePharma's eight-strong business development team was expanded both in number and geographic coverage during 2000 with particular emphasis on new opportunities in the US, from which some 80% of the Company's business emanates. The team's first success of the year was the signing of a development agreement with Amgen to use DepoFoam for an undisclosed drug, followed by a tranche of further deals, a number of which we have been able to announce.

The scientific calibre and potential market value of drugs using our technologies has enthused the team to pursue and gain new business at levels of return in keeping with our aspirations to tap the top end of the market's value chain. Proof of our success in this strategy has been the steady flow of new partnerships – Pfizer, Merck KGaA, Amgen, Kirin, Bioglan and PA Consulting to name a few.

Just prior to reporting, a further deal was struck with Kowa Ltd of Japan for development of their Statin NK-104, a new lipid-lowering agent for the treatment of high cholesterol. NK-104 is a potent new statin under development by Kowa and already submitted for marketing authorisation in Japan. Phase II trials have been completed in Europe and are expected to start in the US shortly. We are delighted that Kowa has selected SkyePharma as the partner for its first important product aimed at the European and US markets. The deal will give us responsibility for providing materials for clinical trials at our Lyon factory and highlights the expertise we can offer partners in product development and manufacturing.

The year was also one in which significant enhancements to our manufacturing and R&D sites were unveiled. In Basel construction work was completed for the new R&D building, largely prompted by imminent large-scale development activities in our inhalation business and to accommodate our expanding nano-particulate activities. The new building adds new technical installations, galenical facilities for the oral drug delivery department and analytical and galenical laboratories for the aerosols and inhalation department. Providing space for approximately 45 people, the building is designed to allow for further expansion at a later date. The new building will help R&D staff handle more projects to tighter deadlines and work in closer co-operation with regulatory and clinical affairs colleagues.

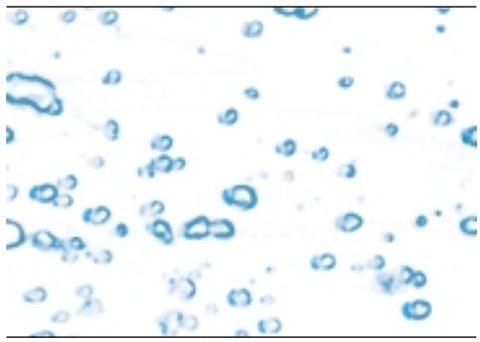
We are delighted that in early 2001 the FDA approved the reintroduction of DepoCyt into the US market. We have been manufacturing stable product from our San Diego facility since December 1999. In addition a separate 85,000 sq. ft. factory has gained Drug Enforcement Agency approval and is poised to produce DepoMorphine and other products to a capacity of 12 million vials a year.

In Lyon we continue to manufacture GEOMATRIX tablets and inhaled metered dry powder formulations from our 183,000 sq. ft. production facility, deemed approvable by the FDA in 1998. A key achievement in 2000 was the manufacture of 35,000 dry powder inhalers for the start of Phase III clinical trials for Foradil in Europe and the US. To ensure on-time production and delivery, new machinery – such as an automated and integrated line for granulation and drying – has been installed during the year.

The quantity and quality of our traditional business, combined with our decision to develop selectively a number of projects to a later stage of development prior to licensing, has begun to provide return. We are therefore increasingly being rewarded in the 13% to 15% royalty rate band, rather than the 3% to 5% that was the norm when SkyePharma floated in 1996. Additionally, by funding products through the clinical trial process we can share up to 50% of the profits, as illustrated in our agreement with Chiron for DepoCyt.

We will continue along this path to profit, combining unrivalled technological infrastructure, a highly skilled workforce and flexible manufacturing, marketing and distribution models to further establish SkyePharma as the world's number one choice for drug delivery.

Michael Ashton
Chief Executive Officer



Nano-particulate technology
SkyePharma has three technologies for the production of nano-sized drug particles based on a simple clean and economic process. We are now able to produce drugs that would not otherwise be suitable for formulation.

Directors and officers 2000

Ian Gowrie-Smith * (aged 52) Executive Chairman, appointed in January 1995. Mr Gowrie-Smith has more than 13 years of management experience in the pharmaceutical industry and was responsible for the founding and subsequent flotation of Medeva plc.

Michael Ashton * (aged 55) became Chief Executive Officer in November 1998, appointed to the Board in March 1997. He has over 30 years of experience in the pharmaceutical industry having worked for Merck Inc., Pfizer Inc., Purepac Inc. and, prior to this appointment, Faulding Inc where Mr Ashton was Chairman, President and CEO.

Air Chief Marshal Sir Michael Beavis (aged 71) Non-executive Director, appointed in May 1989. Sir Michael entered the Royal Air Force in 1947 and retired in 1987, his last appointment being Deputy Commander-in-Chief Allied Forces Central Europe, NATO. He is a defence consultant with Burdeshaw Associates, USA and a Non-executive Director of Alliance Aircraft, USA. He is a Freeman of The City of London and a Liveryman in the Guild of Air Pilots and Navigators.

Dr Jacques Gonella (aged 59) joined the Board in May 1996, Non-executive Director since April 1998. Dr Gonella founded the Jago Group in 1983 and was its sole shareholder. He founded Jago after 15 years of working in product development, general management, and acquisition and licensing positions in major pharmaceutical companies.

R Stephen Harris (aged 58) Non-executive Director, appointed in November 1995. He has 35 years' commercial experience in the pharmaceutical industry, having worked for ICI Pharmaceuticals, Merck, Eli Lilly, Boots, Reckitt & Colman and Gensia; and was Director of Development and Licensing with Medeva plc. He is Non-executive Chairman of Proteome Sciences plc and Non-executive Director of Advanced Medical Solutions Group plc, Pharmaceuticals Profiles Ltd, Microscience Ltd and Trigen Ltd.

Dr Keith Mansford (aged 69) Non-executive Director appointed in March 1996. He has over 40 years' experience in the pharmaceutical and biotechnology sectors principally with Beecham Group and SmithKline Beecham. From 1989 to 1992 Dr Mansford was Chairman of Research and Development at Beecham Group and subsequently SmithKline Beecham plc. He is an External Director of Sepracor Inc. and of Mindset Pharmaceuticals. He is Chairman of Mansford Associates, an international healthcare consultancy.

Donald Nicholson * (aged 43) Finance Director, appointed in March 1997, joined SkyePharma in February 1996. He is a member of the Institute of Chartered Accountants of Scotland. He began his professional career with Deloitte Haskins & Sells and has spent over 10 years in healthcare with Wellcome plc and Corange Group where he was Corporate Strategy & Finance Director.

Walter Zeller (aged 70) Non-executive Director, appointed in February 1996. Mr Zeller had an extensive career with Ciba Geigy and was most recently Chief Financial Officer of Corange Limited, the holding company of Boehringer Mannheim and DePuy. Mr Zeller is a Non-executive Director of Henkel and Cie AG, Switzerland.

Suzanne V. McLean * (aged 46) General Counsel and Company Secretary, joined SkyePharma in September 1999. She has 20 years of international commercial legal experience in commerce and industry. Miss McLean's most recent appointment was as Legal Director and Company Secretary at Biocompatibles International plc.

Tamar Howson (aged 52) Non-executive Director, appointed in September 2000. Ms Howson was Senior Vice President and Director Worldwide Business Development at SmithKline Beecham until mid 2000. Ms Howson's previous appointments also include Director of Worldwide Business Development and Licensing at Squibb Corporation.

Dr Jerry Karabelas (aged 48) Non-executive Director, appointed in November 2000. Dr Karabelas has more than 20 years' experience of the pharmaceutical industry having spent the majority of his career with SmithKline Beecham. Dr Karabelas was appointed Chairman of the Novartis Venture Fund in July 2000 having previously held the position of CEO of Novartis Pharma AG. He is also an External Director of Layton Biosciences, California; Fox Chase Cancer Center, The University of the Sciences in Philadelphia, and a member of the Scientific Advisory Committee of the Massachusetts General Hospital, Boston.

*Member of Executive Committee

SkyePharma has wo capability providing su full scale commercial

San Diego

Occupying an 82,000 sq. ft. facility which houses administrative, research and development and future manufacturing activities, DepoTech is located north of San Diego in a purpose built facility suitable for current and future needs.

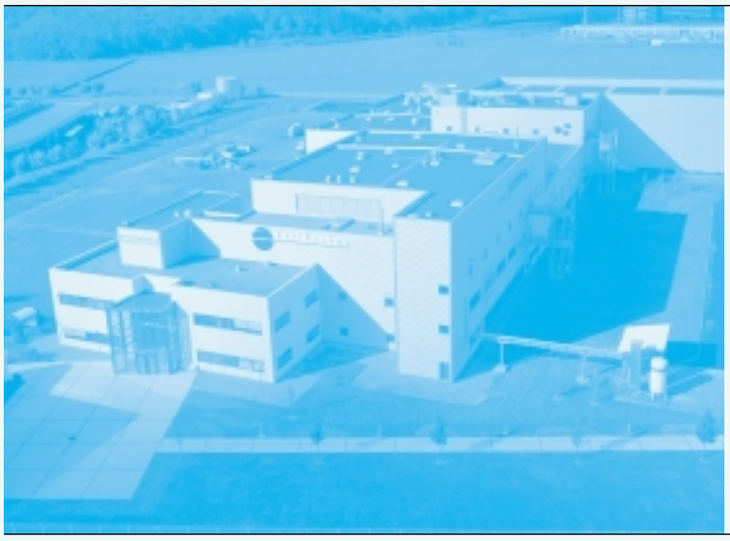
rldwide development and manufacturing pport to clients from feasibility through to manufacturing.

Lyon

Completed in 1994 and purchased by SkyePharma in 1997 the 183,000 sq. ft. Lyon facility is the centre of manufacturing for oral delivery – GEOMATRIX tablets and inhalation powder formulation and filling.

Basel

SkyePharma's research and development facility in Basel is the home of GEOMATRIX and inhalation development. It also provides pilot scale manufacturing capability.



Financial review

Donald Nicholson
Finance Director

Turnover

Turnover in the year ended 31 December 2000 increased by 37% to £24.3 million compared to £17.7 million in 1999. This represents a cumulative annual growth rate of 28% since 1996.

Contract research and development including milestone payments increased by 86% to £16.8 million in 2000. Milestone payments in 2000 include £8.9 million ($14 million) received from Bioglan on the licensing of Solaraze in the US, Canada and Mexico. Manufacturing and distribution revenues decreased to £3.5 million in 2000 compared to £4.6 million in 1999, mainly as a result of the absence of revenues from the manufacture and sale of DepoCyt. Royalty income was earned primarily from the licensing of part of the Group's portfolio of generic products and from Dilacor XR and amounted to £4.0 million in 2000 compared to £4.1 million in 1999. The first royalty income from Xatral was also received in the year. The Company also received £2.9 million during 2000 under its agreement to finance the development of DepoMorphine shown below as 'other operating income'.

Cost of sales

Cost of sales consists of research and development expenditures, including the costs of certain clinical trials incurred on behalf of our collaborative partners; the direct costs of contract manufacturing; direct costs of licensing arrangements; and royalties payable. Cost of sales were £15.6 million in 2000 compared to £14.9 million in 1999. Gross profit trebled to £8.7 million in 2000 compared to £2.9 million in 1999 as a result of the increase in milestone payments received.

Expenses

Selling, marketing and distribution expenses were £3.8 million in 2000 compared to £3.2 million in 1999, primarily due to a full year's expenses for SkyePharma's business development presence in North America. Research and development expenses increased by 95% to £13.1 million compared to £6.7 million in 1999, due primarily to increased expenditure on DepoCyt and DepoMorphine. Administrative expenses were £12.6 million in 2000, the same as in 1999.

Other operating income

In December 2000 the Group received £2.9 million ($4.4 million) under an agreement with Paul Capital Royalty Acquisition Fund, L.P. by which it will receive a total of $30 million over the next two years to fund the clinical development and regulatory submission of DepoMorphine in return for the sale of a proportion of potential future royalty and revenue streams from DepoMorphine and certain SkyePharma products. Research and development costs for DepoMorphine were £4.3 million in 2000. This is explained more fully in note 3.

Operating results

Operating loss fell by 8% from £19.6 million in 1999 to £18.0 million in the year. This was achieved at a time when R&D expenses were almost doubled. The absence of DepoCyt from the market place in 2000 also adversely impacted SkyePharma's operating result by some £5.8 million. DepoCyt was reintroduced to the market in March 2001. The cost of amortising goodwill and recent intellectual property acquisitions more than doubled to £3.3 million during the year.

The Group's loss on ordinary activities before tax was £19.7 million in 2000, after a net interest payable increase of £1.7 million, compared to £19.3 million in 1999. The loss per share for the year fell by 7% to 3.9 pence compared to 4.2 pence in 1999.

Foreign currency exchange movements did not have a material impact on the results of operations in 2000 compared with 1999.

Cash balances and cash flow

On 16 June 2000 the Company issued five-year 6% Convertible Bonds, raising approximately £57.4 million net of expenses. The Bonds have an initial conversion price of 132 pence, representing a premium of 27% over the prevailing market price of 104 pence on the pricing date of 17 May 2000. The conversion price may be recalculated based upon the average of the 10 dealing days prior to 19 June 2001. In no event can the conversion price fall below 83 pence.

At 31 December 2000 SkyePharma had cash and short-term deposits of £42.8 million and bank overdrafts of £2.8 million. The net cash used in operating activities fell by 39% during 2000 to £9.3 million. Purchases of intangible fixed assets were £7.2 million and purchases of tangible fixed assets were £8.4 million. The intangible purchases related principally to the acquisition of the Crystalip, DermaStick and ES-Gel technology rights from Bioglan for £5.9 million and the capitalisation of certain patent costs. The tangible fixed asset purchases in the year relate primarily to the extension of the Group's Muttenz administration building to accommodate the expansion of the Group's Inhalation business and the new solubility technology (£1.6 million) and £3.9 million of expenditure in Muttenz and Lyon related to DPI manufacturing for Foradil, our DPI product with Novartis. Other purchases were £3.0 million, primarily equipment across the Group. The resulting total cash outflow from operations (before financing) for the year was £26.8 million, compared to £29.7 million in 1999. In addition the Group repaid some £3.8 million (net) of debt.

Balance sheet

The Group balance sheet at 31 December 2000 shows shareholders' funds of £69.0 million.

The balance sheet is significantly impacted by goodwill, deferred consideration and shares to be issued. At 31 December 2000 the goodwill recorded within the profit and loss account reserve amounted to £152.6 million and the deferred consideration and shares to be issued amounted to £7.0 million.

