Healthcare Enterprise Group PLC

Annual report 2006

HEALTHCARE ENTERPRISE
GROUP PLC

Healthcare Enterprise Group PLC
is an international healthcare product development and distribution Group

Highlights

> Turnover of £16.4 million (2005: £15.0 million) as the business consolidates and restructures

> Operating losses, before exceptional items, £4.4 million (2005: profit £0.9 million)

> After goodwill impairment of £12 million and net exceptional items of £1.8 million pretax losses were £18.6 million (2005: loss £0.3 million)

> HSS, UK's largest first aid and occupational health business, stabilising

> Some progress on Ebiox whilst the evaluation of its potential continues

> Optiscope prototypes have become available for analysis by healthcare professionals and industry participants

> Current trials of Fertiligent in Germany continue and initial results are positive

> Minority shareholdings in HCEG brand technology have been sold at a premium

Chairman's statement

Introduction

As reported in the November 2005 trading update, the problems of the Healthcare Sales & Service Ltd ("HSS") site in Warrington continued for the remainder of the financial year. Corrective action was implemented, with a turnaround team comprising the Chairman, Executive Deputy Chairman and turnaround professionals. The new management team took control of the business in November 2005 and introduced a wide range of measures to stabilise the business. The loss of customers was halted as the supply chain was stabilised, and service levels improved. Cost reductions to reflect the lower operating level of turnover have also been implemented.

The new management team is carrying out a review to re-evaluate immediate opportunities and funding requirements of the Brands portfolio:

- Ebiox: Some progress continues to be made with the Ebiox range, and new, additional distribution agreements have been signed in Japan, China and Malaysia. Sales in the UK were disappointing and European markets are only now being addressed as a result of recent CE approvals. EPA approvals for Ebiox in the United States suffered a further delay due to the requirement for additional inhalation testing by the federal authorities. This has now been completed satisfactorily and we are on track for Federal approval by the end of 2006.
- Optiscope: Optiscope prototypes are now available to be analysed by potentially interested parties including industry leaders and healthcare professionals.
- Medilator: Medilator is subject to a market survey sponsored by a large industry participant to ascertain its value.
- Fertiligent: Tests have been conducted in Israel achieving success rates up to three times greater than traditional procedures. Current trials continue in Germany where initial results have been positive.
- The sale of minority investments in Optiscope and Fertiligent are currently in negotiation at enhanced valuation multiples relative to their book values.

Financials

Despite problems with the integration process at HSS and lower than expected Ebiox sales, turnover increased 9.6% to £16.4 million (2005: £14.9 million). Gross profits declined to £6.5 million (2005: £7.7 million) due to the write off and write down of obsolete and slow moving inventories, reduced margins and credit notes issued. The Group reported operating losses before exceptional items of £4.4 million (2005: profit of £0.9 million).

Group restructuring costs and write offs resulted in a net exceptional charge of £1.8 million, and the goodwill impairment review resulted in an additional write off of goodwill of £12 million.

The Board has taken the view that:

- development costs should, in the main, be written off;
- adequate provisions be made for old, surplus and overvalued inventory;
- adequate provisions be made for old, bad and doubtful debts;
- costs associated with disposals of surplus inventories be charged against the current year's profit and loss account;
- costs associated with the turnaround be provided for against the current years profit and loss account;
- goodwill will be adjusted to recognise changes in the values of the underlying assets and investments.

After interest, tax, exceptional items, impairment of goodwill and minority interests the Group reported a loss of £18.6 million (2005: loss £0.3 million), including the write off of goodwill of £12 million, this write off of goodwill did not involve any outlay of cash.

At the interim results the Group reported that it was recording losses. In January, in order to accelerate the return to operating profitability at HSS, the Board decided, following consultation with the Group's corporate bankers, to inject approximately £3.4 million by way of an equity fundraising. This was achieved by a private placement in February/March 2006. The Directors invested approximately £0.6 million as part of that placing with the balance being placed with various institutional investors. At the same time, the Group's bankers agreed to extend their credit facilities.

The funds so raised were used in the business to rebalance inventories at HSS, pay suppliers to restore trade credit to more acceptable levels, repay the balance of the Crest intercompany loan, fund the costs of the turnaround and operating losses, and secure our holdings in Optiscope and Fertiligent by contributing to their next capital rounds.

As at 28 February 2006, cash balances for the business were £0.5 million and undrawn credit lines under the invoice discounting facility a further £1.6 million.

Post year end the Group has raised a total of £2.2 million, being £2.0 million from the completion of the private placement, and £0.2 million through the sale of a minority stake in Optiscope. A similar negotiation is in progress for the sale of a minority stake in Fertiligent. The Group has also restructured its banking facilities including repayment of the £1.0 million bridging loan and arranging for the term loan of £1.5 million to be repayable from realisations or by the latest in June 2007.

Healthcare Sales & Service ("HSS")

HSS is the Group's business distributing products to the occupational health, first aid, medical, veterinary and retail markets, operating out of a 66,000 sq ft site in Warrington. It has been formed by the consolidation of five companies over the last 24 months, Safa, IPS, First Aid UK, Crest Medical and CICS Holdings Limited and its wholly owned subsidiary, Cross Infection Control Services (CICS) Limited (together "CICS"), which was acquired in June 2005. CICS sells sterile kits and other disposables to dental practice customers and is profitable.

HSS had sales of £15.3 million in the 12 months ended 28 February 2006 (2005: £13.1 million) and recorded an operating loss of £1.3 million (2005: profit £1.8 million). The integration of the Crest Medical business, acquired in November 2004, proved more difficult and took longer than anticipated which resulted in incorrect stocking, incorrect pricing, customer dissatisfaction and delayed payments.

A number of significant and immediate improvements have been made, whilst we have also implemented appropriate cost reductions in line with the reduced turnover. Since November 2005, staff has been reduced from 155 to 136 personnel. Operating losses at HSS have been contained to £9,000 for the first three months of the current financial year. Thereafter the business is expected to be profitable. Further overhead reductions are also anticipated in the short term.

Accounts receivable have been brought within industry norms and significant progress has been achieved in rebalancing inventories. Work is continuing on the disposal of surplus and redundant stock although the company has a greater investment in inventories at this stage than is desirable. Funds have been used for the inventory rebalancing, payments to suppliers in order to restore trade credit to more acceptable terms, loan repayments, and to fund operating losses and the costs of the turnaround.

Chairman's statement continued

HSS has taken steps to secure its supply lines and has reached agreement in principle, subject to contract, to acquire a 5% stake in its main supplier of disposable products located in China, and in exchange, that supplier has undertaken to execute an exclusive ten year UK supply agreement in favour of HSS.

HCEG brands

Ebiox

Ebiox is the Group's proprietary range of instrument cleansing and decontamination products including a high level disinfectant for use in hospitals. Other products in the range are surgical instrument cleaning and reconditioning products, a hand rub and hand wash and surface cleaning wipes, which have applications in the healthcare sector and other industries such as clean rooms and food preparation. The Ultra surgical cleaning products are gaining some sales, as are the Trionic wipes. However, the Esense hand products have failed to make headway as the NHS protocols still require alcohol based products.

Ebiox sales for the year ended 28 February 2006 totalled £0.25 million (2005: £0.79 million) and operating losses were £0.5 million (2005: profit £0.33 million). A further £0.3 million (2005: £0.3 million) was spent on product development.

In the US the Group's regulatory consultants have indicated that the Environmental Protection Agency ("EPA") approval timing for the TruKleen (Trionic in the UK) range may now be three months later than previously thought as the product was subjected to additional aspiration testing due to its unique (and therefore "new") formulation within the USA. It is expected before the calendar year end – the products have now passed all requested testing to date and the registration process is underway. US EPA approval will be followed by individual State approvals and the Board anticipates being able to sell the Ebiox range (other than the hand products) in the US from early 2007.

The Ebiox Trionic range has been granted a European CE grade 2 mark which classifies the product as the first non-alcohol wipe and spray that may be used to disinfect instruments and surfaces.

New distribution agreements have been executed in Japan, China and Malaysia, and sales have now commenced in all three territories in the first part of the new financial year.

Optiscope

Optiscope is HCEG's disposable rigid endoscope. Progress on development of Optiscope continues to be good and the initial batch of prototypes, of a 10mm laparoscope, are now available for industrial and commercial evaluation.

The 10mm laparoscope addresses almost half of this substantial market. Work is planned to commence on smaller sizes later in the year. These will address the rest of the market.

Optiscope recorded no revenues in the period (2005: £Nil) and reported an operating loss of £0.07 million (2005: loss £0.05 million). During the year ended 28 February 2006, HCEG invested a further £0.16 million under the original shareholders agreement to increase its stake to 72.5%.

Subsequent to the year end, HCEG has arranged to transfer its Optiscope holding into an intermediate holding company, Healthcare Endoscopy Limited ("HEL"). HCEG has, subject to contract, negotiated to sell a 2.85% stake in HEL for £0.2 million in cash, and a further 4.27% for £0.3 million in cash valuing HEL at £7 million. The funds so raised will be used for marketing HEL's products to prospective buyers/licensees and for general working capital purposes. Following the two transactions, HCEG will own approximately 93% of HEL.

HEL is negotiating to purchase, for US$50,000, a 10% stake in Ultrasurge Technologies Limited, an Israeli incubator company, developing a disposable, minimally invasive device that enables precise and selective cutting and tissue removal using focused liquid jets, followed by blood vessel sealing, without causing injury to the surrounding tissue.

The technology is designed to be applied to a range of urology and gynaecology procedures including removal of enlarged prostate glands, removal of polyps and treatment for endometriosis. Since the device is to be used under local anaesthetic, patients are expected to be treated in day case clinics reducing the burden on hospital resources and improving patient recovery rates.