As reported last year a settlement agreement was signed on 31 March 2000 establishing the full and final settlement of the deferred consideration payable on the 1996 acquisition of Jago. The settlement was approved by shareholders at the Company's Annual General Meeting held on 11 July 2000. Following approval, some six million Ordinary Shares and 24 million Deferred Shares were issued. The conversion of Deferred Shares into 24 million Ordinary Shares is contingent upon the commercial sale of Paroxetine/Paxil CR (see note 21). The issue of the 24 million Deferred Shares has been recorded on the balance sheet as non-equity shares and non-equity share premium based upon a share value of 94.25 pence, the price on the date of issue.

On 4 April 2000 the Company announced that the final contingent payment on the acquisition of DepoTech had been triggered following the signing of a contract to utilise DepoFoam technology for a macromolecule. As a result 12.1 million shares were issued on 25 April 2000 at a value of £13.3 million, bringing the total consideration payable on the acquisition to £49.4 million.

On 21 July 2000, the Company issued 1,461,455 shares with a market value of $2.0 million to Medac GmbH being deferred consideration due upon the satisfactory transfer of the nano-particulate technology and know-how to SkyePharma.

Under US GAAP, the Company's loss on ordinary activities would have been £29.2 million, and shareholders' equity would be positive at £145.9 million. The increased loss under the US GAAP is due principally to increased amortisation of intangible assets and to differences in revenue recognition.

Forward-looking statements

The foregoing discussions contain certain forward-looking statements with respect to certain development projects, potential collaborative partnerships, results of operations and certain plans and objectives of SkyePharma. By their nature forward-looking statements involve risk and uncertainty that could cause actual results and developments to differ materially from those expressed or implied. The significant risks related to SkyePharma's business are discussed in SkyePharma's SEC filings under the captions, Risk Factors and Certain Investment Considerations.

Donald Nicholson
Finance Director

Report of the Directors

The Directors present their report on the affairs of the Group, together with the consolidated financial statements and auditors' report for the year ended 31 December 2000.

Principal activities and business review

A review of the Operating and Financial business and future developments of the Group is set out in the Chairman's Statement, Review of Operations and Financial Review on pages 6 to 19 and 24 to 25.

The principal activities of the Group are the research and development, manufacture and sale of prescription pharmaceutical products.

Results and dividends

The Group made a loss for the year to 31 December 2000 of £19.7 million (1999: £19.4 million). The Directors do not propose to pay a dividend and the whole of the loss will be transferred to reserves.

Research and development

The Group incurred research and development costs of £13.1 million (1999 : £6.7 million) during the year which has been written off to the profit and loss account in accordance with the Group's accounting policy.

Payment of creditors

The Group's policy is to pay its suppliers within 30 days from receipt of invoice unless otherwise agreed with suppliers prior to goods or services being ordered. Suppliers are made aware of the terms of payment and it is the Company's policy to abide by the agreed terms subject to the terms and conditions being fulfilled by the supplier. At 31 December 2000 creditor days outstanding in respect of the Company amounted to 25 days (1999: 26 days).

Directors

The membership of the Board on 2 April 2001 was as follows:

Ian Gowrie-Smith •
Dr Jacques Gonella
Michael Ashton •
Air Chief Marshal Sir Michael Beavis * †•
Stephen Harris * †
Tamar Howson
Dr Argeris (Jerry) Karabelas
Dr Keith Mansford † •
Donald Nicholson
Walter Zeller * •

Suzanne V McLean
Secretary to the Board

* Audit Committee
† Remuneration Committee
• Nomination Committee

On 3 November 2000 Dr Thomas Rinderknecht retired as a Non-executive Director and on 30 November Nigel Wray retired as a Non-executive Director. On 28 September 2000 Ms Tamar Howson joined the Board as a Non-executive Director and on 30 November 2000 Dr Jerry Karabelas joined the Board as a Non-executive Director.

The Directors retiring by rotation at the Annual General Meeting are Messrs Harris, Mansford and Dr Gonella who, except for Dr Gonella, being eligible, offer themselves for re-election. Dr Gonella will retire from the Board at the conclusion of the AGM. Ms Howson and Dr Karabelas were appointed since the last AGM and retire in accordance with Article 106 of the Company's Articles of Association and being eligible offer themselves for reappointment. In accordance with the Companies Act 1985, S.293, Sir Michael Beavis and Mr Zeller, both having reached 70 years of age, will offer themselves for re-election to be appointed under a resolution of which special notice will be given. Subject to the overriding approval of the shareholders, Non-executive Directors hold their appointments for a period of three years except for those aged over 70.

Details of Directors' interests in the share capital of the Company together with details of the share options granted to them are disclosed in the Report of the Remuneration Committee on pages 29 to 33 of this Report and Accounts.
As at the date of this report, the Directors of the Company had an interest, beneficially and non-beneficially, in an aggregate of 122,132,362 Ordinary Shares, representing 23.6% of the Company's issued share capital.

Directors' and officers' liability insurance

During the period under review, the Company and the Group maintained an insurance policy for its Directors and officers in respect of liabilities which could arise in the discharge of their duties in the ordinary course of business.

Substantial shareholdings

With the exception of Directors' interests as disclosed in the Report of the Remuneration Committee on pages 32 and 33 the Company has not been advised of any individual interests which at 2 April 2001 exceeded 3% of the Company's issued share capital.

Employees and disabled persons

The Group is committed to a policy of promoting employees' awareness of its activities, encouraging employees' participation in the growth of the Group and welcomes staff input at all levels.

It is recognised that by far the most important form of involvement and information regarding the progress, performance and plans of the Group take place during informal daily discussions between management and other employees. It is Group policy to offer the same opportunity to disabled people as to all others in matters of recruitment and career advancement, provided they have the ability to perform the tasks required, with training where appropriate, and to institute retraining where practical in cases where disability is incurred during employment with the Group.

Report of the Directors continued/ Statement of Directors' responsibilities

All employees may have the opportunity to participate in the Company's relevant Share Option Schemes. Details of the schemes are provided in note 21 to the financial statements.

Charitable and political donations

No contributions were made to charities (1999: Nil). No contributions were made to political organisations (1999: Nil).

Close company provisions

The Company is not a 'close' company within the meaning of the Income and Corporation Taxes Act 1988, and there have been no changes since the end of the year.

Annual General Meeting

At the Annual General Meeting to be held on 6 June 2001, the Company proposes to seek the usual limited disapplication of the statutory pre-emption rights on the issue of new shares. The Company also proposes to amend the rules of the Deferred Share Bonus Plan; the Share Option Scheme Part A – Approved Part; the Share Option Scheme Part B – Unapproved Part and the Employees Stock Option Plan. A separate letter from the Chairman explains the reasons for these resolutions, and also contains the Notice of Annual General Meeting.

Auditors

PricewaterhouseCoopers have indicated their willingness to continue in office and a resolution for their reappointment will be proposed at the Annual General Meeting.

By order of the Board

Suzanne V McLean
Company Secretary
2 April 2001

Statement of Directors' responsibility in relation to the accounts

The Directors are required by law to prepare accounts for each financial period which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial period and of the profit or loss for that period. The Directors confirm that suitable accounting policies have been consistently applied and supported by reasonable and prudent judgements and estimates as necessary; applicable accounting standards have been followed, and the Accounts have been prepared on the going concern basis.

The Directors are responsible for ensuring the maintenance of proper accounting records, which disclose with reasonable accuracy the financial position of the Company and the Group at any time and from which accounts can be prepared to comply with the Companies Act 1985. They are also responsible for ensuring the operation of systems of internal control for safeguarding the assets of the Group and for taking reasonable steps to prevent and detect fraud and other irregularities.

The financial statements for the year ended 31 December 2000 are included in the Annual Report 2000, which is published by the Company in hard-copy printed form and on the Company's website on the Internet. The Directors are responsible for the maintenance and integrity of the Annual Report on the website in accordance with UK legislation governing the preparation and dissemination of financial statements. Access to the website is available from outside the UK, where comparable legislation may be different.

Ian Gowrie-Smith
Executive Chairman
2 April 2001

Corporate governance

The Board

The Board of SkyePharma PLC is responsible for the Group's system of corporate governance and is ultimately accountable for its activities throughout the world. The Board comprises three Executive and seven Non-executive Directors. The roles of Chairman and Chief Executive are distinct and are held by different people. The role of Non-executive Directors is to bring independent judgement to Board deliberations and decisions. The Executive and Non-executive Directors are subject to retirement by rotation and re-election by shareholders in accordance with the Articles of Association whereby one-third of the Directors retire by rotation each year.

All Directors have access to the advice and services of the Company Secretary and are able, if necessary, to take independent professional advice at the Company's expense. The Board meets regularly throughout the year. It has a formal schedule of matters reserved to it for decision but otherwise delegates specific responsibilities to committees, as described below.

Board Committees

The Group Executive Committee is responsible for the executive management of the Group. It is chaired by the Chief Executive and comprises the Executive Directors and other Senior Managers as detailed on pages 20 and 21. The Committee generally meets monthly between Board meetings and informs the Board of key issues through the Company Secretary.

The Audit Committee reviews the half year and full year results and the Interim and Annual Report and Accounts prior to their submission to the Board and considers any matters raised by the external auditors. The Committee is chaired by Mr Walter Zeller. It meets formally twice a year with the external auditors in attendance.

Corporate governance continued

The Remuneration Committee approves the remuneration of the Executive Directors and Senior Executives and is responsible for the policy and operation of the SkyePharma Share Option Schemes. The Committee is chaired by Sir Michael Beavis. The Report of the Remuneration Committee is presented on pages 29 to 33 of the Report and Accounts.

The Nomination Committee considers and makes recommendations to the Board on the appointment of Directors and proposes which Non-executive Directors should be invited to retire, having regard to the changing needs of the Board as a whole. The Committee is chaired by Mr Ian Gowrie-Smith. The Committee meets as required.

The members of the Audit Committee, Remuneration Committee and Nomination Committee are detailed on page 26.

Accountability and control

SkyePharma operates, and attaches importance to, clear principles and procedures designed to achieve the accountability and control appropriate to a science-based business operating internationally in a highly regulated business sector.

SkyePharma has established an organisational structure with clearly drawn lines of accountability and delegation of authority. All Group employees are required to adhere to specified codes of conduct, policies and procedures. The identification and appraisal of risks is carried out through the annual process of preparing business plans and budgets and through the close monitoring of operations.

Financial results and key operational and financial performance indicators are reported regularly throughout the year and variances from plans and budgets are investigated and reported. The Group has a system of high-level financial control procedures which are supplemented by detailed procedures at each operating entity.

Compliance with these procedures is monitored by the corporate office supplemented by external audit.

The Board has reviewed the effectiveness of internal financial, operational and compliance controls and risk management as they operated during the year. The Board receives regular reports on areas of significant risk to the Company, and on related internal controls. In addition to its consideration of these reports the Board reviews annually the overall framework and effectiveness of controls. Such a system can provide only reasonable and not absolute assurance against material misstatement or loss.

Going Concern

SkyePharma is an emerging pharmaceutical company and expects to absorb cash until products are fully commercialised. Much of the Group's cash requirement is of an investment nature and is to a great extent discretionary. Further funding may therefore be required dependent on the timing of investments and the development and commercialisation of the Group's own products. The Directors have a reasonable expectation that the Group and the Company have adequate cash resources to continue in operational existence. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

Relations with shareholders

The Company is committed to ongoing communication across the shareholder base, whether to institutional investors, private or employee shareholders. This is achieved through annual and interim reports, other trading statements and the AGM. The website at www.skyepharma.com contains corporate and customer information updated on a regular basis.

The Combined Code

In June 1998, the London Stock Exchange issued the final version of the Principles of Good Governance and Code of Best Practice ('The Code').

The Group is committed to the highest standards of corporate governance. During 2000 the Board considers that the Company complied with all relevant principles and provisions of The Code during the period covered by the annual report and accounts save that there was no recognised senior member of the Non-executive Directors. In the opinion of the Board, considering the extensive experience of the Non-executive Directors, the Board composition of three executive Directors and seven Non-executive Directors and their ability to express concerns both at Board meetings and informally, the appointment of a senior Non-executive Director is not considered to be appropriate at the present time. In the opinion of the Board all of the Non-executive Directors in addition to their considerable experience bring an independence of mind to decision making. However, by reason of his shareholding, Dr J Gonella may not meet the criteria for independence outlined in the Code.

Walter Zeller
Chairman, Audit Committee
2 April 2001

Remuneration report

The Remuneration Committee is comprised wholly of independent, Non-executive Directors of the Company: Sir Michael Beavis (Chairman), Mr R S Harris and Dr K Mansford. The principal function of the Remuneration Committee is to determine, on behalf of the Board, the remuneration and other benefits of all Executive Directors and Senior Executives including pension contributions, bonus payments, share options and service contracts. The fees paid to the Non-executive Directors are determined by the Board.

During the year the Company complied with the recommendations of the Combined Code on Directors' remuneration as implemented by the London Stock Exchange in its Listing Rules for listed companies, including Section B of the Best Practice Provisions annexed thereto.

The Report of the Auditors to the Members of SkyePharma PLC, on page 34 covers the disclosures specified for audit by the Listing Rules.

Executive Director remuneration

The Company's policy on Executive Director remuneration is as follows:

Total level of remuneration

The Remuneration Committee is aware that it must both attract and retain individuals of the highest calibre by offering remuneration that is competitive with comparable publicly listed companies, without paying more than necessary, and fairly and responsibly reward individuals for their contribution to the success of the Company. When setting the remuneration of Directors, levels of remuneration within the Group as a whole are considered.

Base salary

The basic salary of each Executive Director is determined by the Remuneration Committee, taking into account the individual's performance and responsibilities. Directors' emoluments for the year ended 31 December 2000 are set out in the emoluments table on page 31.

Performance bonus

Bonuses are non-pensionable and are based on a percentage of basic salary. Bonuses are paid, at the discretion of the Remuneration Committee, in recognition of the Directors' contribution to the success of the Company and the achievement of specified objectives. In 2000 the primary performance targets were a combination of share price appreciation, corporate financial and individual targets. The Remuneration Committee awarded bonuses of 16%, against a maximum of 25%, to all three Executive Directors as shown in the emoluments table on page 31.

Pension

The Company makes contributions into individual personal pension schemes for UK Directors at a defined percentage of salary excluding bonus and other forms of remuneration.

Future remuneration policy

Early in 2001 the Board completed a review, initiated in late 2000, of the Company's remuneration policy with particular focus on bonus and share remuneration policy. The review carried out by Meis Limited, an independent firm of Executive Compensation Consultants, concluded that Directors' and key executives' basic salary lay largely in the median sector of comparator companies but that the Company's equity arrangements for share options and bonuses did not go far enough to enable the Company to recruit and retain high-calibre individuals. In particular, that the current arrangements did not provide sufficient retention of executives at times when options became less effective due to external market fluctuations independent of the Company's actual performance. In addition the review concluded that the Company's Share Option Schemes needed to be amended to bring them into line with current competitive practices within the markets in which the Company operates while being mindful of ABI Guidelines. As a result of these concerns the SkyePharma PLC Deferred Share Bonus Plan (the Deferred Share Bonus Plan) was implemented and certain amendments are proposed to the Company's existing Option Schemes, full details of which are contained in the Notice of Meeting accompanying this Annual Report. In drawing up these proposed changes, the Board has also consulted with its largest shareholders.

Long-term incentive

The Deferred Share Bonus Plan has been introduced for 2001. Under the Plan, the maximum bonus an Executive of the

Company can earn is increased to 60% of salary but there will be a mandatory deferral, currently 50% of all bonuses in the form of Company shares which will normally have to be held by recipients for a period of three years. As a further inducement to retention of key personnel, the Company is currently proposing to provide one matching share for each executive share acquired, provided that the shares are held for three years. The primary performance targets for the executives of the Company for FY 2001 are that the Company achieves its financial targets for 2001, substantially a break-even position.

Executive Directors and key personnel participate in the SkyePharma Executive Share Option Scheme, the European and North American Scheme and the SkyePharma PLC 1999 Share Option Scheme as appropriate. During 2000, individual participation limits under the schemes were set at four times individual remuneration, with the exception of Super Options set at a further four times remuneration. Options granted under the schemes (other than Super options), granted at the market price ruling at the date of grant, are exercisable after three years and up to a maximum of 10 years from date of grant. Options granted under each of the schemes may be exercised only if over a period of three consecutive years, the shareholder return of the Company exceeds the growth in the FT-SE All Share Index over the same period. Super options, also granted at the market price ruling at the date of grant, are exercisable after five years and are subject to more challenging performance conditions based upon top quartile performance in the FT-SE 250 Index.

Following publication in March 2001 of revised ABI guideline principles relating to equity investment schemes, the Board is seeking shareholder approval to make certain changes to the Company's Option schemes. In particular, it is proposed to remove the individual participation limits described above and introduce an annual limit of 200% of remuneration and to amend the performance conditions so that exercise is dependent upon total shareholder return performance against a comparator group of companies. Full details of the proposed changes requiring shareholder approval are given in the accompanying Circular to shareholders.

Service contracts

All Executive Directors' contracts are for a fixed period of one year from date of appointment, and will continue thereafter unless terminated by at least 12 months' written notice.

Non-executive Directors

The fees paid to the Non-executive Directors are determined by the Board. In 2000 Non-executive Directors were remunerated at a basic rate of £25,000 per annum, adjusted for the acceptance of additional and specific responsibilities. Non-executive Directors do not participate in the Company's Share Option Schemes, nor do they receive pension contributions or a bonus. Non-executive Directors are appointed for three years, except for those aged over 70 who offer themselves for re-election annually. Non-executive Directors do not have service contracts.

Employees

The Group is committed to a policy of encouraging employees' participation in the growth of the Group. As a result, all employees may have the opportunity to participate in the Company's relevant Share Options Schemes. Employee remuneration is determined on an annual basis by the Executive Committee upon guidelines agreed by the Remuneration Committee.
The Remuneration Committee is aware that the Group must attract and retain employees of the highest calibre by offering remuneration that is in line with that offered by industry competitors and local practice in the countries in which it operates.

Directors' remuneration

The table below sets out details of the Directors' emoluments for the years ended 31 December 2000 and 31 December 1999.

	2000				1999			
	Fees and Salary £'000	**Benefits £'000**	**Bonuses £'000**	**Total £'000**	Fees and Salary £'000	Benefits £'000	Bonuses £'000	Total £'000
Executive Directors								
I R Gowrie-Smith (Executive Chairman)	**376**	**20**	**60**	**456**	350	22	60	432
M Ashton	**323**	**59**	**52**	**434**	300	60	51	411
D Nicholson	**161**	**10**	**26**	**197**	150	10	37	197
	860	**89**	**138**	**1,087**	800	92	148	1,040
Non-executive Directors								
Sir M G Beavis	**25**	**–**	**–**	**25**	25	–	–	25
Dr J Gonella	**25**	**–**	**–**	**25**	25	–	–	25
R S Harris	**25**	**–**	**–**	**25**	25	–	–	25
D J Lees (to 19 May 1999)	**–**	**–**	**–**	**–**	10	–	–	10
T Howson (from 28 September 2000)	**6**	**–**	**–**	**6**	–	–	–	–
A N Karabelas (from 30 November 2000)	**2**	**–**	**–**	**2**	–	–	–	–
Dr K Mansford	**25**	**–**	**–**	**25**	25	–	–	25
Dr T Rinderknecht (from 3 November 2000)	**33**	**–**	**–**	**33**	37	–	–	37
N W Wray (to 30 November 2000)	**21**	**–**	**–**	**21**	25	–	–	25
W Zeller	**37**	**–**	**–**	**37**	37	–	–	37
	199	**–**	**–**	**199**	209	–	–	209
	1,059	**89**	**138**	**1,286**	1,009	92	148	1,249

The emoluments of Dr T Rinderknecht and W Zeller include remuneration in respect of their capacity as Non-executive Director of subsidiary companies. Benefits for M Ashton include a living allowance and school fees.

Pensions

Contributions made to defined contribution pension schemes on behalf of the Directors are set out below.

	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
I R Gowrie-Smith	**47**	44
M Ashton	**40**	37
D Nicholson	**20**	19
	107	100

Total Directors' emoluments, excluding pension contributions, amounted to £1,285,707 (1999: £1,249,531). No Director waived emoluments in the year ended 31 December 2000 or 1999.

Directors' interests

The following table sets out the interests of Directors (including the interests of their immediate families and persons connected with the Directors) as at 31 December 2000 and 31 December 1999. All interests are beneficial unless otherwise stated in the notes to the table.

	At 31 December 2000						At 31 December 1999	
	Ordinary Shares	ADRs	'B' Warrants	Deferred 'A' Shares	Deferred 'B' Shares	Convertible Bonds	Ordinary Shares	'B' Warrants
Executive Directors								
I R Gowrie-Smith (1)	**25,122,972**	**–**	**19,797,143**	**–**	**–**	**20,000**	37,122,972	19,797,143
M Ashton	**110,000**	**–**	**–**	**–**	**–**	**–**	110,000	–
D Nicholson	**137,000**	**–**	**–**	**–**	**–**	**–**	137,000	–
Non-executive Directors								
Sir M G Beavis (2)	**172,000**	**–**	**84,000**	**–**	**–**	**–**	172,000	84,000
Dr J Gonella (3)	**96,472,890**	**–**	**–**	**12,000,000**	**12,000,000**	**–**	90,472,890	–
R S Harris	**46,500**	**–**	**–**	**–**	**–**	**–**	46,500	–
T Howson	**–**	**–**	**–**	**–**	**–**	**–**	–	–
A N Karabelas	**–**	**2,000**	**–**	**–**	**–**	**–**	–	–
Dr K Mansford (4)	**16,000**	**–**	**–**	**–**	**–**	**–**	16,000	–
Dr T Rinderknecht	**–**	**–**	**–**	**–**	**–**	**–**	5,785,065	–
N W Wray	**–**	**–**	**–**	**–**	**–**	**–**	8,367,560	1,589,510
W Zeller (5)	**55,000**	**–**	**–**	**–**	**–**	**–**	55,000	–
	122,132,362	**2,000**	**19,881,143**	**12,000,000**	**12,000,000**	**20,000**	142,284,987	21,470,653

Interests in the Ordinary Shares and 'B' Warrants held by N W Wray and Dr T Rinderknecht at 31 December 2000 are not shown as they ceased to be a Director during the year. Similarly, the interests of D J Lees are not shown as at 31 December 2000 or 31 December 1999 as he ceased to be a Director during 1999.

Notes:

(1) 1,340,718 of the Ordinary Shares in which Mr Gowrie-Smith is shown above as having an interest are owned by and registered in the name of Walkvale Limited. The entire issued share capital of Walkvale Limited is held on behalf of The I R Gowrie-Smith Family Trust, the beneficiaries of which are certain members of Mr Gowrie-Smith's family. 19,146,000 Ordinary Shares and 18,387,000 'B' Warrants are registered in the name of Buttress Nominees Limited and 93,000 Ordinary Shares and 93,000 'B' Warrants are registered in the name of Fortress Nominees Limited. All of the existing Ordinary Shares and 'B' Warrants registered in the name of Buttress Nominees Limited and Fortress Nominees Limited are owned by Cangary Limited as trustee of the I R Gowrie-Smith Family Trust. 4,543,254 Ordinary Shares and 1,317,143 'B' Warrants are registered in the name of Estuary Investments Limited. The entire issued share capital of Estuary Investments Limited is also held on behalf of The IR Gowrie-Smith Family Trust, the beneficiaries of which are certain members of Mr Gowrie-Smith's family. The 20,000 convertible bonds due 2005 were acquired on issue in June 2000 and are registered in the name of J M Finn Nominees, account Thornaby.

(2) The Ordinary Shares registered in the name of Dunman Nominees, in which Sir Michael Beavis is beneficially interested are held by Fidelity Trustees Limited for the Kittler Settlement, a family trust.

(3) 17,111,111 of the Ordinary Shares in respect of which Dr Gonella has a beneficial interest are held by Roy Nominees A/c 205000 (Royal Trust of Canada, London), 8,666,667 Ordinary Shares are held by Morstan Nominees Limited, 1,111,111 Ordinary Shares are held by SCS Nominees Limited, 40,584,001 Ordinary Shares are held by NY Nominees Limited, 20,000,000 Ordinary Shares are held by Goldman Sachs Securities Nominees Ltd, 8,700,000 Ordinary Shares are held by HSBC Global Custody Nominees Ltd and 300,000 Ordinary Shares are held by Veritas Anstalt, for Crédit Suisse, Lugano.

(4) 5,000 of the Ordinary Shares beneficially owned by Dr Mansford are registered in the name of Sharelink Nominees Limited.

(5) The Ordinary Shares beneficially owned by Mr Zeller are registered in the name of Rood Nominees Limited.

Save as disclosed in this paragraph, no interest exists which the Company is required pursuant to Section 325 of the Act to enter in the register maintained pursuant to that section.

Options over shares in the Company

Ordinary Options over shares of 10 pence each

Directors	1 January 2000	Granted	31 December 2000	Exercise price	Date from which options can be exercised	Expiry date
I R Gowrie-Smith	**1,234,568**	–	**1,234,568**	81.0p	06-12-99	06-12-06
	575,539	–	**575,539**	69.5p	19-04-02	19-04-09
M Ashton	**639,077**	–	**639,077**	93.0p	31-03-01	31-03-08
	871,451	–	**871,451**	69.5p	19-04-02	19-04-09
D Nicholson	**533,333**	–	**533,333**	75.0p	29-04-99	29-04-06
	86,022	–	**86,022**	93.0p	31-03-01	31-03-08
	172,662	–	**172,662**	69.5p	19-04-02	19-04-09

Super Options over shares of 10 pence each

Directors	1 January 2000	Granted	31 December 2000	Exercise price	Date from which options can be exercised	Expiry date
I R Gowrie-Smith	**2,385,009**	–	**2,385,009**	56.67p	25-05-04	25-05-09
M Ashton	**2,044,293**	–	**2,044,293**	56.67p	25-05-04	25-05-09
D Nicholson	**1,022,147**	–	**1,022,147**	56.67p	25-05-04	25-05-09

The above options are granted to Directors under the terms of the SkyePharma Executive Share Option Scheme, the European and North American Scheme and the SkyePharma PLC 1999 Share Option Scheme described on page 55.

As at 31 December 2000, none of the Directors had any interests in shares of any other Group company. The market value of Ordinary Shares at 31 December 2000 was 64 pence. The market value of Ordinary Shares during 2000 ranged from the lowest closing mid price of 49.75 pence to the highest closing mid price of 190.0 pence. There has been no change in the total interest of each Director since 31 December 2000.

Sir Michael Beavis
Chairman, Remuneration Committee

2 April 2001

Auditors' report to the members of SkyePharma PLC

We have audited the financial statements on pages 29 to 33 and 35 to 62 which have been prepared under the historical cost convention and the accounting policies set out on pages 42 and 43.

Respective responsibilities of directors and auditors

The Directors are responsible for preparing the Annual Report. As described on page 27, this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and the Listing Rules of the Financial Services Authority and our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the United Kingdom Companies Act. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding Directors' remuneration and transactions is not disclosed.

We read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

We review whether the statement on pages 27 and 28 reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group at 31 December 2000 and of its loss and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers
Chartered Accountants and
Registered Auditors
London
2 April 2001

Consolidated profit and loss account

	Notes	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
Turnover	2	**24,292**	17,739
Cost of sales	2	**(15,598)**	(14,854)
Gross profit		**8,694**	2,885
Selling, marketing and distribution expenses		**(3,844)**	(3,161)
Administration expenses			
Amortisation		**(3,339)**	(1,540)
Other administration expenses		**(9,291)**	(11,044)
		(12,630)	(12,584)
Research and development expenses		**(13,104)**	(6,728)
Other operating income	3	**2,900**	–
Operating loss	2,4	**(17,984)**	(19,588)
Share of operating loss in Joint Venture		**–**	(48)
Loss on ordinary activities before interest and tax		**(17,984)**	(19,636)
Reversal of provision for loss on disposal of fixed asset investment		**–**	381
Interest receivable		**1,806**	1,364
Interest payable	6	**(3,508)**	(1,391)
Loss on Ordinary activities before taxation		**(19,686)**	(19,282)
Taxation	7	**(4)**	(132)
Retained loss		**(19,690)**	(19,414)
Basic and diluted loss per Ordinary Share	8	**(3.9p)**	(4.2p)

There was no material difference between the loss on ordinary activities before taxation and the historical cost loss before taxation in 2000 and 1999. All results represent continuing activities.

See Notes to the Financial Statements.