Women's Reproductive Health – Medilator and Fertiligent

The Group is focussed on two key product groups in this area, Medilator and Fertiligent.

In May 2005 the Group acquired 2.5% of the share capital of Medilator Limited ("Medilator") with a series of options to acquire up to 65% of the ordinary share capital. Medilator has developed a platform for single-use, disposable cervical dilatation devices. Medilator is the subject of a market survey, sponsored by a large industry participant, to ascertain its value.

In June 2005 the Group acquired 2.5% of the share capital of Fertiligent Limited ("Fertiligent") with a series of options to acquire up to 100% of the ordinary share capital. The Group's ownership is currently 13.94%, with a further cash call in June 2006 which will increase the holding to 20.8%. HCEG has the option to acquire those shares of Fertiligent which it does not own on the basis of a valuation of US$2 million for the whole company before June 2007 and at a valuation of US$4.5 million thereafter.

Fertiligent is a unique, high quality, low cost intrauterine sperm pump to help assist infertile couples conceive in a more effective, natural, less invasive manner than other more costly, conventional fertility treatments. Fertiligent's first product, the IQI-100, is a disposable, slow-release insemination device that extends the "window of opportunity" for ovum fertilization by emulating the natural insemination process.

Tests have been conducted in Israel, with Fertiligent IQI-100 achieving success rates up to three times greater than those of traditional intra-uterine inseminations (IUIs). A second trial is underway in Germany, which is showing similar promising results, and a third, larger trial will commence in China in the summer.

Subsequent to the year end, HCEG has arranged to transfer its Women's Health holdings into an intermediate holding company 100% owned by HCEG, Healthcare Delivery Systems Limited ("HDS"). HCEG has negotiated the sale of a 5% stake in HDS for €250,000 (£171,000) in cash, subject to contract, and is negotiating to sell a further 5% for a similar amount in cash valuing HDS at €5 million (£3.4 million). The funds raised will be used for additional capital investment in the underlying investments, marketing HDS's products to prospective buyers/licensees and for general working capital purposes.

HDS also is negotiating to purchase, for a US$50,000 option fee, a stake in "Deliverance" an Israeli incubator company, developing a high quality, low cost disposable drug delivery pump for provision of local anaesthesia and irrigation of chronic wounds and burns.

The innovation should enable the manufacture of a high quality pump at a low cost to improve both the accuracy of drug delivery and the quality of care for patients.

The Group has decided not to proceed with the proposed acquisition of Fertiloscopy.

Chairman's statement continued

Other investments

Ridgecrest Healthcare Group, Inc. ("Ridgecrest"; US Pink Sheets: RCHG) is a US-based healthcare management and service company, which was formed from the disposal of certain non-core assets of HCEG including minority interests in a number of developing healthcare ventures.

HCEG owns 17.3% of RCHG in the form of common stock and in addition the equivalent of 31.4% of the company in non voting preference stock. Since year end, in order to provide an incentive for the managers of Ridgecrest which would more accurately align their interests with the company's shareholders, HCEG agreed to grant a five year option over the preference shares at an exercise price of US$800,000 plus profit share on sale. The market value of HCEG's holding at year end was in excess of book value of £1.4 million. The Board has made provision against this value to reflect the illiquidity of these shares. Ridgecrest has also taken over 90% of the costs of operating HCEG's Los Angeles office.

Management and structural changes

In the second half of the year a number of management changes were made including the appointment in late November 2005 of the team to manage the turn around of the business, including the appointment of Mark Tompkins as non executive Chairman of the Group, and Lyndon Gaborit as Executive Deputy Chairman. These two individuals have been responsible for the execution of the turnaround plan with professional assistance from Joe Considine, principal of Considine Associates LLP who has acted as Executive Chairman of HSS. They have been supported by Gordon Wood, Executive Chairman of the Group's Brands Division. The Board intends to appoint a Group Finance Director in due course.

Strategy and outlook

The immediate task of the new management team was to stabilise HSS and restore it to profitability. HSS is now breaking even and is expected to shortly become profitable. Focus was also given to the investments most likely to provide shareholder value in the immediate future, Optiscope and Fertiligent. Minority stakes were sold in order to fund the next milestones in their respective development from external sources at enhanced valuations. The third, and most challenging task, was the assessment of the Ebiox range in order to secure not only additional revenues but also to correctly position the product in the markets it addresses. That work is ongoing.

- Having stabilised HSS, the Group is now in the process of identifying the growth and profit opportunities for that business. The Group will continue to work to build and strengthen its market position as well as optimising its many relationships with our distributors and retail clients.
- Third party investment into HEL and HDS, both at enhanced valuations compared to book values, provides self funding going forward. The Board are focussed on realising value from one or more of the Brands either through a licensing agreement or through other options in the medium term.
- Since the year end, the Board has commissioned a study to evaluate the markets to be serviced by the Ebiox product range. This study was conducted by a specialist marketing and brand consultancy. Preliminary findings have been advised to the Board who are now evaluating the best way forward to maximise shareholder value with this wholly owned suite of products.

HJM Tompkins
Chairman

9 June 2006

Board of Directors

HJ Mark Tompkins (65)
Non-Executive Chairman

Mark Tompkins is a private investor with experience in assisting emerging companies in Europe and the US. His prior experience includes investment banking, management consulting and investment advice on an international level. He currently serves, inter alia, on the board of Sodexho Alliance SA, the Paris listed food services and facilities management company and on the board of NASDAQ listed Allied Healthcare Group International Inc. In the past he has served on the boards of two NYSE listed healthcare companies, Abbey Healthcare Group, Inc. and Apria Healthcare Group, Inc. and on that of AIM-quoted Bioprojects International Plc (now Original Investments PLC).

Lyndon Gaborit (58)
Executive Deputy Chairman

Lyndon Gaborit, a Chartered Accountant, was formerly the Chief Operating Officer (Europe) for Moore Clayton & Co, Inc. Before that he was Deputy Chairman and CEO of Infoshare Europe Ltd and adviser to ConAgra Foods, Inc. He also serves as Executive Chairman of Industrial Management & Equity Ltd, a corporate strategy adviser to HCEG, and as Deputy Chairman of Capital Accumulation Ltd, a holding company of financial services businesses.

Gordon Wood (44)
Executive Chairman and CEO, HCEG Brands

Following a blue chip pharmaceutical background with Hoechst AG, he established a successful veterinary supply business in 1989. He joined Lloyds Chemists PLC as Commercial Director, Veterinary Division before moving to Intercare PLC as CEO of its Medical Products division. He led the buy out of the Safa Group from Intercare in 1996. In 1999 he established SafaTec, an Israeli company with equity holdings in a pipeline of innovative healthcare products, successfully bringing a number to market. In 2001 he established Safasia Co. Ltd (Thailand), a manufacturer and distributor of medical disposables. In November 2003 he reversed his Safa Group and SafaTec companies into Healthcare Enterprise Group PLC, becoming COO in the process. In November 2005, he became Executive Chairman of HCEG Brands.

Nicholas Brigstocke (63)
Non-executive Director

Nick Brigstocke was Chairman of UK Equity Capital Markets at Credit Suisse First Boston ("CSFB") in London from 1998 to 2001 following CSFB's acquisition of Barclays de Zoete Wedd ("BZW"), where he was Chairman and Managing Director of UK Corporate Broking. He is also a non-executive director of Turbo Genset Co. Ltd, Azure Dynamics Corp, Bridgewell Group Ltd, DDD Group Plc, Capital Accumulation Ltd and Inter Pipeline Fund.

Nigel Wray (58)
Non-executive Director

Nigel Wray has extensive experience as an investor in both quoted and unquoted companies. He was Chairman of Burford Holdings Plc from 1988 until February 2001. He is currently a major shareholder and non-executive director Domino's Pizza UK and IRL plc and other quoted and unquoted companies. He is also a director and major shareholder of Saracens Rugby Club.

Directors' report
for the year ended 28 February 2006

The Directors present their Annual Report together with the Audited Financial Statements for the year ended 28 February 2006.

Principal activities
During the year under review, the principal activities were the distribution of occupational health and first aid products and the development and marketing of innovative medical products to the healthcare market. A full review of the businesses is given in the Chairman's Statement on pages 2 to 6.

Results and dividends
The results for the year ended 28 February 2006 are set out in the Group Profit and Loss Account on page 19.

The Directors have not paid a dividend for this accounting period.

Directors
The Directors who served during the year were as follows:
HJM Tompkins
LJ Gaborit
GA Wood
NO Brigstocke
NW Wray
MK Low (Resigned 8 November 2005)
KI Denos (Resigned 8 November 2005)
J Bradshaw (Resigned 15 November 2005)
S Bruck (Resigned 30 January 2006)

A statement on Directors' remuneration and their interests in the shares and options of the Company are disclosed in the Report on Directors' Remuneration on pages 10 to 13.

Substantial shareholdings
The following interests in 3% or more of the issued share capital of the Company at 9 June 2006 have been disclosed to the Company.

Name	Number of ordinary shares	Percentage of issued share capital
LPMCC, LLC	24,616,437	13.13
Fidelity International Limited	17,617,043	9.40
NW Wray[1]	15,422,254	8.23
GA Wood[2]	15,270,323	8.15
PIHL Equity LLP	12,412,237	6.62
N Leslau[3]	12,412,237	6.62

Note 1 At 9 June 2006 NW Wray had an interest in 3,010,017 ordinary shares of the Company. PIHL Equity LLP, an entity in which NW Wray is entitled to exercise more than one third of the voting power at general meetings, held 12,412,237 ordinary shares. Therefore at 9 June 2006 NW Wray was interested, directly and indirectly, in 15,422,254 ordinary shares of the Company.