Consolidated balance sheet

	Notes	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
Fixed assets			
Intangible assets	9	**72,086**	49,753
Tangible assets	10	**40,288**	33,838
		112,374	83,591
Current assets			
Stocks	12	**1,636**	1,134
Debtors	13	**6,937**	8,335
Cash and short-term bank deposits		**42,878**	13,674
		51,451	23,143
Creditors – amounts falling due within one year	14	**(20,541)**	(16,632)
Net current assets		**30,910**	6,511
Total assets less current liabilities		**143,284**	90,102
Creditors – amounts due after more than one year			
Other creditors	15	**(14,667)**	(15,855)
Convertible debentures due February 2001		**–**	(103)
Convertible bonds due June 2005	16	**(57,546)**	–
		(72,213)	(15,958)
		71,071	74,144
Provisions for liabilities and charges			
Deferred consideration	17	**2,008**	1,861
Other	17	**111**	226
		2,119	2,087
Capital and reserves			
Share capital	21	**54,132**	49,409
Share premium	23	**261,569**	221,091
Currency translation reserve	23	**(1,427)**	(2,185)
Shares and warrants to be issued	22	**4,985**	38,131
Other reserves	23	**11,212**	11,058
Profit and loss account	23	**(261,519)**	(245,447)
Shareholders' funds			
Attributable to equity interests		**46,332**	72,057
Attributable to non-equity interests		**22,620**	–
		68,952	72,057
		71,071	74,144

Approved by the Board of Directors on 2 April 2001 and signed on its behalf by:

I R Gowrie-Smith
Executive Chairman

D Nicholson
Finance Director

See Notes to the Financial Statements

Company balance sheet

	Notes	31 December 2000 £'000	31 December 1999 £'000
Fixed assets			
Tangible assets	10	**214**	271
Investments	11	**338,038**	287,937
		338,252	288,208
Current assets			
Debtors	13	**6,457**	7,852
Cash and short-term bank deposits		**36,595**	6,471
		43,052	14,323
Creditors – amounts falling due within one year	14	**(7,860)**	(2,981)
Net current assets		**35,192**	11,342
Total assets less current liabilities		**373,444**	299,550
Creditors – amounts due after more than one year			
Convertible debentures due February 2001		**–**	(103)
Convertible bonds due June 2005	15	**(57,546)**	–
		315,898	299,447
Provisions for liabilities and charges			
Deferred consideration	17	**2,008**	1,861
Other	17	**26**	–
		2,034	1,861
Capital and reserves			
Share capital	21	**54,132**	49,409
Share premium	23	**261,569**	221,091
Shares and warrants to be issued	22	**4,985**	38,131
Other reserves	23	**11,212**	11,058
Profit and loss account	23	**(18,034)**	(22,103)
Shareholders' funds			
Attributable to equity interests		**291,244**	297,586
Attributable to non-equity interests		**22,620**	–
		313,864	297,586
		315,898	299,447

Approved by the Board of Directors on 2 April 2001 and signed on its behalf by:

I R Gowrie-Smith
Executive Chairman

D Nicholson
Finance Director

See Notes to the Financial Statements

Consolidated cash flow statement

	Notes	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
Net cash outflow from operating activities	(b)	**(9,312)**	(15,139)
Returns on investments and servicing of finance			
Interest received		**1,297**	1,449
Interest paid		**(2,941)**	(1,337)
Interest element of finance lease payments		**(232)**	(92)
		(1,876)	20
Taxation		**(8)**	(194)
Capital expenditure and financial investment			
Purchase of intangible fixed assets		**(7,180)**	(4,029)
Purchase of tangible fixed assets		**(8,470)**	(7,820)
Proceeds from sale of fixed asset investment		**–**	381
		(15,650)	(11,468)
Acquisition and disposals			
Purchase of subsidiary undertakings		**–**	(2,998)
Net cash acquired with subsidiary		**–**	48
		–	(2,950)
Cash outflow before use of liquid resources and financing		**(26,846)**	(29,731)
Management of liquid resources			
Net (increase)/decrease in amounts held in short-term bank deposits		**(21,641)**	19,989
Financing			
Issue of Ordinary Share capital		**2,088**	5,038
Issue of convertible bonds		**59,400**	–
Expenses of convertible bond issue		**(2,022)**	–
Debt due within one year:			
Increase in borrowings		**1,187**	–
Repayment of loans		**(2,846)**	(460)
Debt due beyond one year:			
Increase in borrowings		**–**	2,998
Repayment of loans		**(1,226)**	(1,357)
Lease payment received under sale and lease back transaction		**–**	2,999
Repayment of capital element of finance lease payments		**(891)**	(944)
		55,690	8,274
Increase/(decrease) in cash		**7,203**	(1,468)

Notes to the consolidated cash flow statement

(a) Reconciliation of movements in net (debt)/funds

	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
Increase/(decrease) in cash in the year	**7,203**	(1,468)
Cash outflow/(inflow) from change in debt and lease financing	**3,776**	(3,236)
Cash outflow/(inflow) from increase in liquid resources	**21,641**	(19,989)
Issue of convertible bonds	**(57,378)**	-
Change in net debt resulting from cash flows	**(24,758)**	(24,693)
Loans and finance leases acquired with subsidiary	**–**	(5,187)
Short-term bank deposits acquired with subsidiary	**–**	3,223
New finance leases	**–**	(34)
Conversions of debentures	**103**	2,337
Debenture interest	**–**	(116)
Expenses of convertible bonds	**(167)**	
Issue of loan note	**(2,307)**	(6,008)
Translation difference	**(907)**	921
Movement in net debt in the year	**(28,036)**	(29,557)
Net (debt)/funds at beginning of the year	**(8,254)**	21,303
Net debt at end of the year	**(36,290)**	(8,254)

Net (debt)/funds is defined as cash and liquid resources less borrowings.

(b) Reconciliation of operating loss to net cash outflow from operating activities

	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
Operating loss	**(17,984)**	(19,588)
Depreciation	**3,945**	3,842
Amortisation	**3,339**	1,540
(Increase)/decrease in stocks	**(426)**	325
Decrease/(increase) in debtors	**3,247**	(1,627)
(Decrease)/increase in creditors	**(1,283)**	1,124
Decrease in provisions	**(150)**	(755)
Net cash outflow from operating activities	**(9,312)**	(15,139)

Notes to the consolidated cash flow statement continued

c) Analysis of net debt

	At 1 January 2000 £'000	Cash flow £'000	Non-cash changes £'000	Exchange movement £'000	**At 31 December 2000 £'000**
Cash at bank and in hand	3,465	7,014	–	290	**10,769**
Overdrafts	(2,809)	189	–	(228)	**(2,848)**
Short-term bank deposits	10,209	21,641	–	259	**32,109**
	10,865	28,844	–	321	**40,030**
Debt due within one year	(4,424)	1,659	(3,055)	(411)	**(6,231)**
Debt due after one year	(11,305)	(56,152)	684	(768)	**(67,541)**
Finance leases	(3,390)	891	–	(49)	**(2,548)**
	(19,119)	(53,602)	(2,371)	(1,228)	**(76,320)**
Total	(8,254)	(24,758)	(2,371)	(907)	**(36,290)**

Cash at bank and in hand and short-term deposits are aggregated on the balance sheet. Debt includes a secured mortgage and convertible bonds.

Other non-cash changes relate to the conversion of debentures, amortisation of the issue costs on the convertible bonds and the issue of a further portion of the Chiron loan note (see note 15: Creditors: amounts falling due after more than one year).

Statement of total recognised gains and losses

	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
Loss attributable to shareholders	**(19,690)**	(19,414)
Net currency translation effect		
Group	**758**	(2,220)
Share of Joint Venture	**–**	(627)
	758	(2,847)
Total recognised gains and losses for the year	**(18,932)**	(22,261)

Reconciliation of movements in shareholders' funds

	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
Shareholders' funds at the beginning of the year	**72,057**	6,235
Total recognised gains and losses for the year	**(18,932)**	(22,261)
Reinstatement on dissolution of joint venture of goodwill previously written off to reserves	**–**	5,760
Goodwill adjustments on deferred consideration	**3,618**	8,900
Equity shares issued, net of expenses	**22,581**	41,573
Non-equity shares issued, net of expenses	**22,620**	–
(Decrease)/increase in shares and warrants to be issued	**(29,528)**	40,750
Revaluation of shares and warrants to be issued	**(3,618)**	(8,900)
Issue of warrants	**154**	–
Net movement in the year	**(3,105)**	65,822
Shareholders' funds at the end of the year	**68,952**	72,057

1 Accounting policies

Accounting convention and presentation
The financial statements have been prepared under the historical cost convention and in accordance with applicable UK accounting standards. The principal accounting policies, which have been applied consistently, are set out below. The results for the year all relate to continuing operations. The financial statements have been prepared on a going concern basis.

The Group has applied two new accounting standards during the period. The publication of FRS 15 and FRS 16 has not required any amendment to the Group's existing accounting policies.

Consolidation
The consolidated financial information includes the financial statements for the Company and its subsidiary undertakings. Intra-group sales and profits are eliminated fully on consolidation. The results of subsidiaries sold or acquired are included in the consolidated profit and loss account up to the date of their sale or from their date of acquisition respectively.

Investments which are held for the long term and where the Group exercises joint control are accounted for using the gross equity method. Where the Group has certain contractual agreements with other participants to engage in joint activities that do not create an entity carrying on a trade or business of its own, they are accounted for as a joint arrangement. The Group includes its share of the assets, liabilities and cash flows in such joint arrangements measured in accordance with the terms of each arrangement which is usually pro-rata to the Group's interest in the joint arrangement.

Revenue recognition
Turnover comprises contract development, manufacturing and distribution, and royalty income. Contract development income represents amounts invoiced to customers for services rendered under development contracts or for non-refundable milestone payments and technology access fees in accordance with the contract terms. Manufacturing and distribution revenues principally comprise manufacturing fees invoiced to Wyeth-Ayerst International Inc. and its affiliated companies formerly under a three-year manufacturing contract entered into on the acquisition of the Group's manufacturing facility in Lyon which expired in 1999 and subsequently under a new two-year agreement, non-contract manufacturing revenues under a collaboration agreement with Chiron Corporation, plus other contract manufacturing revenue and income from product sales. Royalty income represents income earned as a percentage of product sales. Advance royalties received are treated as deferred income until earned, when they are recognised as income.

Research and development costs
Research costs are charged as an expense in the period in which they are incurred. Development costs are also recognised as an expense in the period in which they are incurred, unless all of the criteria are met for asset recognition. The major asset recognition criteria include: the ability to clearly define the product or process, demonstration of its technical feasibility and that a market for it exists. Development costs recognised as an asset do not exceed the probable net amount to be recovered in marketing the product or process and they are amortised over the estimated economic life.

Foreign currencies
Foreign currency transactions by Group companies are booked in local currency at the exchange rate ruling on the date of transaction. Assets and liabilities expressed in foreign currencies are translated into sterling at the exchange rates ruling at the balance sheet date. Unrealised gains and losses on forward contracts undertaken to manage foreign currency exposure are deferred and are recognised in the same period that the foreign currency exposure is recognised. Exchange differences which relate to the translation of net assets of overseas companies are taken directly to reserves. All other foreign exchange differences are taken to the profit and loss account in the year in which they arise. The Group uses the average of exchange rates prevailing during the year to translate the results of overseas subsidiaries into sterling and year-end rates to translate the net assets of those undertakings.

Tangible fixed assets
Tangible fixed assets are included in the balance sheet at cost less accumulated depreciation. Depreciation is provided on tangible fixed assets at rates calculated to write off the cost, less estimated residual value, of each asset over its expected useful life. The rates and bases are as follows:

Freehold land	not depreciated
Freehold buildings	2% - 5% straight line
Short leasehold property	period of lease
Plant, equipment and fixtures	10% - 33% straight line
Motor vehicles	20% straight line
Finance leases	period of lease

Intangible fixed assets
Intangible fixed assets comprise goodwill, intellectual property and capitalised development costs. Goodwill, both positive and negative, being the difference between the purchase consideration in subsidiary undertakings and the Group's share of the fair value of the net assets acquired, is capitalised and amortised over a period of 20 years or less in line with the Directors' view of its useful economic life. Prior to the introduction of FRS 10, the policy adopted was to write off goodwill to reserves. As permitted by FRS 10 goodwill written off to reserves in previous years has not been reinstated on the balance sheet and adjustments to such goodwill have been taken directly to reserves. Goodwill previously written off to reserves is charged to the profit and loss account in the event of disposal of the related business.

Intellectual property comprises acquired patents, trademarks, know-how and other similarly identified rights. These are recorded at their fair value at acquisition date and are amortised in equal instalments over their estimated economic lives, from the date when the transfer of technology is complete. The period over which the Group expects to derive economic benefits does not exceed 20 years. Costs associated with internally developed intellectual property are generally treated as research and development costs. Development costs are recognised under the criteria stated above. Intangible fixed assets are reviewed for impairment and any provision charged to the profit and loss account.

1 Accounting policies (continued)

Fixed asset investments
Group fixed asset investments of marketable equity securities are recorded at cost, less provision for permanent diminution in value. In addition, the Company has fixed asset investments relating to equity and loan investments in subsidiaries.

Stocks and work-in-progress
Stocks and work-in-progress are valued at the lower of cost and net realisable value and calculated using the first-in, first-out basis.

Liquid Resources
Liquid resources comprise short-term bank and commercial deposits with a maturity of less than one year.

Deferred consideration
The provision for deferred consideration comprises the fair value of contingent consideration arising from acquisitions. The eventual outcome is subject to the Group's future performance and certain contractual terms. The provision is reviewed annually by the Directors and changes to the estimated fair value of the contingent consideration are recorded as an adjustment to goodwill or the underlying asset value. Where the effect of the time value of money is material the provision is reflected at its present value and the interest element arising on discounting the liability is recorded as interest payable in the profit and loss account as it unwinds.

Deferred taxation
Deferred taxation is provided on timing differences using the liability method where it is probable that tax liabilities or assets will crystallise within the foreseeable future.

Leased and hired assets
Assets acquired under hire purchase and finance lease agreements are included in tangible fixed assets. The capital element of amounts owed to the finance company at the balance sheet date is included in creditors as amounts falling due either within or after more than one year. Repayments are treated as consisting of both capital and interest with the interest element being charged to the profit and loss account in proportion to the outstanding obligations. Payments under operating leases and short-term hire contracts are charged to the profit and loss account as they fall due.

Pension costs
The costs of the Group's defined contribution pension arrangements are charged to the profit and loss account in the year to which they relate. The costs of the Group's defined benefits scheme are charged on a systematic basis allowing for the expected pension cost over the service lives of employees, based on actuarial advice.