Note 2 At 9 June 2006, GA Wood held 13,189,979 ordinary shares in the Company directly. In addition, 2,080,344 ordinary shares were held by GA Wood's family trust, of which he is a trustee. Therefore at 9 June 2006 GA Wood was interested, directly and indirectly, in 15,270,323 ordinary shares of the Company.

Note 3 PIHL Equity LLP, an entity in which N Leslau is entitled to exercise more than one third of the voting power at general meetings, held 12,412,237 ordinary shares and therefore N Leslau was interested, indirectly, in 12,412,237 ordinary shares of the Company at 9 June 2006.

Payment of creditors
The Company's current policy concerning the payment of its trade creditors is to:

(a) settle the terms of payment with its suppliers when agreeing the terms of such a transaction.
(b) ensure that these suppliers are made aware of the terms of payment by inclusion of the relevant terms in contracts; and
(c) pay in accordance with its contractual and other legal obligations.

The payment policy applies to all payments to creditors for all supplies of goods and services.

At 28 February 2006, the Company's trade creditors represented 4 days (2005: 82 days) of purchases.

Donations
There were no charitable or political contributions made by the Company during the year.

Annual General Meeting
The formal notice of the Company's Annual General Meeting ("AGM") and resolutions to be proposed at the AGM are set out on pages 39 to 40.

Auditors
On 1 April 2006 HLB AV Audit plc changed its name to HLB Vantis Audit plc. A resolution proposing that HLB Vantis Audit plc be re-appointed as auditors of the Company will be submitted at the forthcoming Annual General Meeting.

By Order of the Board

LJ Gaborit
Company Secretary

9 June 2006

Report on Directors' remuneration

The remuneration of the executive Directors is determined by the Remuneration Committee, which consists of two non-executive Directors and one executive Director under the Chairmanship of HJM Tompkins.

The Committee's principal function is to determine the remuneration, benefits and terms of employment of the executive Directors with due regard to the interests of shareholders. It is also responsible for making allocations from the Company's share option schemes and setting objective conditions governing its exercise.

Remuneration policy

In determining the remuneration policy that applies to the executive Directors, the Committee strives to ensure that Directors are rewarded competitively relative to comparable companies in order to retain and motivate them.

Remuneration of executive Directors

The Committee's aim is to provide a balanced package to executive Directors with both fixed and variable elements to ensure that an appropriate proportion is performance related. No executive Director is involved in deciding his own remuneration.

Remuneration of executive Directors comprises elements of basic salary and benefits, bonus, pension arrangements and share options.

The benefits provided to executive Directors may include a car allowance, medical insurance, permanent health insurance and life assurance.

Under the terms of their service contracts, executive Directors may earn bonuses that are discretionary and/or based on specific performance targets set by the Committee.

Executive Directors are eligible for share options, granted at the discretion of the Board (or the Remuneration Committee), under the Company's share option schemes.

Remuneration of non-executive Directors

The Board determines the remuneration of non-executive Directors. No non-executive Director is involved in deciding his own remuneration.

Directors' service contracts

There are two executive Directors, GA Wood and LJ Gaborit. GA Wood's appointment is for a fixed term of two years from 2 December 2003 and thereafter on a rolling 12 month basis, but may be terminated early in certain specific circumstances including the giving of not less than 12 months' prior written notice by either the Company or the Director. LJ Gaborit's contract is for a term of 12 months from 31 October 2005 and thereafter may be terminated on not less than three months' written notice by either the Company or the Director. The contract may be terminated early in certain specific circumstances.

The agreements with non-executive Directors are not for fixed terms, but are each terminable on not less than three months' written notice at any time by the Director or Company.

Directors' emoluments

The remuneration of the Directors of the Company from the date of their appointment to 28 February 2006 (or date of resignation, if earlier) was as follows:

	Year ended 28 February 2006 Salaries and fees £'000	Benefits £'000	Pension contributions £'000	Total £'000
Executive Directors				
S Bruck[1]	142	5	12	159
GA Wood	163	6	16	185
MK Low[2]	84	5	2	91
LJ Gaborit[3]	5	–	–	5
J Bradshaw[4]	92	4	5	101
	486	**20**	**35**	**541**

Note 1 S Bruck served as an executive Director until 15 November 2005 and as a non-executive Director until 30 January 2006.

Note 2 MK Low served as an executive Director until 8 November 2005.

Note 3 LJ Gaborit served as a non-executive Director until 1 November 2005 and thereafter as an executive Director (see below).

Note 4 J Bradshaw served as an executive Director until 15 November 2005.

	Year ended 28 February 2005 Salaries and fees £'000	Benefits £'000	Pension contributions £'000	Total £'000
Executive Directors				
S Bruck	142	7	2	151
GA Wood	133	1	14	148
MK Low	89	3	–	92
LJ Gaborit[5]	25	–	–	25
KI Denos[5]	–	–	–	–
J Bradshaw[6]	22	1	1	24
	411	12	17	440

Note 5 LJ Gaborit and KI Denos served as executive Directors until 3 January 2005; these fees represent fees paid to them to that date in their capacity as executive Directors.

Note 6 J Bradshaw was appointed a Director on 3 January 2005.

	2006 Salaries and fees £'000	2005 Salaries and fees £'000
Non-executive Directors		
NO Brigstocke	**15**	15
HJM Tompkins	**15**	15
NW Wray	**15**	11
LJ Gaborit[1]	**10**	2
KI Denos[2]	**10**	2
	65	45

Note 1 LJ Gaborit served as a non-executive Director from 3 January 2005 until 1 November 2005; these fees represent fees paid to him between those dates in his capacity as a non-executive Director.

Note 2 KI Denos served as an executive Director until 3 January 2005 and as a non-executive Director until 8 November 2005, these fees represent fees paid to him between those dates in his capacity as a non-executive Director.

Non-executive Directors do not receive other benefits or pension contributions. One executive Director is accruing benefits under money purchase pension schemes.

Report on Directors' remuneration continued

The interests of the Directors in the share capital of the Company at 28 February were as follows:

	2006 Number of ordinary shares of 2.5p each	2005 Number of ordinary shares of 2.5p each
GA Wood[1]	**15,270,323**	14,190,022
LJ Gaborit[2]	**220,018**	–
NO Brigstocke	**1,765,755**	1,037,953
HJM Tompkins[3]	**787,940**	57,350
NW Wray[4]	**15,376,617**	13,450,174

Note 1 At 28 February 2006, GA Wood held 13,189,979 ordinary shares in the Company directly. In addition, 2,080,344 ordinary shares were held by GA Wood's family trust, of which he is a trustee. Therefore at 28 February 2006 GA Wood was interested, directly and indirectly, in 15,270,323 ordinary shares of the Company.

Note 2 At 28 February 2006 LJ Gaborit held 220,018 ordinary shares through a family trust.

Note 3 At 28 February 2006 HJM Tompkins has a contingent beneficial interest in 57,350 shares through Ballerat International Limited and 714,286 shares through Turut Limited, companies which are wholly owned by trusts associated with HJM Tompkins. In addition he held 16,304 shares directly. Accordingly HJM Tompkins is interested, directly and indirectly, in 787,940 shares at 28 February 2006.

Note 4 At 28 February 2006 NW Wray had an interest in 2,964,380 ordinary shares of the Company. Prestbury Investment Holdings Limited, a company in which NW Wray is entitled to exercise more than one third of the voting power at general meetings, held 12,412,237 ordinary shares. Therefore at 28 February 2006 NW Wray was interested, directly and indirectly, in 15,376,617 ordinary shares of the Company.

At 9 June 2006 these shareholdings had changed as follows:

	Number of ordinary shares of 2.5p each
GA Wood[1]	15,270,323
LJ Gaborit[2]	220,018
NO Brigstocke	1,825,804
HJM Tompkins[3]	787,940
NW Wray[4]	15,422,254

Note 1 At 9 June 2006, GA Wood held 13,189,979 ordinary shares in the Company directly. In addition, 2,080,344 ordinary shares were held by GA Wood's family trust, of which he is a trustee. Therefore at 9 June 2006 GA Wood was interested, directly and indirectly, in 15,270,323 ordinary shares of the Company.

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Note 4 At 9 June 2006 NW Wray had an interest in 3,010,017 ordinary shares of the Company. PIHL Equity LLP, an entity in which NW Wray is entitled to exercise more than one third of the voting power at general meetings, held 12,412,237 ordinary shares. Therefore at 9 June 2006 NW Wray was interested, directly and indirectly, in 15,422,254 ordinary shares of the Company.

Directors' share options

Details of options held under the Company's share option scheme are set out below:

Options granted under the amended and restated 2001 L&P MCC, Inc. ("L&P MCC") stock option plan, which was adopted by the Company in connection with the acquisition of Healthcare Enterprise Group, Inc. ("HEI") in March 2003.

Directors	At 1 March 2005	Granted in the year	Exercised in the year	At 28 February 2006	Exercise price	First exercise date	Expiry date
LJ Gaborit	199,476	–	–	199,476	2.5p	1 January 2003	31 December 2007
NO Brigstocke	276,645	–	–	276,645	2.5p	1 August 2001	31 July 2006
NO Brigstocke	113,246	–	–	113,246	2.5p	1 January 2003	31 December 2007
HJM Tompkins[1]	1,358,952	–	–	1,358,952	10.25p	19 December 2002	18 December 2007

Note 1 HJM Tompkins has a contingent beneficial interest in options through Ballerat International Limited, a company which is wholly owned by a trust associated with HJM Tompkins.