Convertible debt
On issue, convertible debt is stated at the amount of net proceeds after deducting issue costs. On conversion the amount recognised in shareholders' funds in respect of the shares issued is equal to the carrying value at the date of conversion. Interest payable on convertible debt is calculated to unwind the issue costs and any discount on issue at a constant rate over the term of the debt.

2 Segmental analysis

The Group's operations relate wholly to one class of business, pharmaceuticals. A further analysis of turnover, operating loss and net assets by geographical area is set out below, together with an analysis of cost of sales.

	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
(a) Turnover		
By class of business:		
Pharmaceuticals		
Contract development, including milestone payments	**16,805**	9,045
Manufacturing and distribution	**3,476**	4,597
Royalties receivable	**4,011**	4,097
	24,292	17,739
Contract development split:		
R&D costs recharged	**4,808**	6,078
Milestone payments	**11,997**	2,967
	16,805	9,045
By location of customer:		
UK	**13,178**	2,237
Continental Europe	**6,095**	10,812
US	**4,284**	4,590
Rest of the world	**735**	100
	24,292	17,739
By location of operation:		
Continental Europe	**22,646**	14,219
US	**1,646**	3,520
	24,292	17,739

	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
(b) Cost of sales		
By class of business:		
Pharmaceuticals		
Contract development	**(6,986)**	(5,780)
Manufacturing and distribution	**(7,073)**	(8,241)
Royalties payable	**(1,539)**	(833)
	(15,598)	(14,854)

2 Segmental analysis (continued)

	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
(c) Operating loss		
By class of business:		
Pharmaceuticals	**(17,984)**	(19,588)
By location of operation:		
UK	**(5,291)**	(4,733)
Continental Europe	**973**	(4,776)
US	**(13,666)**	(10,079)
	(17,984)	(19,588)

	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
(d) Net assets		
By class of business:		
Pharmaceuticals	**68,952**	72,057
By location of operation:		
UK	**95,764**	105,405
Continental Europe	**(67,138)**	(62,508)
US	**40,326**	29,160
	68,952	72,057

3 Other operating income

Other operating income in 2000 consists of £2.9 million ($4.4 million) earned under the agreement with Paul Capital Royalty Acquisition Fund, L.P. ('PCRAF') to develop DepoMorphine. Under the agreement, PCRAF will provide a total of $30 million over the next two years, to fund the clinical development and regulatory submission of DepoMorphine, in return for the sale of a portion of potential future royalty and revenue streams from DepoMorphine, Xatral OD, Solaraze and DepoCyt. Between January 2003 and December 2014, PCRAF will receive 15% of the annual royalties and revenues from the stated products, up to an agreed ceiling. Once the predetermined ceiling is reached, the percentage participation will fall to 3% for the remainder of the period until 31 December 2014.

4 Operating loss

Operating loss is stated after charging:

	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
Auditors' remuneration (details of non-audit services shown below)		
– audit of SkyePharma PLC	**64**	39
– audit of subsidiary undertakings – overseas	**117**	101
Depreciation of tangible fixed assets		
– owned assets	**3,501**	3,508
– assets held under finance leases	**441**	334
Amortisation of intangible fixed assets		
– amortisation of goodwill	**2,099**	1,211
– amortisation of intellectual property	**1,082**	329
Research and development expenses		
– current year expenditure	**13,104**	6,728
– amortised from deferred expenditure	**158**	–
Operating lease rentals		
– hire of plant and machinery	**2,593**	1,844
– other	**373**	486

4 Operating loss (continued)

It is the Group's policy to employ PricewaterhouseCoopers on assignments additional to their statutory audit duties where their expertise and experience with the Group are important, principally tax advice and due diligence reporting on acquisitions, or where they are awarded assignments on a competitive basis. During the year PricewaterhouseCoopers earned the following fees from the Group:

	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
Due diligence and other audit-related work	**159**	152
Tax advice	**231**	230
Other services	**144**	66
Total non-audit fees	**534**	448

5 Employees

	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
Employment costs:		
Wages and salaries	**13,506**	11,559
Social security costs	**2,011**	1,815
Pension costs	**532**	469
	16,049	13,843

The average number of persons employed by the Group during the year was as follows:

	Year to 31 December 2000 Number	Year to 31 December 1999 Number
Pharmaceuticals	**373**	354

6 Interest payable

	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
Interest payable on bank loans, overdrafts and other loans:		
Repayable within five years, not by instalments	**268**	242
Repayable within five years, by instalments	**715**	630
Repayable wholly or partly in more than five years	**241**	311
Finance leases	**232**	92
Interest on convertible debentures	**–**	116
Interest on convertible bonds	**2,052**	–
	3,508	1,391

7 Taxation

Loss from ordinary activities before taxes, as shown in the consolidated profit and loss account, is analysed over its component parts as follows:

	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
UK	**4,069**	234
Overseas	**(23,755)**	(19,516)
	(19,686)	(19,282)
Taxation charge based on profits for the year:		
UK corporation tax	**–**	–
Overseas taxation	**(19)**	(57)
Under-provision in previous years	**15**	(75)
	(4)	(132)

There was no deferred tax component in the tax charge for the years presented.

The Group has estimated total tax losses available to be set off against future taxable profits of £165.5 million (31 December 1999: £105.0 million). These losses arise primarily in the UK, Switzerland and US. Of the £165.5 million of losses carried forward, £1.3 million expire in 2001, £24.0 million expire between 2002 and 2004, £127.0 million expire from 2005 onwards and £13.2 million of losses may be carried forward indefinitely.

The above charges reconcile with the applicable UK statutory corporation tax rates as follows:

	Year to 31 December 2000 %	Year to 31 December 1999 %
Statutory UK Corporation tax rate	**30.0**	30.3
Tax rate differences	**12.0**	9.0
Tax losses not recognised as deferred tax assets	**(21.9)**	(26.1)
Other items not recognised as deferred tax assets	**(35.2)**	0.2
Other	**15.0**	(13.7)
Prior year items	**0.1**	(0.4)
Effective tax rate	**(0.0)**	(0.7)

8 Loss per Ordinary Share

	Year to 31 December 2000	Year to 31 December 1999
Attributable loss (£'000)	**(19,690)**	(19,414)
Weighted average number of shares in issue ('000)	**508,228**	467,214
Loss per share	**(3.9p)**	(4.2p)

There is no difference between basic and diluted loss per share since all potential Ordinary Shares including convertible bonds, warrants and options are anti-dilutive.

9 Intangible fixed assets

Group	Goodwill £'000	Intellectual property £'000	Development costs £'000	Total £'000
Cost				
1 January 2000	32,306	17,836	1,531	51,673
Exchange adjustments	–	1,918	161	2,079
Additions	13,720	10,017	–	23,737
At 31 December 2000	46,026	29,771	1,692	77,489
Amortisation				
1 January 2000	1,211	484	225	1,920
Exchange adjustments	–	113	31	144
Charge for the year	2,099	1,082	158	3,339
At 31 December 2000	3,310	1,679	414	5,403
Net book value at 1 January 2000	31,095	17,352	1,306	49,753
Net book value at 31 December 2000	42,716	28,092	1,278	72,086

On 4 April 2000 the Company announced that the final contingent payment on the acquisition of DepoTech had been triggered following the signing of a contract to utilise DepoFoam technology for a macromolecule. As a result 12.1 million shares were issued on 25 April 2000 at a value of £13.3 million.

In connection with the acquisition of DepoTech, the Company agreed that outstanding warrants to purchase DepoTech common stock on the effective date of the merger would become warrants to purchase the Company's Ordinary Shares. Following the issue of shares on 25 April 2000, the former DepoTech shareholders became entitled to a further 458,144 warrants with a value of £0.2 million.

Taking into account the final payments above, the total consideration paid on the acquisition of DepoTech was £49.4 million.

Significant additions to intellectual property during the year comprised £5.9 million ($9 million) paid to Bioglan for certain exclusive development and commercial rights in relation to new products from the Crystalip and DermaStick technologies and also the right to develop with Bioglan two new products in the ES-Gel system, £2.3 million ($3.5 million) capitalised on the Chiron Loan note (see note 15; Amounts falling due after more than one year) and an additional Cdn$1.3 million paid to the receiver of Hyal (see note 11(a); Investments).

10 Tangible fixed assets

Group	Land and buildings £'000	Laboratory equipment and machines £'000	Assets in the course of construction £'000	Office and other equipment £'000	Motor vehicles £'000	Total £'000
Cost						
At 1 January 2000	23,439	14,659	1,105	2,613	277	42,093
Exchange adjustments	851	1,092	171	176	15	2,305
Additions	330	5,113	2,334	930	29	8,736
Disposals	–	(277)	(1)	(76)	–	(354)
At 31 December 2000	24,620	20,587	3,609	3,643	321	52,780
Depreciation						
At 1 January 2000	3,259	3,477	–	1,370	149	8,255
Exchange adjustments	155	319	–	72	10	556
Disposals	–	(197)	–	(64)	–	(261)
Charge for the year	1,407	1,929	–	546	60	3,942
At 31 December 2000	4,821	5,528	–	1,924	219	12,492
Net book value at 1 January 2000	20,180	11,182	1,105	1,243	128	33,838
Net book value at 31 December 2000	19,799	15,059	3,609	1,719	102	40,288

10 Tangible fixed assets continued

Land and buildings, at net book value, is as follows:

	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
Freehold property	**17,365**	17,812
Long leaseholds	**–**	2,306
Short leaseholds	**2,434**	62
	19,799	20,180

Included in freehold property is an amount of £4,561,000 (31 December 1999: £4,335,000) in respect of land which is not depreciated.

Tangible fixed assets include net book value of £2,922,000 (31 December 1999: £5,616,000) in respect of assets held under finance leases and hire purchase contracts.

Company	Land and buildings £'000	Office and other equipment £'000	Motor vehicles £'000	Total £'000
Cost				
At 1 January 2000	107	424	75	606
Additions	–	40	–	40
Disposals	–	(3)	–	(3)
At 31 December 2000	107	461	75	643
Depreciation				
At 1 January 2000	45	241	49	335
Disposals	–	(1)	–	(1)
Charge for the period	11	69	15	95
At 31 December 2000	56	309	64	429
Net book value at 1 January 2000	62	183	26	271
Net book value at 31 December 2000	51	152	11	214

11 Investments

(a) Group

Fixed asset investment

On 28 October 1999 SkyePharma completed its acquisition of the tangible assets and intellectual property of Hyal Pharmaceutical Corporation of Mississauga, Ontario ('Hyal') for a purchase price of Cdn$14.0 million. Consideration was satisfied by the set-off of Cdn$11.6 million of SkyePharma's secured and unsecured debt owed by Hyal including the interest due and $2.4 million in cash. In addition, and because Hyal was in receivership at this time, SkyePharma indemnified the receiver to the extent that Cdn$11.6 million exceeded the amount that SkyePharma may ultimately be entitled to receive as a creditor of Hyal. This indemnity was secured by an irrevocable letter of credit open for up to one year in the amount of Cdn$1.0 million.

During 2000 the letter of credit was called to recover the shortfall in the receivership process. In return, SkyePharma, as one of the creditors of Hyal, was awarded seven Hyal shares for every dollar shortfall in the process. As a result, SkyePharma will receive approximately 8.1 million shares, representing approximately 19.5% of Hyal in 2001. Since the shares are not currently traded on a public market there is currently no value attributable to these shares and thus they will be recorded at zero cost.

(b) Company

	Shares in group undertakings £'000	Loans to group undertakings £'000	Total £'000
At 1 January 2000	154,626	133,311	287,937
Additions	13,719	40,000	53,719
Revaluation of shares and warrants to be issued (note 22)	(3,618)	–	(3,618)
At 31 December 2000	164,727	173,311	338,038

12 Stocks

	Group 31 December 2000 £'000	Group 31 December 1999 £'000
Raw materials and consumables	**1,428**	1,082
Work in progress	**206**	32
Finished goods	**2**	20
	1,636	1,134

The replacement cost of stocks is not materially different from original cost.

13 Debtors

	Group 31 December 2000 £'000	Group 31 December 1999 £'000	Company 31 December 2000 £'000	Company 31 December 1999 £'000
Trade debtors	**1,118**	5,403	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**4,181**	7,141
Other debtors	**1,261**	1,219	**448**	336
Prepayments and accrued income	**3,016**	1,634	**286**	337
Interest receivable	**1,542**	79	**1,542**	38
	6,937	8,335	**6,457**	7,852

14 Creditors: amounts falling due within one year

	Group 31 December 2000 £'000	Group 31 December 1999 £'000	Company 31 December 2000 £'000	Company 31 December 1999 £'000
Bank overdrafts	**2,848**	2,809	**–**	–
Bank loans	**3,120**	2,263	**–**	–
Current portion of secured mortgage (note 15)	**165**	155	**–**	–
Current portion of Chiron loan note (note 15)	**2,946**	2,006	**–**	–
Trade creditors	**2,836**	3,279	**155**	90
Amounts owed to fellow subsidiary undertakings	**–**	–	**4,706**	1,800
Corporation tax	**3**	7	**–**	–
Other taxation and social security costs	**233**	1,406	**55**	96
Obligations under hire purchase and finance leases	**861**	1,132	**–**	–
Accruals and deferred income	**7,529**	3,575	**2,944**	995
	20,541	16,632	**7,860**	2,981

At 31 December 2000 the Group had a secured overdraft facility of £2.0 million with the Basellandschaftliche Kantonalbank. In addition, and included within bank loans, the Kantonalbank has extended a fixed credit facility of £0.6 million and a construction loan of £1.3 million. Both loans are renewable annually and bear interest at 6.0% and 3.0% respectively. The overdraft and bank loans are all secured on the assets of Jago with the overdraft and credit facility also guaranteed by SkyePharma PLC.

At 31 December 2000 the Group also had an overdraft facility with Société Générale of £0.8 million, secured by the trade debtors of SkyePharma Production SAS and guaranteed by SkyePharma PLC.