Options issued under the Healthcare Enterprise Group PLC ("HCEG") 2003 Share Option Scheme.

Directors	At 1 March 2005	Granted in the year	Exercised in the year	At 28 February 2006	Exercise price	First exercise date	Expiry date
Approved							
GA Wood	75,000	–	–	75,000	40p	14 November 2003	13 November 2013
Unapproved							
GA Wood	1,240,000	–	–	1,240,000	24.42p	14 November 2003	13 November 2013
GA Wood	–	250,000	–	250,000	14p	3 February 2006	2 February 2016
LJ Gaborit	1,524,961	–	–	1,524,961	25p	10 December 2003	9 December 2013
LJ Gaborit	–	1,000,000	–	1,000,000	14p	3 February 2006	2 February 2016
NO Brigstocke	518,989	–	–	518,989	25p	10 December 2003	9 December 2013
NO Brigstocke	–	500,000	–	500,000	14p	3 February 2006	2 February 2016
HJM Tompkins[1]	575,895	–	–	575,895	25p	10 December 2003	9 December 2013
HJM Tompkins	–	1,000,000	–	1,000,000	14p	3 February 2006	2 February 2016
NW Wray	–	250,000	–	250,000	14p	3 February 2006	2 February 2016

Note 1 HJM Tompkins has a contingent beneficial interest in these options through Ballerat International Limited, a company which is wholly owned by a trust associated with HJM Tompkins.

Options issued under an unapproved stand alone share option scheme.

Directors	At 1 March 2005	Granted in the year	Exercised in the year	At 28 February 2006	Exercise price	First exercise date	Expiry date
GA Wood[1]	685,000	–	–	685,000	24.42p	14 November 2003	13 November 2013

Note 1 Options granted prior to appointment as a Director.

In addition to the options held above, certain Directors have been granted options over shares held by LPMCC. These options (with the exception of the options granted to HJM Tompkins) carry warrants in the ratio of five warrants for every two ordinary shares. Details of share warrants are given in Note 23 to the financial statements.

Directors	At 1 March 2005	Granted in the year	Exercised in the year	At 28 February 2006	Exercise price	First exercise date	Expiry date
LJ Gaborit[2]	1,310,651	–	–	1,310,651	14p[3]	13 November 2004	12 November 2009
NO Brigstocke	229,323	–	–	229,323	1.35p	15 January 2003	31 December 2007
NO Brigstocke	1,122,062	–	–	1,122,062	14p[3]	13 November 2004	12 November 2009
HJM Tompkins[1]	1,000,000	–	–	1,000,000	14p[3]	13 November 2004	12 November 2009

Note 1 HJM Tompkins has a contingent beneficial interest in options through Ballerat International Limited, a company which is wholly owned by a trust associated with HJM Tompkins.

Note 2 These options were granted to LJ Gaborit's family trust.

Note 3 These options were repriced from 25p to 14p on 28 February 2006.

Warrants

At 28 February 2006, 1,141,675 share warrants were held by Ballerat International Limited, a company which is wholly owned by a trust associated with HJM Tompkins and 14,737,149 were held by GA Wood. At 28 February 2006, 3,701,300 share warrants were held by LJ Gaborit's family trust. Details of these warrants are given in Note 23 to the financial statements.

Statement of Directors' responsibilities

Company law requires the Directors to prepare financial statements 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 of the Group for that period. In preparing those financial statements, the Directors are required to:

> select suitable accounting policies and then apply them consistently;

> make judgements and estimates that are reasonable and prudent;

> state whether applicable accounting standards have been followed; and

> prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and the Group to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The maintenance and integrity of the web site is the responsibility of the Directors; the work carried out by the Auditors does not involve consideration of these matters and, accordingly, the Auditors accept no responsibility for any changes that may have occurred to the information contained in the financial statements since they were presented on the web site.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Corporate governance

Corporate Governance Committee

HCEG is listed on the Alternative Investment Market ("AIM") and is not subject to the requirements of the Combined Code on Corporate Governance, nor is it required to disclose its specific policies in relation to corporate governance. However, the Directors are committed to delivering high standards of corporate governance to the Company's shareholders and other stakeholders, including employees, suppliers and the wider community. A Corporate Governance Committee, comprising NO Brigstocke (Chairman), HJM Tompkins and LJ Gaborit, has been established for this purpose. The Board of Directors operates within the framework described below.

The Board of Directors

The Board comprises the non-executive Chairman, two executive Directors, and two other non-executive Directors. The Directors believe that the composition of the Board is appropriate for the current size of the Group and its stage of development. The Board demonstrates a range of experience and calibre sufficient to ensure appropriate independent judgement on issues of strategy, performance and standards of conduct vital to the continued success of the Group.

The Board meets at least four times a year and has a schedule of matters reserved for its decision. The Board directs and controls the Group and is responsible for its strategy, operating performance and the stewardship of the Group's resources. Relevant papers are circulated to the Board on a timely basis and in advance of each meeting. In furtherance of their duties, all Directors have access, as appropriate, to independent professional advice and to the services of the company secretary.

Any Director appointed during the year is required under the Company's articles of association to retire and seek re-appointment by the shareholders at the next annual general meeting.

The Board does not consider it necessary to have a Nomination Committee to make recommendations to the Board on new Board appointments. The Board itself considers all such appointments and decides whether persons nominated have the appropriate skills and experience.

In addition to the Corporate Governance Committee, the Board has appointed two other standing committees, as follows:

The Audit Committee

The Audit Committee is chaired by NO Brigstocke and comprises HJM Tompkins and LJ Gaborit. It meets twice a year and its duties include a comprehensive review of the annual and interim financial statements before they are presented to the Board for approval. It also reviews the findings of the external auditors and key accounting policies and judgements. It has unrestricted access to the Group's auditors. Each year the auditors provide written confirmation in relation to their independence.

The Remuneration Committee

The Remuneration Committee meets not less than twice a year and comprises two of the non-executive Directors HJM Tompkins and NO Brigstocke, and one executive Director, LJ Gaborit. It is chaired by HJM Tompkins and is responsible for making recommendations to the Board on remuneration policy for executive Directors and for setting the salaries, incentive payments and granting share options relating to the executive Directors. The Board of Directors (excluding non-executive Directors) determines the remuneration of the non-executive Directors.

Relations with shareholders

The Board of Directors seeks to ensure that all shareholders are kept informed about the Group and its activities. A comprehensive annual report and accounts and an interim report are sent to shareholders and there is frequent dialogue with institutional investors, including presentations following the preliminary and interim announcements.

The Annual General Meeting provides shareholders with the opportunity to meet and question Directors, including the Chairman of the Board. Details of the resolutions to be proposed at the annual general meeting, to be held on 27 July 2006, are set out in the Notice of Annual General Meeting which is attached to this report.

Corporate governance
continued

Internal control

The Directors recognise that they have overall responsibility for ensuring that the Group maintains a sound system of internal control. However, it should be recognised that such a system can provide only reasonable and not absolute assurance against material misstatement or loss.

As an AIM listed company, the Board is not required to make a statement on the effectiveness of its internal controls, however the Directors believe it is useful to highlight the following elements of the Group's systems and control:

> a clearly defined structure which delegates authority, responsibility and accountability;

> a comprehensive system for reporting financial results. Actual results are measured monthly against budget which, together with a commentary on variances and other unusual items, allows the Board to monitor the Group's performance on a regular basis;

> a comprehensive annual budgeting process; and

> a revision of annual forecasts on a quarterly basis.

Going concern

Under company law, the Directors are required to consider whether it is appropriate to prepare the financial statements on the basis that the Company and Group are going concerns. As part of its normal business practice, budgets, cash flow forecasts and longer term financial projections are prepared, and in reviewing this information, the Directors are satisfied that the Company and the Group have adequate resources to enable them to continue in business for the foreseeable future.

The Directors have therefore adopted the going concern basis in the preparation of the financial statements.

Independent auditors' report
to the Shareholders of Healthcare Enterprise Group PLC

We have audited the group and parent company financial statements (the "financial statements") of Healthcare Enterprise Group PLC for the year ended 28 February 2006 which comprise the Group Profit and Loss Account, the Group and Company Balance Sheets, the Group Cash Flow Statement, the Group Statement of Total Recognised Gains and Losses and the related notes 1 to 32. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

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 Companies Act 1985. 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 regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report, and consider whether it is consistent with the audited financial statements. This other information comprises only the Chairman's Statement, the Directors' Report and the Report on Directors' remuneration. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) 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 judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and 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, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the group's and the parent company's affairs as at 28 February 2006 and of the group's loss for the year then ended; and

> Have been properly prepared in accordance with the Companies Act 1985.

Independent auditors' report to the Shareholders of Healthcare Enterprise Group PLC continued

Emphasis of matter – going concern

In forming our opinion, which is not qualified, we have considered the adequacy of the disclosure made in note 1 to the financial statements concerning the uncertainty over the Group's ability to continue as a going concern. The financial statements are prepared on a going concern basis which is dependent on the Group managing its cash flows in the foreseeable future by achieving its sales forecasts, reducing its overhead costs and selling surplus stock and from minority share sales and sales of certain of its holdings. There can be no certainty that the outcome of these assumptions, along with the other matters explained in note 1 to the financial statements will be as forecast by the Directors. In view of the significance of these uncertainties we consider that they should be drawn to your attention. The financial statements do not include any adjustments that would result if the group was unable to continue as a going concern.