15 Creditors: amounts falling due after one year

	Group 31 December 2000 £'000	Group 31 December 1999 £'000	Company 31 December 2000 £'000	Company 31 December 1999 £'000
Bank loans	**71**	1,222	**–**	–
Secured mortgage	**6,197**	5,969	**–**	–
Chiron loan note	**3,727**	4,011	**–**	–
Deferred income	**2,985**	2,395	**–**	–
Convertible debt:				
Convertible debentures due February 2001	**–**	103	**–**	103
Convertible bonds due June 2005	**57,546**	–	**57,546**	–
Obligations under finance leases	**1,687**	2,258	**–**	–
	72,213	15,958	**57,546**	103
Bank and other loans are repayable as follows:				
Between one and two years	**3,181**	3,316	**–**	–
Between two and three years	**946**	2,227	**–**	–
Between three and four years	**3,139**	155	**–**	–
Between four and five years	**166**	2,946	**–**	–
After five years	**2,563**	2,558	**–**	–
	9,995	11,202	**–**	–
Obligations under finance leases are repayable as follows:				
Between one and two years	**842**	758	**–**	–
Between two and three years	**844**	743	**–**	–
Between three and four years	**1**	757	**–**	–
Between four and five years	**–**	–	**–**	–
	1,687	2,258	**–**	–

At 31 December 2000 the Group had a property mortgage facility with the Basellandschaftliche Kantonalbank of £6.4 million. The mortgage is in two tranches, both secured by the assets of Jago, and guaranteed by SkyePharma PLC. The first tranche bears interest at 5.0% and is repayable by instalments over 21 years semi-annually. The second tranche bears interest at 3.0% and is repayable in 2004.

At 31 December 2000 the Group had £1.3 million outstanding on a loan payable to the Silicon Valley Bank of which £1.2 million is shown within current liabilities. The loan is secured upon specific fixed assets of SkyePharma Inc. and is guaranteed by SkyePharma PLC. The loan bears a floating rate of interest set at the US prime rate plus 0.5% and the principal is repayable in monthly instalments until February 2002.

At 31 December 2000 the Group had £6.7 million outstanding on the Chiron loan note of which £2.9 million is shown within current liabilities. The original note was issued in 1999 on the acquisition of SkyePharma Inc. (formerly DepoTech Corporation). Under a collaboration agreement with Chiron Corporation, DepoTech had an obligation to pay Chiron $11.7 million within six months of US or European marketing approval of DepoCyt. Consequent upon the acquisition, SkyePharma, DepoTech and Chiron further amended the agreement with Chiron in March 1999 such that the Group issued a note payable to Chiron of $9.7 million on the receipt of FDA approval of DepoCyt on 1 April 1999. During 2000, SkyePharma and Chiron amended the March 1999 agreement whereby SkyePharma would have issued a note payable for $3.5 million to Chiron upon the filing of an application for DepoCyt for paediatric indications in the US. Under the amendment dated 4 October 2000 the note became payable on the earlier of the filing of an application for DepoCyt for paediatric indications in the US or the date on which Phase IV clinical trials, required by the US FDA as a condition of product approval, commenced. The $3.5 million note was issued in December 2000. The notes are secured on the rights to DepoCyt and bear a floating rate of interest based on LIBOR. The principals are payable in equal instalments on 30 June 2001 and 2002 for the first tranche and 30 June 2001, 2002 and 2003 for the second.

16 Issue of Convertible Bonds

On 16 June 2000, the Company issued £59.4 million 6% Convertible Bonds (the 'Bonds') due 2005. The Bonds are convertible at the option of the holder into fully paid 10 pence Ordinary Shares in the Company at an initial conversion price of 132 pence at any time up to 19 June 2005. The initial conversion price represents a premium of 27% over the prevailing market price of 104 pence on the pricing date of 17 May 2000. The conversion price will be recalculated on 19 June 2001 based upon the average of the closing bid quotations of an Ordinary Share for the previous 10 dealing days. Where this price is less than 132 pence, the conversion price will be reduced accordingly to a minimum of 83 pence. Unless previously redeemed or converted, the Bonds will be redeemed by the Company at their principal amount on 19 June 2005.

The net proceeds recognised on issue were £57,328,000 being gross proceeds of £59,400,000 less expenses of £2,072,000, of which £2,022,000 were paid in the period.

Of the gross proceeds of the Bond issue, £30 million has been subject to a cancellable interest rate swap agreement by which the Company has swapped a fixed obligation to floating and will pay 5.6% until June 2001 and then LIBOR minus 0.7250% over the life of the Bond.

During 1998, debentures were issued at a discount equivalent to an annual interest rate of 3%. All such debentures were converted in the six months ended 30 June 2000.

17 Provision of liabilities and charges

Group	Deferred consideration £'000	Pension £'000	Restructuring Provision £'000	National Insurance £'000	Total other £'000
At 1 January 2000	**1,861**	130	96	–	**226**
Charged in the year	**–**	–	–	26	**26**
Revaluation	**–**	–	–	–	**–**
Reclassification	**–**	–	–	–	**–**
Utilised	**–**	(49)	(102)	–	**(151)**
Exchange adjustments	**147**	4	6	–	**10**
At 31 December 2000	**2,008**	85	–	26	**111**

Company	Deferred consideration £'000	National Insurance £'000
At 1 January 2000	**1,861**	**–**
Charged in the year	**–**	**26**
Exchange adjustments	**147**	**–**
At 31 December 2000	**2,008**	**26**

Medac Deferred consideration
Deferred consideration at 31 December 2000 consists of £2.0 million ($3.0 million) cash payable to Medac GmbH under the purchase agreement for their intellectual property. The payment is subject to compliance by the vendor with terms specified in the agreement and became due on 31 March 2001.

Pension provision
The pension provision relates to the retirement commitments under a defined benefit scheme for SkyePharma Production SAS employees (note 25: Pension Arrangements).

Restructuring provision
The restructuring provision, established in 1998, for the reorganisation and associated write down of fixed assets and inventory following a decision to withdraw from the sales and marketing activities of Brightstone Pharma Inc., was fully utilised during the year.

National Insurance provision
Following the Social Security Act of 1998 and the introduction of a national insurance charge on UK employers on the gains made by employees upon the exercise of options issued under certain unapproved share schemes, a provision of £26,000 has been recognised at 31 December 2000 in accordance with UITF 25.

18 Deferred taxation

	Group Full potential		Company Full potential	
	31 December 2000 £'000	31 December 1999 £'000	**31 December 2000 £'000**	31 December 1999 £'000
Accelerated capital allowances	**4,030**	3,535	**36**	31
Other timing differences	**10,891**	4,469	**14**	28
UK tax benefits from losses carried forward	**1,893**	1,896	**1,893**	1,896
US tax benefits from losses carried forward	**31,480**	27,414	**–**	–
Potential deferred tax asset	**48,294**	37,314	**1,943**	1,955

No deferred tax asset is recognised, given the uncertainty of the recoverability of the Group's tax losses carried forward.

19 Contingent liabilities and guarantees

At 31 December 2000 the Company had provided guarantees on various bank borrowings of its subsidiaries as set out in note 14; Creditors – amounts falling due within one year and note 15; Creditors – amounts falling due after one year. In addition, at 31 December 2000 the Company has provided Cdn$1.0 million (£0.6 million) in a guarantee supported by a letter of credit to the Receiver of Hyal. In February 2001 Cdn $1.3 million was paid to the receiver of Hyal and the letter of credit cancelled.

At 31 December 2000, the Company has guaranteed the obligations of SkyePharma Inc. on its capital equipment lease with LMSI Venture Finance to an amount of $0.4 million (£0.3 million).

In December 1999 SkyePharma Production SAS entered into a leasing arrangement with Lombard North Central PLC by which certain pharmaceutical manufacturing and laboratory equipment was the subject of a four year sale and leaseback arrangement. The Company has guaranteed the obligations of the lessee under this lease to an amount of FF30 million (£2.8 million).

On 13 June 2000, a summons was filed in respect of a claim by RTP Pharma Corporation against SkyePharma PLC and others in the US District Court for the District of Columbia. The lawsuit seeks the correction of inventorship of a US patent, together with unspecified monetary damages on behalf of RTP Pharma Corporation. In March 2001 SkyePharma PLC together with the other defendants filed a motion to dismiss the claim and will continue to strongly defend it. In common with most business enterprises, group companies are subject to a number of claims and potential claims from third parties, the outcome of which cannot at present be determined. These claims and potential claims are not considered to be material in the context of these Financial Statements. Provision has been made in these accounts for any liabilities which are expected to materialise from such potential claims.

20 Commitments

	Group 31 December 2000 £'000	Group 31 December 1999 £'000	**Company 31 December 2000 £'000**	Company 31 December 1999 £'000
Capital commitments				
Contracted for but not provided in the accounts	**344**	390	**–**	–
Commitments under operating leases to pay rentals for the next year				
Operating leases on land and buildings which expire:				
In one year or less	**238**	20	**17**	–
In two to five years	**642**	186	**640**	186
In five years or more	**2,378**	2,369	**–**	245
	3,258	2,575	**657**	431
Other operating leases which expire:				
In one year or less	**152**	246	**5**	1
In two to five years	**69**	223	**13**	17
In five years or more	**–**	–	**–**	–
	221	469	**18**	18

21 Share capital

Equity share capital

	31 December 2000 Number of shares	31 December 1999 Number of shares	31 December 2000 £'000	31 December 1999 £'000
Authorised				
Ordinary Shares of 10p each	**1,114,000,000**	1,090,000,000	**111,400**	109,000

	Ordinary Shares of 10p each Number	Nominal value £'000
Issued, allotted and fully paid		
At 1 January 2000	**494,086,980**	**49,409**
Exercise of 'B' Warrants	**196,356**	**20**
Exercise of share options	**3,226,173**	**322**
Conversion of debentures	**219,204**	**22**
Shares issued to acquire DepoTech	**12,132,600**	**1,213**
Shares issued to Dr Gonella	**6,000,000**	**600**
Shares issued to Medac	**1,461,455**	**146**
At 31 December 2000	**517,322,768**	**51,732**

On 11 July 2000 the authorised share capital of the Company was increased to 1,114,000,000 Ordinary Shares. Consideration received on the issue of Ordinary Shares during the year amounted to £2,088,000 (1999: £5,038,000).

Non-equity share capital

	31 December 2000 Number of shares	31 December 1999 Number of shares	31 December 2000 £'000	31 December 1999 £'000
Authorised and issued				
Deferred 'A' Shares of 10p each	**12,000,000**	–	**1,200**	–
Deferred 'B' Shares of 10p each	**12,000,000**	–	**1,200**	–
	24,000,000	–	**2,400**	–

The Deferred 'A' and 'B' Shares were issued to Dr Gonella, the vendor of Jago, on 20 July 2000 under the Settlement Agreement that established the full and final settlement of the deferred consideration payable on the acquisition of Jago. The holders of Deferred 'A' and 'B' Shares have no rights to participate in the profits of the Company, no voting rights and on a winding up or other return of capital only receive the nominal value of their shares if the holders of Ordinary Shares in the capital of the Company have received the sum of £1,000,000 per Ordinary Share and, as such, are classified as non-equity shares.

The Deferred Shares automatically convert to Ordinary Shares on the happening of the following contingent events:

(i) 12 million 'A' Deferred Shares. These Deferred Shares automatically convert into 12 million Ordinary Shares on the first commercial sale of Paroxetine/Paxil in combination with GEOMATRIX technology under the current Licence Agreement;

(ii) 12 million 'B' Deferred Shares. These Deferred Shares automatically convert into 12 million Ordinary Shares on the Company's receipt of a royalty statement under the current Licence Agreement stating that reported sales of Paroxetine/Paxil in combination with the GEOMATRIX technology have exceeded $1,000 million during any calendar year prior to 1 January 2006 or exceeded $337 million between 1 January 2006 and 3 May 2006.

In the event that the conditions set out in (ii) and (iii) above are not satisfied prior to 3 May 2006, the Deferred 'A' and 'B' Shares will not be converted and will be cancelled. The vendor will not be entitled to any other compensation nor additional compensation.

The Deferred Shares were issued on 20 July 2000 when the price of an Ordinary Share was 94.25 pence. The difference between the nominal value of the Deferred Shares and the fair value of those shares, taken to be 94.25 pence, at issue has been recorded as non-equity share premium. See note 23: Reserves.

Warrants

The Company has the following warrants outstanding:

(a) 'B' Warrants

	Number
At 1 January 2000	58,709,055
Warrants exercised	1,963,560
At 31 December 2000	56,745,495

21 Share capital (continued)

The 'B' Warrants, which were issued in January 1996 on the basis of one warrant for every ten existing Ordinary Shares subscribed pursuant to the placing, rights issue and capitalisation of loan notes and in consideration for the outstanding warrants of Krypton, entitle the holders to subscribe for 5,674,550 Ordinary Shares at any time during the period beginning six months after the date of issue and ending on 31 December 2002 at an effective price of 40p per Ordinary Share. Consequent upon the consolidation of existing Ordinary Shares in May 1996 the terms under which the 'B' Warrants may be exercised were amended so that a holder is required to exercise ten 'B' Warrants to acquire one Ordinary Share.

The market value of 'B' Warrants as at 31 December 2000 was 2.5 pence (31 December 1999: 3.5 pence). The market value of 'B' Warrants during the period from 1 January 2000 to 31 December 2000 ranged from the lowest mid-price of 2.5 pence to the highest mid-price of 19.5 pence per 'B' Warrant.

(b) 'C' Warrants

The Class 'C' Warrant, issued in March 1998 in consideration of services provided in connection with the debenture issue, entitles the holders to purchase up to 1.8 million Ordinary Shares at an exercise price of 120 pence per Ordinary Share at any time up to three years from 11 March 1998. The aggregate number of Ordinary Shares which would have been issued under the terms of the Class 'C' Warrant and the Debentures would not have exceeded 30.0 million. The total number of shares issued to Debenture holders amounted to 21.4 million. The fair value of the warrant at issue was £271,000. As at 11 March 2001, the 'C' Warrant lapsed, unexercised.

(c) Warrants issued on the acquisition of DepoTech

In connection with the acquisition of DepoTech Corporation, the Company agreed that outstanding warrants to purchase DepoTech common stock on the effective date of the merger would become warrants to purchase the Company's Ordinary Shares. Subsequent to the acquisition, additional warrants were issued to the former DepoTech shareholders, as contingent consideration became payable. The fair value of the warrants at issue was £212,000. The Company has the following warrants outstanding at 31 December 2000:

Ordinary Shares issuable upon exercise of warrants	Exercise price per Ordinary Share	Expiration date
1,683,472	$1.885	2001
371,353	$1.178	2005

Share options

The Company encourages employee participation in its shares through ownership and continues to operate various Share Option Schemes and the Unapproved Share Option Scheme. Under the terms of these Schemes the Board may offer options to purchase Ordinary Shares in the Company to employees, including Directors, at a price not less than the higher of the nominal value and the market value of the shares.

Options granted to UK and European employees are only exercisable between the third and tenth anniversary of the date of grant, and are subject to the Company's Code of Conduct for dealing in Shares, and the Model Code. Options granted to US employees vest at 25% per annum from the date of grant and currently there are no performance criteria. UK and European options may only be exercised if the growth in the Company's share price over a consecutive three-year period exceeds the growth over the same period in the FT-SE All Share Index. This condition was satisfied for the first time in March 2000. Employees with options that are within their exercise period are now able to exercise those options within any one-year period from the date the performance condition is satisfied. Super Options are exercisable after five years and are subject to higher performance conditions in accordance with those recommended by the Association of British Insurers.