HLB Vantis Audit plc
Chartered Accountants
Registered Auditor
66 Wigmore Street
London W1U 2SB

9 June 2006

Group profit and loss account
for the year ended 28 February 2006

	Notes	Year ended 28 February 2006 Before exceptional items £'000	Exceptional items £'000	Total £'000	Year ended 28 February 2005 £'000
Turnover	2				
Acquisitions		**618**	**–**	**618**	3,687
Continuing activities		**15,171**	**–**	**15,171**	11,280
Discontinued activities		**612**	**–**	**612**	–
		16,401	**–**	**16,401**	14,967
Cost of sales		**(9,880)**	**–**	**(9,880)**	(7,275)
Gross profit		**6,521**	**–**	**6,521**	7,692
Net operating expenses		**(10,962)**	**(15,320)**	**(26,282)**	(6,811)
Group operating profit (loss)					
Acquisitions		**180**	**–**	**180**	364
Continuing activities		**(4,623)**	**(15,320)**	**(19,943)**	517
Discontinued activities		**2**	**–**	**2**	–
Group operating profit (loss)	3	**(4,441)**	**(15,320)**	**(19,761)**	881
Share of operating results of associates		**–**	**–**	**–**	6
Total operating profit (loss)		**(4,441)**	**(15,320)**	**(19,761)**	887
Exceptional income (costs)	3	**–**	**1,522**	**1,522**	(1,135)
Loss on ordinary activities before interest		**(4,441)**	**(13,798)**	**(18,239)**	(248)
Net interest payable and similar charges	6	**(334)**	**–**	**(334)**	(74)
Loss on ordinary activities before taxation		**(4,775)**	**(13,798)**	**(18,573)**	(322)
Taxation on loss on ordinary activities	7	**–**	**–**	**–**	(30)
Loss on ordinary activities after taxation		**(4,775)**	**(13,798)**	**(18,573)**	(352)
Minority interests		**22**	**–**	**22**	18
Loss for the financial year		**(4,753)**	**(13,798)**	**(18,551)**	(334)
Basic and diluted loss per share	9			**(11.93)p**	(0.27)p

Group statement of total recognised gains and losses
for the year ended 28 February 2006

	2006 £'000	2005 £'000
Loss for the financial year	**(18,551)**	(334)
Exchange losses offset in reserves	**(28)**	(45)
Movement in provision for share options	**–**	–
Total recognised gains and losses relating to the year	**(18,579)**	(379)

Balance sheets
as at 28 February 2006

	Notes	Group 2006 £'000	Group 2005 £'000	Company 2006 £'000	Company 2005 £'000
Fixed assets					
Intangible assets	11	**21,933**	33,759	**–**	–
Tangible assets	12	**545**	514	**68**	77
Investments in subsidiary undertakings	13	**–**	–	**27,304**	31,415
Other investments	13	**1,538**	116	**–**	13
		24,016	34,389	**27,372**	31,505
Current assets					
Stocks	15	**2,096**	3,048	**–**	–
Debtors	16	**3,181**	6,008	**19,347**	14,211
Current asset investments		**–**	4	**–**	–
Cash at bank and in hand		**489**	1,010	**240**	1,931
		5,766	10,070	**19,587**	16,142
Creditors: amounts falling due within one year	17	**5,606**	5,911	**2,108**	1,105
Net current assets		**160**	4,159	**17,479**	15,037
Total assets less current liabilities		**24,176**	38,548	**44,851**	46,542
Creditors: amounts falling due after more than one year	18	**2,827**	4,236	**2,795**	4,198
Provisions for liabilities and charges	20	**–**	289	**–**	447
Deferred shares		**746**	–	**746**	–
Warrants issued		**357**	–	**357**	–
Net assets		**20,246**	34,023	**40,953**	41,897
Capital and reserves					
Called up share capital	21	**4,298**	4,492	**4,298**	4,492
Shares to be allotted	21	**620**	2,348	**620**	2,348
Warrants issued	23	**–**	364	**–**	364
Share premium account	24	**39,078**	32,042	**45,277**	38,241
Profit and loss account	24	**(22,249)**	(3,670)	**(10,936)**	(5,083)
Merger reserve	24	**(2,293)**	(2,293)	**–**	–
Other reserves	24	**728**	728	**1,694**	1,535
Shareholders' funds	25	**20,182**	34,011	**40,953**	41,897
Minority interests		**64**	12	**–**	–
Capital employed		**20,246**	34,023	**40,953**	41,897

The financial statements were approved by the Board of Directors on 9 June 2006.

HJM Tompkins
Director

LJ Gaborit
Director

Group cash flow statement
for the year ended 28 February 2006

	Notes	Year ended 28 February 2006 £'000	2005 £'000
Net cash outflow from operating activities	27	**(4,868)**	(2,634)
Returns on investments and servicing of finance			
Interest received		**14**	48
Interest paid		**(348)**	(202)
Net cash outflow for returns on investments and servicing of finance		**(334)**	(154)
UK corporation tax paid		**(73)**	(320)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(221)**	(293)
Development costs capitalised		**(441)**	(211)
Proceeds of sale of tangible fixed assets		**–**	1,288
Purchase of fixed asset investments		**(114)**	(107)
Net cash (outflow)/inflow from capital expenditure and financial investment		**(776)**	677
Acquisitions			
Purchase of subsidiary undertakings		**(120)**	(2,032)
Acquisition expenses		**(176)**	(719)
Net cash acquired with subsidiaries		**297**	195
Net cash disposed of with subsidiaries		**(73)**	–
Net cash outflow from acquisitions		**(72)**	(2,556)
Net cash outflow before financing		**(6,123)**	(4,987)
Financing			
Issue of share capital		**4,769**	5,766
Share issue costs		**(200)**	(456)
Increase/(decrease) of long term borrowings		**100**	(476)
Repayment of short term borrowings		**(377)**	(1,148)
Repayment of principal under hire purchase contracts		**(22)**	(28)
Net cash inflow from financing		**4,270**	3,658
Decrease in cash in the year	29	**(1,853)**	(1,329)

Notes to the financial statements
for the year ended 28 February 2006

1. Accounting policies

Basis of preparation

The financial statements have been prepared under the historical cost convention and in accordance with applicable accounting standards.

The financial statements have been prepared on the going concern basis, which assumes that the Group will continue to be able to meet its liabilities as they fall due for the foreseeable future.

At 28 February 2006, the Group has net current assets totalling £0.16 million. After the year end the Group raised approximately £2 million after expenses from a share placing with institutional shareholders. The short term bridging loan of £1 million, arranged in February 2006, was repaid in full early in March 2006 from the placing proceeds.

The Group's bankers have also agreed that the existing £1.5 million loan repayable monthly over three years will be amended to a one year term loan repayable in full in June 2007 or earlier by Group realisations in excess of £0.5 million.

The Directors have produced cashflow forecasts to 29 February 2008. In preparing these cashflow forecasts the Directors have assumed that:

> The forecast sales for both HSS and the HCEG Brands, are achieved and payment from the customers is received within the forecast credit terms allowed to them.

> Overhead cost reductions will be made and that the sales forecast can be achieved with the reduced cost structure.

> Surplus stock realisation will raise £0.3 million in June and July 2006.

> Approximately £0.8 million will be raised in June and July 2006 by way of minority share sales.

> Realisation of certain Group holdings will raise £2.6 million in June 2007 which will fund the repayment of the £1.5 million term loan.

There can be no certainty that the outcome of all the matters discussed above will be as forecast by the Directors. The Directors believe that they will meet their sales forecasts, achieve the various realisations and manage their cashflows as described above. On this basis the Directors believe it appropriate to prepare the financial statements on the going concern basis. The financial statements do not include any adjustments to the value of balance sheet assets, particularly the carrying value of capitalised development costs of £0.68 million and goodwill of £21.25 million, or provision for further liabilities, which would result should the going concern concept not be valid.

Basis of consolidation and comparative figures

The consolidated profit and loss account and the balance sheet include the financial statements of the company and its subsidiary undertakings made up to 28 February 2006. The results of the subsidiaries sold and acquired are included in the profit and loss account up to, or from the date control passes. Intra-group sales and profits are eliminated fully on consolidation.

Goodwill

Goodwill represents the difference between the fair value of the consideration paid on the acquisition of a business and the fair value of the identifiable net assets acquired.

Goodwill arising on acquisitions is capitalised and subjected to annual impairment reviews under FRS 11: Impairment of Fixed Assets and Goodwill. Any excess of goodwill over the value in use of the underlying assets is written off to the profit and loss account. This accounting policy departs from the specific requirements of the UK Companies Act to amortise goodwill over a finite period for the overriding purpose of giving a true and fair view. The impact of this departure cannot be quantified.

During the current year, the Directors reviewed the remaining life of the Healthcare Sales and Service Limited business and have concluded that the remaining goodwill needs to be written down by £11.253 million. The Directors concluded that the goodwill associated with Alpha Trading (Asia) Ltd should be written down by £0.747 million. An indefinite life has been applied to the goodwill relating to the business included in HCEG Brands due to the strength of the intellectual property and marketing agreements associated with the HCEG Brands products.

Associates
Entities (other than subsidiary undertakings) in which the Group has a participating interest and over whose operating and financial policies the Group exercises significant influence are treated as associates. In the group financial statements associates are accounted for using the net equity method.

Tangible fixed assets and depreciation
Tangible fixed assets are stated at cost less depreciation. Depreciation is provided at rates calculated to write off the cost less estimated residual value of each asset over its expected useful life, as follows:

Leasehold property	Over the term of the lease
Plant, machinery, fixtures & fittings	15-25% per annum
Motor vehicles	25% per annum

Development costs
Development costs are capitalised in accordance with SSAP 13: Accounting for Research and Development and amortised over the period expected to benefit from the cost which is considered to be up to ten years.

Financial instruments
The Company has included additional disclosures in line with the requirements of FRS 13: Derivatives and other financial instruments.