The following table summarises the activity in share options for the years to 31 December 1999 and 31 December 2000:

	Share options	Option price
At 1 January 1999	15,341,644	44.8p – 145.0p
Granted	15,446,096	56.7p – 69.5p
Exercised	(214,073)	44.8p
Cancelled or expired	(2,786,354)	75.0p – 145.0p
At 31 December 1999	27,787,313	44.8p – 93.0p
Granted	4,059,406	81.7p – 91.3p
Exercised	(3,226,174)	44.8p – 81.5p
Cancelled or expired	(2,303,717)	44.8p – 93.0p
At 31 December 2000	26,316,828	44.8p – 93.0p

The market value of Ordinary Shares as at 31 December 2000 was 64.0 pence. The market value of Ordinary Shares during 2000 ranged from the lowest closing mid-price of 49.75 pence to the highest closing mid-price of 190.0 pence per share.

21 Share capital (continued)

At 31 December 2000 the following Ordinary Shares were under option to employees or former employees of the Group:

Option price for each Ordinary Shares of 10p	Number of options over Ordinary Shares of 10p	Expiry date
75.0 p	1,525,744	29 April 2006
92.0 p	417,255	28 May 2006
81.0 p	1,234,568	6 December 2006
66.5 p	1,074,414	7 April 2007
51.0 p	124,073	28 January 2008
93.0 p	872,974	31 March 2008
44.8 p	2,380,903	5 October 2008
69.5 p	3,813,725	19 April 2009
56.7 p	9,673,700	25 May 2009
56.9 p	1,298,066	7 September 2009
91.3p	1,514,609	6 June 2010
81.7p	2,386,797	3 November 2010

22 Shares and warrants to be issued

Group and Company	£'000
At 1 January 2000	38,131
Revaluation	(3,618)
Issue of equity shares	(6,908)
Issue of non-equity shares	(22,620)
At 31 December 2000	4,985

Jago Deferred Consideration
At 31 March 2000, a Settlement Agreement was signed establishing the full and final settlement of the deferred consideration payable to the vendor of Jago, Dr Gonella. The settlement was approved by shareholders at the Company's Annual General Meeting held on 11 July 2000 to be made entirely in shares. On 20 July 2000, 6 million Ordinary Shares were issued to Dr Gonella at a price of 94.25 pence. Also on 20 July 2000, 24 million Deferred non-equity Shares were issued. The contingencies determining the conversion of the Deferred Shares into Ordinary Shares are set out in note 21: Share capital. In the event that these conditions are not satisfied prior to 3 May 2006, the Deferred Shares will not be converted and will be cancelled. The vendor will not be entitled to any other compensation nor additional compensation. On issue, the Ordinary and Deferred Shares were recorded in share capital and share premium. At 31 December 1999 prior to the issue of shares, in the Directors' opinion, 30 million Ordinary Shares were likely to be issued under the terms of the Settlement Agreement and a figure of £33 million was recorded within shares and warrants to be issued, based upon a closing share price of 110 pence on 31 March 2000, the date of the Settlement Agreement.

Krypton Deferred Consideration
The deferred consideration on the acquisition of Krypton was revised on April 26, 1996, such that a maximum of 37.5 million Ordinary Shares and 37.5 million 'B' Warrants would be issued contingent on a change in control of the Company at a share price of not less than 80 pence compounded at an annual rate of 10 %, or satisfaction of the following conditions and hurdles:

(i) 2.5 million Ordinary Shares and 2.5 million 'B' Warrants on each Krypton product obtaining ANDA approval subject to a maximum of 7.5 million Ordinary Shares and 7.5 million 'B' Warrants;
(ii) an additional 10 million Ordinary Shares and 10 million 'B' Warrants in the event that the aggregate annual sales of the Krypton products exceeds $50 million and the Company is profitable in respect of these products before December 31, 2003;
(iii) an additional 10 million Ordinary Shares and 10 million 'B' Warrants in the event that the aggregate annual sales of the Krypton products and annual revenues of the Company exceeds $200 million and the Company is profitable in respect of these products before December 31, 2003;
(iv) an additional 10 million Ordinary Shares and 10 million 'B' Warrants in the event that the aggregate annual sales of the Krypton products and annual revenues of the Company exceeds $275 million and the Company is profitable in respect of these products before December 31, 2003.

In the event that two of hurdles (i), (ii) and (iii) are satisfied in relation to any single year's sales, only the first such hurdle will be considered as having been satisfied.

22 Shares and warrants to be issued (continued)

Certain of the hurdles relating to the Krypton acquisition were not formulated to take account of the detailed arrangements currently envisaged by the Company. Should any of the Krypton products be approved and marketed, SkyePharma will need to renegotiate elements of the Krypton acquisition agreement.

The Directors have formed the opinion that until products are marketed and agreement is reached with the Krypton vendors, certain elements of deferred consideration cannot be estimated with any degree of certainty. Therefore the deferred consideration recognised in the accounts at 31 December 2000 relates only to the extent that hurdle (i) is reasonably expected to be met.

Consequently, an estimate of £5.0 million has been recognised as deferred consideration based on market prices on 31 December 2000 and 1999 for 7.5 million Ordinary Shares and 7.5 million 'B' Warrants.

Medac Deferred Consideration
At 31 December 1999, £1.2 million was recorded within shares and warrants to be issued for the $2.0 million of Ordinary Shares to be issued to Medac GmbH under the purchase agreement for their intellectual property. On 21 July 2000, 1,461,455 Ordinary Shares, with a market value of $2.0 million were issued to Medac. A final payment of $3.0 million became due in cash on 31 March 2001 (see note 17: Provisions for liabilities and charges).

23 Reserves

Group	Equity share premium £'000	Non-equity share premium £'000	Other reserves £'000	Currency translation reserve £'000	Profit and loss account £'000
At 1 January 2000	221,091	–	11,058	(2,185)	(245,447)
On issue of shares and warrants	20,121	20,220	212	–	–
On exercise of warrants	58	–	(58)	–	–
On conversion of debentures	79	–	–	–	–
Goodwill adjustments on deferred consideration	–	–	–	–	3,618
Exchange adjustments	–	–	–	758	–
Loss for the year	–	–	–	–	(19,690)
At 31 December 2000	241,349	20,220	11,212	(1,427)	(261,519)

The non-equity share premium account was created during the year on issue of 24 million Deferred Shares. See note 21: Share capital.

As at 31 December 2000 the cumulative amount of goodwill eliminated against reserves was £152,617,000 (1999: £156,235,000).

Company	Equity share premium £'000	Non-equity share premium £'000	Other reserves £'000	Profit and loss account £'000
At 1 January 2000	221,091	–	11,058	(22,103)
On issue of shares and warrants	20,121	20,220	212	–
On exercise of warrants	58	–	(58)	–
On conversion of debentures	79	–	–	–
Profit for the year	–	–	–	4,069
At 31 December 2000	241,349	20,220	11,212	(18,034)

As permitted by Section 230 of the Companies Act 1985, the Profit and Loss Account of the Company is not presented. The profit attributable to shareholders dealt with in the accounts of the Company is £4,069,000 (1999: £234,000).

24 Financial instruments

The Group holds financial instruments to finance its operations and to manage the currency risk that arises from these operations. The Group finances its operations through a combination of shareholders' funds, convertible bonds, bank loans and long-term borrowings. The main risks arising from the Group's financial instruments are liquidity risk, foreign currency, interest rate risk and credit risk.

Liquidity risks

The Group's policy is to maintain continuity of funding through a mixture of long-term debt and bank loans, raised to cover specific projects, and through the issue of shares to collaborative partners, where necessary, to obtain development contracts. During the year £59.4 million was raised through the issue of convertible bonds. Further debt finance was raised through the issue of a note to a collaborative partner, Chiron. Short-term flexibility is provided through the use of overdrafts. The maturity profile of the Group's debt is set out below at note (c).

Foreign currency risk

All of the Group's operations are based overseas in Continental Europe and the US giving rise to exposures to changes in foreign exchange rates notably the Swiss Franc, French Franc and US dollar. To minimise the impact of any fluctuations, the Group's policy has historically been to maintain natural hedges by relating the structure of borrowings to the trading cash flows that generate them. Where subsidiaries are funded centrally, this is achieved by the use of long-term loans the exchange differences on which are taken to reserves. Where it was not possible to use natural hedges, forward currency contracts were used. During 2000, £59.4 million of funding was raised in sterling. As a result the Group has actively used forward currency contracts and currency options during the year to minimise the currency exposure on operational transactions. Foreign currency exchange movements did not have a material impact on the results of operations in 2000 compared with 1999.

Interest rate risk

The Group borrows at fixed and floating rates of interest as deemed appropriate for its circumstances. Where necessary the Group uses interest rate swaps to achieve the desired interest rate profile. During the year the Group entered a cancellable, floating rate, interest rate swap on £30 million of the 6% convertible bond liability. The interest rate profile of the Group's financial assets and liabilities is set out in note (a) and (b) respectively.

Credit risk

The Group is exposed to credit related losses in the event of non-performance by third parties to financial instruments. The Group does not expect any third parties to fail to meet their obligations given the policy of selecting only parties with high credit ratings and minimising its exposure to any one institution.

In the numerical disclosures that follow, short-term debtors and creditors that arise directly as a result of the Group's operations are excluded from all disclosures with the exception of note (f) on currency exposures.

(a) Interest rate and currency profile of financial assets

31 December 2000 Currency	Floating rate financial assets £'000	Non interest bearing financial assets £'000	Total financial net assets £'000
Sterling	32,170	252	32,422
$US	8,993	215	9,208
French francs	7	–	7
Swiss francs	23	–	23
Other	1,218	–	1,218
	42,111	467	42,878

Financial assets primarily comprise cash and short-term bank deposits.

Included within the sterling denominated financial assets shown above for 2000, is £4 million, placed on deposit for 18 months in December 2000, at a capped rate. The Group will receive 6.5% for each successive week that the two-year sterling swap rate stays below 7.0%. If the two-year sterling swap rate sets above 7.0%, no coupon will accrue for that week.

All other of the Group's financial assets, in both 2000 and 1999, either bear interest at floating rates based upon the floating bank rate in the country in which the funds are held or are non-interest bearing.

24 Financial instruments (continued)

(a) Interest rate and currency profile of financial assets continued

31 December 1999 Currency	Floating rate financial assets £'000	Non interest bearing financial assets £'000	Total financial net assets £'000
Sterling	6,046	305	6,351
$US	4,679	197	4,876
French francs	1,749	620	2,369
Swiss francs	68	–	68
Other	–	10	10
	12,542	1,132	13,674

(b) Interest rate and currency profile of financial liabilities

31 December 2000

Currency	Fixed rate financial liabilities £'000	Floating rate financial liabilities £'000	Total financial liabilities £'000	Weighted average interest rate on fixed financial liabilities %	Weighted average time for which rate is fixed (months)
Sterling	29,400	30,000	59,400	6.00	53.5
$US	–	7,989	7,989	–	–
French francs	2,391	767	3,158	6.25	27.9
Swiss francs	4,386	6,089	10,475	3.04	35.0
At 31 December 1999	36,177	44,845	81,022	5.66	49.2

Financial liabilities primarily comprise bank and other loans and convertible bonds.

The sterling denominated, floating rate financial liability shown above represents £30 million of the £59.4 million convertible bond liability that has been subject to an interest rate swap agreement for the life of the bonds. The Company will pay 5.6% on £30 million until 19 June 2001 and thereafter will pay LIBOR less 0.725%. The weighted average interest rate on the convertible bond during 2000 was 5.8%.

Total financial liabilities does not agree to the total of the balance sheet captions due to the presence of £1,854,000 of unamortised issue costs within the value shown on the balance sheet for convertible bonds.

All other floating rate financial liabilities, in both 2000 and 1999, are interest bearing financial liabilities that bear interest at interest rates based on LIBOR, prime and other bank based lending rates in the country in which the liability arises, which are fixed for periods of up to 12 months.

The non-equity Deferred 'A' and 'B' Shares hold no rights to dividends. See note 21: Share capital.

31 December 1999 Currency	Fixed rate financial liabilities £'000	Floating rate financial liabilities £'000	Total financial liabilities £'000	Weighted average interest rate on fixed financial liabilities %	Weighted average time for which rate is fixed (months)
Sterling	103	–	103	5.68	13.6
$US	370	8,921	9,291	10.84	4.6
French francs	2,801	598	3,399	6.25	48.0
Swiss francs	3,591	5,544	9,135	5.0	21.9
At 31 December 1999	6,865	15,063	21,928	5.84	31.5

24 Financial instruments (continued)

(c) Maturity of financial liabilities

	31 December 2000 £'000	31 December 1999 £'000
Within one year	**9,940**	8,365
Between one and two years	**4,023**	4,177
Between two and five years	**64,496**	6,828
Beyond five years	**2,563**	2,558
	81,022	21,928

The non-equity Deferred 'A' and 'B' Shares will convert to Ordinary Shares on the occurrence of certain future contingent events. See note 21: Share capital.

(d) Borrowing facilities

As at 31 December 2000 the Group had the following undrawn committed borrowing facilities available.

	31 December 2000 £'000	31 December 1999 £'000
Expiring within one year	**–**	1,608

(e) Fair values

The comparison of fair and book values of all the Group's financial instruments as at 31 December 2000 is set out below. Market values have been used to determine the fair values of all swaps and foreign currency contracts. The fair value of the non-equity Deferred 'A' and 'B' Shares has been calculated by reference to the Ordinary Share price at 31 December 2000, based upon the Director's opinion that 24 million Ordinary Shares will be issued in settlement of the deferred consideration payable on the acquisition of Jago. See note 21: Share capital for details of the contingencies that shall determine the issuance of the Ordinary Shares. The fair values of all other items have been calculated by discounting future cash flows at interest rates prevailing at 31 December 2000. At 31 December 1999 there was no material difference between the estimated fair values of the Group's financial instruments and their book values.