The Group's financing strategy, which is approved at Board level, is to use medium term debt together with equity to finance the Group's operations. This debt is currently at floating rates and the resulting interest rate exposure is kept under review by the Board.

The Group's activities are undertaken in a number of markets and as a result there is exposure to currency risk at a Group level although at an operating level exposure to currency risk is not significant.

Deferred shares and warrants issues
Deferred shares and warrants issued have been reclassified from Shareholders' funds to liabilities in accordance with FRS 25 Financial Instruments: Disclosure and Presentation.

Turnover
Turnover represents amounts receivable for goods and services net of VAT and intra-Group transactions.

Stock
Stocks are valued at the lower of cost and net realisable value. Provisions are made for obsolete, slow moving and defective stock where appropriate.

Operating leases
Costs in respect of operating leases are charged to the profit and loss account on a straight line basis over the term of the lease.

Investments
Investments held as fixed or current assets are stated at cost less provision for impairment.

Deferred taxation
Where material, deferred tax is provided in full, as required by FRS 19 – Deferred Tax, in respect of timing differences between the treatment of certain items for taxation and accounting purposes. Deferred tax is not discounted.

Hire purchase contracts
Assets obtained under hire purchase contracts, which transfer to the Group substantially all the risks and rewards of ownership of the asset, are capitalised as tangible fixed assets and depreciated over their estimated useful life. Obligations under such contracts are included in creditors net of finance charges allocated to future periods. The finance element of the rental payment is charged to the profit and loss account so as to produce a constant periodic rate of charge on the net obligations outstanding in each period.

Notes to the financial statements for the year ended 28 February 2006 continued

1. Accounting policies (continued)

Foreign currencies

Transactions in foreign currencies are recorded at the rate of exchange ruling at the date of the transaction. Assets and liabilities expressed in foreign currencies are translated into sterling at the rates of exchange ruling at the balance sheet date.

The results of overseas subsidiary undertakings are translated into sterling at the rates of exchange ruling at the balance sheet date. Any exchange differences arising on the retranslation of opening net assets 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.

Pensions

Certain subsidiaries of the Company operate defined contribution pension schemes for their employees and directors. The assets of the schemes are held separately from those of the Group. The annual contributions payable are charged to the profit and loss account. The Company provides no other post-retirement benefits to its employees and directors.

2. Segmental information

Turnover by destination	2006 £'000	2005 £'000
United Kingdom	**13,461**	12,688
North America	**881**	1,014
Far East	**163**	–
Middle East	**253**	369
Continental Europe	**1,629**	835
Other	**14**	61
	16,401	14,967

Turnover for the year is attributable to the distribution of occupational health and first aid products and services, originating in the United Kingdom. In the opinion of the Directors the disclosure of the results on ordinary activities before taxation and net assets by geographical segment and class of business would be seriously prejudicial to the interests of the Group and have therefore not been provided.

3. Group operating loss

Operating loss is stated after charging (crediting):

	2006 £'000	2005 £'000
Amortisation of development costs (note 11)	**77**	22
Amortisation of goodwill	**12,000**	–
Exchange differences	**(256)**	–
Depreciation of owned tangible fixed assets	**197**	108
Depreciation of tangible fixed assets held under hire purchase contracts	**12**	17
Operating lease rentals – land and buildings	**380**	229
Operating lease rentals – plant and machinery	**219**	85
Auditors' remuneration for audit services	**70**	73
Exceptional item	**3,320**	125

The exceptional item is as follows:

	2006 £'000	2005 £'000
Share options	**(289)**	125
Reorganisation costs	**1,938**	–
Write down of Ridgecrest investment (see note 13b)	**1,671**	–
	3,320	125

In accordance with Urgent Issues Task Force abstract number 25, a provision of £289,000 (2005: £nil) has been released in the year relating to potential employer's national insurance payable on the difference between the share price at the balance sheet date and the exercise price to be paid by the option holder. In the prior year a provision of £125,000 was made.

3. Group operating loss (continued)

In addition a further exceptional item has been (charged)/credited to the profit and loss account as follows:

	2006 £'000	2005 £'000
Reorganisation costs	**(149)**	(1,333)
Profit on disposal of tangible fixed assets	**–**	198
Profit on disposal of investments (see note 13b)	**1,671**	–
	1,522	(1,135)

All exceptional items relate to continuing activities.

4. Directors' emoluments

Details of Directors' emoluments are set out in the report on Directors' remuneration on pages 10 to 13.

5. Employees

The average number of employees, including executive Directors, employed by the Group during the year was:

	2006 No.	2005 No.
Sales	**24**	25
Distribution	**94**	63
Administration	**66**	49
	184	137

At 28 February 2006 the number of employees, including executive Directors, employed by the Group was:

	No.
Sales	**17**
Distribution	**90**
Administration	**52**
	159

Staff costs, including executive Directors' remuneration, was:

	2006 £'000	2005 £'000
Wages and salaries	**4,808**	2,868
Social security costs	**428**	427
Other pension costs	**170**	100
	5,406	3,395

The costs disclosed include exceptional charges relating to share options as follows: wages and salaries – £nil (2005: £nil) and social security costs – £nil (2005: £125,000).

6. Net interest payable and similar charges

	2006 £'000	2005 £'000
Interest payable on bank loans and overdrafts	**(342)**	(199)
Interest payable on hire purchase contracts	**(7)**	(3)
	(349)	(202)
Other interest receivable	**15**	128
	(334)	(74)

Notes to the financial statements for the year ended 28 February 2006 continued

7. Taxation on loss on ordinary activities

	2006 £'000	2005 £'000
Tax charge comprises:		
United Kingdom corporation tax at 30%	**–**	30
The reconciliation of the current year tax charge is as follows:		
Group loss on ordinary activities before taxation	**(18,573)**	(322)
Amortisation of goodwill	**12,000**	–
Exceptional items	**(289)**	125
	(6,862)	(197)
Standard UK corporation tax at 30%	**(2,058)**	(59)
Effects of:		
Expenses not deductible for tax purposes	**30**	14
Capital allowances for the year (higher) lower than depreciation	**(10)**	(4)
Chargeable gains	**6**	(52)
Net creation (utilisation) of overseas losses	**240**	(58)
Net creation (utilisation) of UK losses	**1,798**	182
Other	**(6)**	7
Current tax charge	**–**	30

8. Loss attributable to Healthcare Enterprise Group PLC

No separate profit and loss account is presented for the Company as permitted by section 230 of the Companies Act 1985. The loss after taxation of the Company is £5,853,000 (2005: £1,422,000).

9. Loss per share

(a) Basic loss per share

The basic loss per share is based on the loss for the financial year of £18,551,000 (2005: £334,000) and on the weighted average number of ordinary shares in issue during the year of 155,454,106 (2005: 123,908,141).

(b) Diluted loss per share

Because the inclusion of potential ordinary shares would decrease the basic loss per ordinary share they are not deemed to be dilutive and accordingly the basic and diluted loss per ordinary share are identical.

10. Related party transactions

HJM Tompkins is the Managing Director of Thurloe Capital Partners Limited. The Company purchased management services from Thurloe Capital Partners Limited totalling £51,000 (2005: £nil) in the year. As at 28 February 2006 the Company owed Thurloe Capital Partners Limited £nil (2005: £nil).

LJ Gaborit is the Executive Chairman of Industrial Management and Equity Limited ("IME"). The Company purchased strategic consultancy services from IME totalling £175,000 (2005: £261,000) in the year. As at 28 February 2006 the Company owed IME £nil (2005: £16,000).

KI Denos is the principle of Kenneth I. Denos, P.C. ("KID"). The Group purchased legal services from KID totalling US$125,000 (2005: US$140,000) in the year. As at 28 February 2006 HEI owed KID US$ nil (2005: US$11,000).

KI Denos is the Managing Director of Talwar Capital Group, Inc. ("Talwar"). The Company purchased strategic consulting services from Talwar totalling US$ nil (2005: US$25,000) in the year. As at 28 February 2006 the Company owed Talwar US$ nil (2005: US$ nil).

11. Intangible fixed assets

Group	Patents acquired £'000	Development costs £'000	Goodwill arising on reverse acquisition £'000	Goodwill arising on acquisitions £'000	Total £'000
Cost					
At 1 March 2005	6	335	840	33,685	34,866
Additions	–	441	–	–	441
Acquisition through new subsidiaries	–	–	–	1,793	1,793
Adjustments to consideration payable for past acquisitions	–	–	–	(1,157)	(1,157)
Increased investment in subsidiaries	–	–	–	224	224
Disposal of subsidiary	–	–	–	(1,050)	(1,050)
At 28 February 2006	**6**	**776**	**840**	**33,495**	**35,117**
Amortisation					
At 1 March 2005	–	22	840	245	1,107
Provided for the year	6	71	–	12,000	12,077
At 28 February 2006	**6**	**93**	**840**	**12,245**	**13,184**
Net book value					
At 28 February 2006	**–**	**683**	**–**	**21,250**	**21,933**
At 28 February 2005	6	313	–	33,440	33,759

12. Tangible fixed assets

Group	Leasehold land & buildings £'000	Plant, machinery, fixtures & fittings £'000	Motor vehicles £'000	Total £'000
Cost				
At 1 March 2005	33	1,643	197	1,873
Acquisition through new subsidiaries	–	17	–	17
Additions	29	217	–	246
Disposals	–	–	(89)	(89)
Exchange differences	–	2	–	2
At 28 February 2006	**62**	**1,879**	**108**	**2,049**
Depreciation				
At 1 March 2005	9	1,245	105	1,359
Acquisition through new subsidiaries	–	13	–	13
Charge for the year	5	160	44	209
Disposals	–	–	(78)	(78)
Exchange differences	–	1	–	1
At 28 February 2006	**14**	**1,419**	**71**	**1,504**
Net book value				
At 28 February 2006	**48**	**460**	**37**	**545**
At 28 February 2005	24	398	92	514

The net book value of motor vehicles includes an amount of £22,000 (2005: £55,000) in respect of assets held under hire purchase contracts and a related depreciation charge of £12,000 (2005: £17,000).