Financial instruments held or issued to finance the Group's operations	Book values £'000	Fair values £'000
Cash at bank and in hand	10,769	10,769
Short-term bank deposits	32,109	32,109
Short-term borrowings and current portion of long-term borrowings	(9,940)	(9,940)
Long-term convertible debt	(59,400)	(46,022)
Other long-term debt	(11,682)	(10,942)
Non-equity Deferred 'A' and 'B' Shares	(22,620)	(15,360)
At 31 December 2000	**(60,764)**	**(39,386)**
Derivative financial instruments held to manage the Group's interest rate and currency profile		
Interest rate swap	–	822
Euro currency options	–	221
US$ currency options	–	(104)
At 31 December 2000	**–**	**939**

The fair value of the interest rate swap is based upon the agreement continuing for the life of the convertible bonds. At current interest rates and forward rates it is probable that the Royal Bank of Scotland will cancel the agreement at the end of the first year.

24 Financial instruments (continued)

(f) Currency exposures

The following analysis shows the net monetary assets and liabilities of group companies that are not denominated in their functional currency and therefore give rise to exchange gains and losses in the profit and loss account in both 2000 and 1999.

31 December 2000	Net foreign currency monetary assets/(liabilities)					
Functional currency of Operating Company	Sterling £'000	$US £'000	French francs £'000	Swiss francs £'000	Other £'000	Total £'000
Sterling	–	4,179	7	–	–	4,186
$US	(2,254)	–	–	–	–	(2,254)
French francs	(1,528)	80	–	–	–	(1,448)
Swiss francs	(1,445)	(870)	–	–	1,197	(1,118)
	(5,227)	3,389	7	–	1,197	(634)

31 December 1999	Net foreign currency monetary assets/(liabilities)					
Functional currency of Operating Company	Sterling £'000	$US £'000	French francs £'000	Swiss francs £'000	Other £'000	Total £'000
Sterling	–	246	7	(8)	(38)	207
$US	(1,083)	–	–	73	48	(962)
French francs	(1,182)	–	–	–	–	(1,182)
Swiss francs	(1,776)	(133)	623	–	(15)	(1,301)
	(4,041)	113	630	65	(5)	(3,238)

(g) Hedging

As explained above, the Group's policy is to hedge interest rate exposures through the use of interest rate swaps and currency exposures through the use of currency options and forward foreign currency contracts. Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is recognised.

At 31 December 2000, the Company had written options to purchase £7.2 million Euros and £5.3 million US dollars. These outstanding contracts have maturities of less than 12 months. There were no other forward foreign currency contracts open at 31 December 2000. The excess of fair values over book values for currency options shown in note 24 (e) represents the unrecognised hedging gain on these instruments as at 31 December 2000. The actual gains or losses arising on these currency options will be dependent on future exchange rates and will be recognised in the profit and loss account, in 2001, as the operational transactions to which they are linked, occur.

The excess of fair values over book values for interest rate swaps shown in note 24 (e) represents the unrecognised hedging gain on the swap as at 31 December 2000. This is based upon the agreement continuing for the life of the convertible bonds and as such the gain would be spread in the profit and loss account until 2005 . However, it is unlikely that the entire gain will be recognised in the profit and loss account since at current interest rates and forward rates it is probable that the Royal Bank of Scotland will cancel the agreement at the end of the first year.

There were no derivative interest rate or currency instruments at 31 December 1999 to generate a hedging gain or loss.

25 Pension arrangements

The Group operates various defined contribution plans for its employees in the UK, Switzerland and the US. The Group's contributions to these plans are charged to the income statement in the period to which they relate, and the assets are held in separate trustee administered funds. The charge for the year amounted to £532,000 (1999: £513,000).

The Group operates a defined benefit scheme in respect of its employees in France, the assets of which are not held by an externally administered fund. On acquisition of Jago Production SAS in 1997 the retirement commitments were valued and a provision set up. The actuarial method used was the unit credit with service prorate actuarial cost method. Main assumptions include a discount rate of 6.29% and a rate of salary increase of 3.5%. The calculation of accrued benefits used in valuing the retirement benefit commitment was prepared on the basis of the pharmaceutical industry's collective bargaining agreement applying to the relevant employees.

26 Related party transactions

During the year fees amounting to £69,000 (1999: £99,000) were paid to Rinderknecht, Glaus & Stadelhofer, in which Dr Rinderknecht, a Director of the Company until November 2000, is a partner, in respect of legal advice to SkyePharma AG and to the Company.

At the end of December 1998, Ian Gowrie-Smith, (through a family-owned trust), acquired a 50% interest in 10 East 63rd Street Inc., the company which owns 10 East 63rd Street, a property in New York. SkyePharma PLC has been in occupation of that property since January 1997, subject to a tenancy agreement which expired in January 1999, under which it paid a rent of US $300,000 per annum. In January 1999 the lease was renewed on the same terms. Approximately one-third of the premises are subleased to Fifth Avenue Capital Inc., an unrelated company. In February 2001 the lease became renewable. The lease is currently being renegotiated and an independent valuation obtained.

In 1999, under the agreement for the winding up of the joint venture, an amount of $1,000,000 became payable to VECAP, a company of which Dr Rinderknecht is a director, as their share of the joint venture's licence fees. This charge was recognised during 1999 and the payment made in 2000.

27 Principal subsidiary undertakings

Company	Country of incorporation	% Held	Principal activities
Krypton Limited	Gibraltar	100%	Exploitation of intellectual property
SkyePharma Holding Inc*	US	100%	Holding company
Brightstone Pharma Inc*	US	100%	Development of pharmaceuticals and licensing
SkyePharma Inc	US	100%	Development of pharmaceuticals
SkyePharma Holding AG*	Switzerland	100%	Holding company
Jago Holding AG	Switzerland	100%	Holding company
SkyePharma AG	Switzerland	100%	Research and development
Jago Research AG	Switzerland	100%	Exploitation of intellectual property
Jagotec AG	Switzerland	100%	Exploitation of intellectual property
SkyePharma Production SAS*	France	100%	Manufacturing of pharmaceuticals

*Denotes investment directly held by the Company.

Full details of all subsidiary undertakings will be attached to the Company's Annual Return to be filed with the Registrar of Companies.

Reconciliation to US accounting principles

	Notes	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
Loss under UK GAAP		**(19,690)**	(19,414)
US GAAP adjustments:			
Purchase accounting and goodwill			
Amortisation of intangible assets	I	**(6,086)**	(6,134)
Depreciation of tangible assets	II	**727**	782
Write-off of purchased research and development expenditure	III	**–**	(4,268)
Amortisation effect of in-process research and development write off	III	**213**	–
Goodwill written off previously amortised under US GAAP	I	–	816
Stock-based compensation	X	**(734)**	–
Revenue recognition			
Cumulative effect of change in accounting principle under SAB 101	VIII	**(542)**	–
Current year effect of revenue recognition differences related to SAB 101	VIII	**(189)**	–
Funding	IX	**(2,900)**	–
Approximate net loss under US GAAP		**(29,201)**	(28,218)
Represented by:			
Loss from continuing operations before taxes on income		**(29,197)**	(28,086)
Taxes		**(4)**	(132)
Approximate net loss under US GAAP (all continuing operations)		**(29,201)**	(28,218)
Approximate net loss per Ordinary Share per US GAAP (pence)		**(5.7p)**	(6.0p)

Pro forma amounts assuming SAB 101 Revenue Recognition applied retroactively			
Approximate net loss under US GAAP		**(28,659)**	(28,429)
Represented by:			
Loss from continuing operations before taxes on income		**(28,655)**	(28,297)
Taxes		**(4)**	(132)
Approximate net loss under US GAAP (all continuing operations)		**(28,659)**	(28,429)
Approximate net loss per Ordinary Share US GAAP (pence)		**(5.6p)**	(6.1p)

Shareholders' funds

	Notes	Year to 31 December 2000 £'000	Year to 31 December 1999 £'000
Shareholders' funds under UK GAAP		**68,952**	72,057
US GAAP adjustments:			
Purchase accounting and goodwill			
Intangible fixed assets – gross	I	**121,723**	121,723
Intangible fixed assets – accumulated amortisation	I, III	**(28,188)**	(22,315)
Tangible fixed assets – gross	II	**(10,928)**	(10,813)
Tangible fixed assets – accumulated depreciation	II	**3,003**	2,228
Deferred consideration charged to goodwill reserve	V	**33,260**	36,881
Shares and warrants to be issued	V, VI	**(4,985)**	(38,131)
Share market price and warrant reserve	IV	**11,942**	11,942
Share premium	XI	**(28,275)**	–
Acquired in-process research and development	III, IV	**(11,942)**	(11,942)
In-process research and development written off on acquisition of DepoTech	III	**(4,268)**	(4,268)
Stock-based compensation	X	**(734)**	–
Revenue recognition			
Cumulative effect of change in accounting principle under SAB 101	VIII	**(542)**	–
Current year impact of revenue recognition differences related to SAB 101	VIII	**(189)**	–
Funding	IX	**(2,900)**	–
Approximate shareholders' funds under US GAAP		**145,929**	157,362

Reconciliation to US accounting principles continued

Summary of Material Differences between UK and US GAAP
The principal differences between UK and US GAAP arise from accounting for the acquisitions made by SkyePharma PLC during 1996, 1997 and 1999, the treatment of deferred consideration and differences associated with revenue recognition. Under both UK and US GAAP the acquisitions are accounted for as acquisitions/purchases. In the allocation of consideration, the treatment of deferred consideration and differences associated with revenue recognition, differences between UK and US GAAP arise as set out below.

(I) **Goodwill and intangible fixed assets** Prior to the introduction of FRS10, as permissible under UK GAAP no intangible assets have been recognised as a result of purchase accounting as the intangible assets were considered to be an integral part of the business acquired and are, therefore, included within goodwill and eliminated against shareholders' funds. The Company has adopted transitional provisions under FRS10 to not reinstate goodwill previously eliminated against reserves as an intangible asset.

US GAAP requires an allocation of consideration to identifiable intangible assets, including any resulting from research and development, irrespective of whether they are separable. Intangible fixed assets recognised under US GAAP purchase accounting requirements are depreciated over their estimated revenue earning life. For the purposes of US GAAP, the estimated revenue earning life has been taken to be 20 years, being the estimated remaining life of the GEOMATRIX patents plus five years.

In addition the Company has effected the dissolution of its Joint Venture with Genta. Under UK GAAP, goodwill arising before the introduction of FRS 10, which had been written-off directly to reserves, must be charged to the profit and loss account on the dissolution of the Joint Venture. Under US GAAP, goodwill arising from the acquisition less amounts previously amortised must be charged to the profit and loss account on the dissolution of the Joint Venture.

(II) **Negative goodwill on acquisition** Prior to the introduction of FRS10 under UK GAAP for business acquisitions, where the aggregate of the fair values of the net assets acquired exceeds the cost of the acquired net assets resulting in negative goodwill, such excess is credited directly to reserves. Under US GAAP such excess is eliminated by proportionately reducing the value of the non-current assets acquired.

(III) **Acquired in-process research and development** Under US GAAP, acquired in process research and development which does not have an alternative future use is separately identified and written off directly to net income in the period that the acquisition was made. The write-off of in-process research and development under US GAAP will result in a lower amortisation charge for goodwill capitalised under both UK and US GAAP.

(IV) **Measurement of purchase consideration** The Company effected its acquisition of Krypton through the exchange of shares and warrants and recorded the consideration at the estimated fair value of the shares and warrants.

Under UK GAAP, the fair value of the shares and warrants issued for the acquisition was estimated by reference to the price that the Company's shares were issued for on the same day under a rights issue and public placing. US GAAP requires that the fair value of shares and warrants issued to effect a business combination be based on the market price for a reasonable period before and after the date the terms of acquisition were agreed to and announced.

(V) **Deferred consideration** UK GAAP requires a reasonable estimate of the fair value of any deferred consideration to be included in the cost of acquisition. Under US GAAP deferred consideration is recognised only when the amount is determinable beyond reasonable doubt.

(VI) **Shares to be issued** Under UK GAAP, consideration payable in the future in shares only is included in shareholders' funds as shares to be issued. Under US GAAP such amounts would be recorded in provisions when the amount is determinable beyond reasonable doubt until such time as shares are actually issued.

(VII) **Joint arrangements** Under UK GAAP, where the Group has certain contractual agreements with other participants to engage in joint activities that do not create an entity carrying on a trade or business of its own, they are accounted for as a joint arrangement. The Group includes its share of the assets, liabilities and cash flows in such joint arrangements measured in accordance with the terms of each arrangement which is usually pro rata to the Group's interest in the joint arrangement. Under US GAAP, such arrangements are viewed as synthetic Joint Ventures and accounted for under the gross equity method. This difference does not have an impact on the overall net loss of the Group but under US GAAP selling and marketing costs and research and development costs would be reduced by £2,250,000 and £2,665,000 respectively and be shown net as the Group's share of the operating loss in the Joint Venture.

(VIII) **Revenue recognition** The Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) 101 'Revenue Recognition in Financial Statements' in December 1999. SAB 101 has been adopted by the Group as of 1 January 2000. A cumulative catch up adjustment has been recorded under US GAAP to reflect the difference between the amount of shareholders' funds at the beginning of the period of the change in accounting principle, 1 January 2000, and the amount of shareholders' funds that would have been reported at that date if the new accounting principle had been applied retroactively for all periods that would have been affected. Under UK GAAP, the Group has recognised £189,000 of revenue in 2000 that does not meet the criteria for revenue recognition under SAB 101.

(IX) **Sale of royalty interests** Under UK GAAP, payments received from a third party, to fund the internal research and development of a product, in return for the sale of a portion of potential future royalty streams from a selection of products, are reflected within other operating income where the risk of reimbursement has effectively been transferred to the third party. Under US GAAP, Emerging Issues Task Force (EITF) 88 – 18, 'Sales of Future Revenues', requires such payments to be recorded as debt where there is continuing involvement in the generation of the cash flows due to the third party.

(X) **Stock-based compensation** Under US GAAP, the Group applies Accounting Principles Board Opinion (APB) No 25, 'Accounting for Stock Issued to Employees', and related interpretations in accounting for its plans. Accordingly, compensation expense has been recognised for performance-based compensation plans where it is probable that the performance criteria will be met and the options exercised prior to the expiration of the options issued under these plans. No compensation expense has been recognised for those plans which are considered fixed option plans under APB 25 and where the options granted under the plans are granted at a price which equals the market price at the date of grant.

(XI) **Deferred shares** Under UK GAAP, deferred shares issued which are convertible to Ordinary Shares upon the happening of certain contingent events have been recorded at fair value in shareholders' funds. Fair value is based upon the market price of Ordinary Shares at the date of the deferred share issue. Under US GAAP, the fair value of the deferred share issue would be the nominal value of the deferred shares issued. At the date the occurence of the contingent events becomes probable, a fair value adjustment would be made under US GAAP based upon the Ordinary Share price at that date.

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