Notes to the financial statements for the year ended 28 February 2006 continued

12. Tangible fixed assets (continued)

Company	Leasehold land & buildings £'000	Plant, machinery, fixtures & fittings £'000	Total £'000
Cost			
At 1 March 2005	6	83	89
Additions	–	14	14
Disposals	–	–	–
At 28 February 2006	**6**	**97**	**103**
Depreciation			
At 1 March 2005	1	11	12
Charge for the year	–	23	23
Disposals	–	–	–
At 28 February 2006	**1**	**34**	**35**
Net book value			
At 28 February 2006	**5**	**63**	**68**
At 28 February 2005	5	72	77

13. Fixed assets investments

(a) Investments in subsidiary undertakings

Company	£'000
At 1 March 2005	31,415
Transferred from other investment	13
Acquisitions	1,620
Adjustments to consideration payable for past acquisitions	(1,503)
Permanent write down of investments	(4,241)
At 28 February 2006	**27,304**

(b) Other investments

	Group £'000	Company £'000
At 1 March 2005	116	13
Additions in the year	3,127	–
Transferred to investment in subsidiary undertakings	(13)	(13)
Investments written off	(1,692)	–
At 28 February 2006	**1,538**	**–**

On 9 November 2005 the Group disposed of its entire interest in Medical Development Specialists Inc and other non core investments in return for 3,448,118 shares of Common Stock and 6,283,138 shares of Preferred Stock in Ridgecrest Healthcare Group Inc. ("Ridgecrest"). The total consideration was valued at £3,056,000 giving rise to a profit on sale of £1,671,000. The Directors have written the value of the investment in Ridgecrest down by £1,671,000 to reflect the illiquidity of its shares.

14. Principal subsidiaries

The principal subsidiary undertakings of the Group are as follows:

Name	Principal activity	Country of incorporation or registration	Proportion of issued shares held
Healthcare Enterprise Group, Inc	Healthcare consulting and advisory services	United States of America	100%
Healthcare Enterprise Limited	Holding company	England and Wales	100%
Healthcare Sales & Service Limited	Distribution of occupational health and first aid products	England and Wales	100%
SafaTec (UK) Limited	Holding company	England and Wales	100%
Ebiox Limited	Developer and manufacturer of surface decontamination products	England and Wales	100%
Optiscope Technologies Limited	Developer and manufacturer of disposable endoscopes	Israel	72%
Alpha Trading (Asia) Limited	Distribution of occupational health and first aid products	Thailand	100%

All Group companies have accounting reference dates of 28 February except for Optiscope Technologies Limited whose accounting reference date is 31 December.

15. Stocks

	Group		Company	
	2006 £'000	2005 £'000	**2006 £'000**	2005 £'000
Finished goods and goods for resale	**2,096**	3,048	**–**	–

16. Debtors

	Group		Company	
	2006 £'000	2005 £'000	**2006 £'000**	2005 £'000
Trade debtors	**2,557**	5,018	**–**	–
Loan note receivable	**–**	403	**–**	–
Amounts due from subsidiary undertakings	**–**	–	**19,187**	14,137
Prepayments and accrued income	**272**	413	**83**	41
Other debtors	**352**	174	**77**	33
	3,181	6,008	**19,347**	14,211

Included in amounts due from subsidiary undertakings, in the Company's balance sheet, is an amount of £7,500,000 (2005: £125,000) which is due after one year.

17. Creditors: amounts falling due within one year

	Group		Company	
	2006 £'000	2005 £'000	**2006 £'000**	2005 £'000
Bank loans and overdrafts	**2,306**	1,351	**1,375**	475
Net obligations under hire purchase contracts	**19**	18	**–**	–
Trade creditors	**1,745**	2,633	**22**	159
Corporation tax	**49**	53	**–**	–
Taxes and social security	**185**	98	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**312**	92
Other creditors	**26**	537	**–**	13
Accruals and deferred income	**1,276**	1,221	**399**	366
	5,606	5,911	**2,108**	1,105

Notes to the financial statements for the year ended 28 February 2006 continued

18. Creditors: amounts falling due after more than one year

	Group		Company	
	2006 £'000	2005 £'000	**2006 £'000**	2005 £'000
Bank and other loans	**1,125**	1,025	**1,125**	1,025
Net obligations under hire purchase contracts	**27**	38	**–**	–
Accruals and deferred income	**1,675**	3,173	**1,670**	3,173
	2,827	4,236	**2,795**	4,198

Bank and other loans are repayable as follows:

	2006 £'000	2005 £'000	**2006 £'000**	2005 £'000
In one year or less	**2,306**	1,351	**1,375**	475
Between one and two years	**500**	450	**500**	450
Between two and five years	**625**	575	**625**	575
	3,431	2,376	**2,500**	1,500

Bank and other loans repayable in one year or less includes a £1,000,000 Bridging Loan with Barclays Bank Plc which was taken out on 21 February 2006 and was repaid on 8 March 2006 from the proceeds of a share placing on 6 March 2006.

Bank loans of £2,500,000 are secured as follows:
(a) Cross-guarantees from the Company and certain of its subsidiaries;
(b) Fixed and floating charges over the business and assets of the Company and certain of its subsidiaries;
(c) Share pledges given by certain members of the Group.

Of the Group's £2,500,000 (2005: £1,500,000) invoice discounting facility, £931,000 (2005: £1,332,000) has been drawn down by 28 February 2006 and is secured over the trade debtors of certain members of the Group.

19. Obligations under hire purchase contracts

The maturity of amounts due under hire purchase contracts is as follows:

Group	**2006 £'000**	2005 £'000
Repayable within one year	**25**	22
Repayable between one and five years	**31**	41
	56	63
Finance charges and interest allocated to future accounting periods	**(10)**	(7)
	46	56
Included in creditors falling due within one year	**19**	18
Included in creditors falling due after more than one year	**27**	38
	46	56

20. Provisions for liabilities and charges

	Group		Company	
	2006 £'000	2005 £'000	**2006 £'000**	2005 £'000
Provision for share options	**–**	289	**–**	447

Movement	**2006 £'000**	2005 £'000	**2006 £'000**	2005 £'000
At beginning of year	**289**	29	**447**	29
Provision for share options transferred from reserves	**–**	164	**–**	322
Transfer to investment in subsidiary	**–**	(29)	**(158)**	(29)
Increase(decrease) in provision for share options	**(289)**	125	**(289)**	125
At end of year	**–**	289	**–**	447

21. Called up share capital

Group and Company	2006 £'000	2005 £'000
Authorised		
800,000,000 ordinary shares of 2.5 pence each (2005: 800,000,000 ordinary shares of 2.5 pence each)	**20,000**	20,000
186,502,731 deferred shares of 0.4 pence each	**746**	746
	20,746	20,746

Group and Company	2006 £'000	2005 £'000
Allotted, called up and fully paid		
171,931,438 ordinary shares of 2.5 pence each (2005: 149,837,813 ordinary shares of 2.5 pence each)	**4,298**	3,746
186,502,731 deferred shares of 0.4 pence each	**–**	746
	4,298	4,492

During the year the Company issued 22,093,625 ordinary shares of 2.5 pence each as follows:

Number	Price (pence)	Reason
163,042	46	Issued in connection with the acquisition of DistriMatch GmbH
33,219	22.1	Issued as a result of the exercise of share options
250,000	50	Issued in connection with the achievement of milestones by Ebiox
320,000	50	Issued in connection with the acquisition of Ebiox
732,513	90.3	Issued in connection with the acquisition of CICS (Holdings) Limited
320,000	77.93	Issued to satisfy MDS deferred consideration
540,663	25	Issued as a result of the exercise of share options
301,606	74.6	Issued to satisfy First Aid UK Limited deferred consideration
25,706	37.5	Issued as a result of the exercise of warrants
226,469	2.5	Issued as a result of the exercise of share options
7,347	61.25	Issued in settlement of Non-Executive Directors' fees
26,086	46	Issued in settlement of Non-Executive Directors' fees
5,732	78.5	Issued in settlement of Non-Executive Directors' fees
4,812	93.5	Issued in settlement of Non-Executive Directors' fees
3,734	120.5	Issued in settlement of Non-Executive Directors' fees
4,379,562	68.5	Placing by Numis Securities Limited on 23 September 2005
1,200,000	25	Issued as a result of the exercise of warrants
266,666	59	Issued in connection with the sale of certain assets
350,877	57	Issued in connection with the acquisition of Alpha Trading (Asia) Limited
750,000	50	Issued in connection with the achievement of milestones by Ebiox
215,304	27.45	Issued in connection with the Settlement Agreement with MK Low
2,142,856	21.85	Issued to satisfy First Aid UK Limited deferred consideration
9,371,430	14	Placing by Numis Securities Limited on 3 February 2006
455,996	14	Issued in settlement of fees

Deferred consideration payments, totalling £1,670,000 (2005: £3,416,000) have been accrued at the balance sheet date. These payments will be satisfied by the issue of ordinary shares in the Company and are more fully explained in Note 26 to the financial statements.

Notes to the financial statements
for the year ended 28 February 2006 continued

22. Options

The Company operates both an Inland Revenue approved share option scheme and unapproved share option schemes, under which options have been granted to employees and Directors.

Options over ordinary shares outstanding at 28 February 2006 are as follows:

Date of grant	No. of shares	Exercise price	First exercise date	Expiry date
Approved				
14 November 2003	75,000	40p	14 November 2003	13 November 2013
20 October 2004	61,690	48.63p	20 October 2004	28 February 2007
20 October 2004	123,380	48.63p	20 October 2004	19 October 2014
01 December 2004	100,677	54.63p	1 December 2004	30 November 2014
07 December 2004	50,632	59.25p	7 December 2004	6 December 2014
21 September 2005	41,379	72.5p	21 September 2005	31 March 2006
21 September 2005	41,379	72.5p	21 September 2005	20 September 2015
Unapproved				
01 August 2001	2,179,983	2.5p	1 August 2001	31 July 2006
01 August 2001	1,462,760	2.5p	1 August 2001	7 November 2006
19 December 2002	1,358,952	10.25p	19 December 2002	18 December 2007
01 January 2003	312,745	2.5p	1 January 2003	7 November 2006
01 January 2003	730,924	2.5p	1 January 2003	31 December 2008
14 November 2003	1,925,000	24.42p	14 November 2003	13 November 2013
14 November 2003	842,806	25p	14 November 2003	13 November 2006
10 December 2003	2,406,239	25p	10 December 2003	9 December 2013
10 December 2003	575,895	25p	10 December 2003	10 December 2006
10 December 2003	16,609	22.08p	10 December 2003	23 June 2006
06 January 2004	1,600,000	34.5p	6 January 2004	5 January 2014
20 October 2004	358,310	48.63p	20 October 2004	28 February 2007
20 October 2004	164,508	48.63p	20 October 2004	19 October 2014
04 November 2004	388,664	48.75p	5 November 2004	7 November 2006
01 December 2004	183,048	54.63p	1 December 2004	30 November 2014
07 December 2004	50,632	59.25p	7 December 2004	6 December 2014
1 March 2005	1,000,000	79.25p	1 March 2005	31 May 2006
1 March 2005	150,000	79.25p	1 March 2005	28 February 2015
21 September 2005	38,137	72.5p	21 September 2005	31 March 2006
21 September 2005	27,586	72.5p	21 September 2005	20 September 2015
3 February 2006	4,350,000	14p	3 February 2006	2 February 2016
28 February 2006	3,500,000	14.75p	28 February 2006	28 February 2016

23. Warrants issued

On 14 November 2003, a total of 272,107,681 warrants were issued as follows:

(a) One warrant for every ten shares subscribed for under the Placing by Numis Securities Limited of 1,050,000,000 ordinary shares of 0.1p each;
(b) One warrant for every ten existing ordinary shares of 0.1p each held as at 12 November 2003;
(c) One warrant for every ten ordinary shares of 0.1p each issued as consideration for the acquisition of The S.A.F.A. Group Limited ("SAFA Group"), Industrial Pharmaceuticals Limited ("IPS") and SafaTec.

23. Warrants issued (continued)

On 23 July 2004 a total of 11,039,250 warrants were issued as follows:

(a) One warrant for every ten share options over ordinary shares of 0.1p each granted on that date.

The warrants are tradeable on AIM, separately from the ordinary shares of the Company, and twenty five warrants entitle the holder to subscribe to one ordinary share of 2.5p each of the Company at a price of 1.5 pence per warrant on any one of the following dates: 30 June 2004, 2005, 2006, 2007 and 2008 (or, if later, the thirtieth day after the date on which copies of the audited accounts of the Company for the immediately preceding year are despatched to shareholders). These warrants were assigned a value of 0.13 pence each at the date of issue.

In July 2005 warrant holders exercised a total of 642,650 warrants for a total consideration of £9,640. The Company issued 25,706 ordinary shares of 2.5p each.

In July 2004 warrant holders exercised a total of 4,852,191 warrants for a total consideration of £72,783. The Company issued 194,087 ordinary shares of 2.5p each.

On 29 August 2003, along with 30,000,000 ordinary shares of 0.1p each, 30,000,000 warrants were issued to Prestbury Investment Holdings Limited. Twenty-five warrants entitle the holder to subscribe to one ordinary share of 2.5p each. These warrants, were exercised on 10 November 2005.

24. Reserves

Group	Share premium account £'000	Profit and loss account £'000	Merger reserve £'000	Other reserves £'000
At 28 February 2005	**32,042**	**(3,670)**	**(2,293)**	**728**
Exchange losses offset in reserves	–	(28)	–	–
Retained loss for the financial year	–	(18,551)	–	–
Issue of ordinary share capital	7,263	–	–	–
Costs associated with issue of ordinary share capital	(227)	–	–	–
At 28 February 2006	**39,078**	**(22,249)**	**(2,293)**	**728**

Company	Share premium account £'000	Profit and loss account £'000	Other reserves £'000
At 28 February 2005	**38,241**	**(5,083)**	**1,535**
Retained loss for the financial year	–	(5,853)	–
Issue of ordinary share capital	7,263	–	–
Costs associated with issue of ordinary share capital	(227)	–	–
Movement in provision for share options	–	–	159
At 28 February 2006	**45,277**	**(10,936)**	**1,694**

25. Reconciliation of movements in shareholders' funds

	Group		Company	
	2006 £'000	2005 £'000	**2006 £'000**	2005 £'000
Loss for the financial year	**(18,551)**	(334)	**(5,853)**	(1,373)
Issue of new share capital net of expenses	**7,581**	18,757	**7,581**	18,757
Movement in shares to be allotted	**(1,728)**	90	**(1,728)**	90
Movement in provision for share options	**–**	(118)	**159**	(276)
Exchange losses offset in reserves	**(28)**	(45)	**–**	(49)
Capital adjustment for reverse acquisition accounting	**–**	(46)	**–**	–
Deferred shares transferred	**(746)**	–	**(746)**	–
Warrants issued transferred	**(357)**	–	**(357)**	–
Opening shareholders' funds	**34,011**	15,707	**41,897**	24,748
Closing shareholders' funds	**20,182**	34,011	**40,953**	41,897

26. Acquisitions and disposals
(a) Acquisition of CICS (Holdings) Limited

On 15 June 2005 Healthcare Enterprise Group PLC acquired the entire share capital of CICS Holdings Limited and its wholly owned subsidiary Cross Infection Control Systems (CICS) Limited. Total consideration, including costs of acquisition and deferred consideration payments which have been accrued at the balance sheet date totalled £1,329,000. The transaction has been accounted for using the acquisition method of accounting. The total goodwill arising has been capitalised and will be subjected to annual impairment reviews in accordance with FRS 10 Goodwill and Intangible Assets and FRS 11 Impairment of Fixed Assets and Goodwill.

From 1 November 2004 to 30 June 2005 CICS Holdings Limited and its wholly owned subsidiary had sales of £417,000 and an operating profit of £110,000. The profit before tax was £110,000 and the profit after tax was £75,000. The profit after tax for the year ended 31 October 2004 was £182,000. There was no difference between the profit after tax and the recognised gains and losses in either period.

The following table sets out the book values of the identifiable assets and liabilities acquired and their provisional fair values to the Group:

	CICS (Holdings) Limited £'000	Fair value adjustment £'000	Total fair value to the Group £'000
Fixed assets	4	–	4
Stock	53	–	53
Debtors	102	–	102
Cash at bank and in hand	290	–	290
Creditors and provisions	(166)	–	(166)
Net assets	**283**	**–**	**283**
Goodwill	1,046		1,046
Purchase consideration and costs of acquisition	**1,329**	**–**	**1,329**
Satisfied by:			
Shares issued			630
Deferred consideration			620
Cash			79
			1,329

Effective 15 November 2005 Healthcare Enterprise Group PLC acquired the entire share capital of Alpha Trade (Asia) Limited. Total consideration, including costs of acquisition and deferred consideration payments which have been accrued at the balance sheet date totalled £241,000. The transaction has been accounted for using the acquisition method of accounting. The total goodwill arising has been capitalised and is subject to annual impairment reviews in accordance with FRS 10 Goodwill and Intangible Assets and FRS 11 Impairment of Fixed Assets and Goodwill. The goodwill was written off in the year ended 28 February 2006.

From 1 January 2005 to 30 September 2005 Alpha Trade (Asia) Limited had sales of £310,000 and an operating profit of £47,000. The profit before tax was £47,000 and after tax was £27,000. The loss after tax for the year ended 31 December 2004 was £2,000. There was no difference between the profit after tax and the recognised gains and losses in either period.

26. Acquisitions and disposals (continued)

(b) Acquisition of Alpha Trade (Asia) Limited

The following table sets out the book values of the identifiable assets and liabilities acquired and their provisional fair values to the Group:

	Alpha Trade (Asia) Limited £'000	Fair value adjustment £'000	Total fair value to the Group £'000
Stock	718	(561)	157
Debtors	181		181
Cash at bank and in hand	7		7
Creditors and provisions	(851)		(851)
Net assets	**55**	**(561)**	**(506)**
Goodwill			747
Purchase consideration and costs of acquisition			**241**
Satisfied by:			
Shares issued			200
Cash			41
			241

(c) Disposal of Medical Development Specialists Inc

On 9 November 2005 the Group disposed of its entire interest in Medical Development Specialists Inc in return for an equity interest in Ridgecrest Healthcare Group Inc. (see note 13b).

(d) Adjustment of deferred consideration for Ebiox Limited

On 22 July 2004 Healthcare Enterprise Group PLC acquired 2 ordinary shares of the share capital of Ebiox Limited for £50,000 taking the Group's investment to 51% of the issue share capital. On 25 January 2005 the Company acquired the remaining issued share capital. Total consideration, including costs of acquisition and deferred consideration payments which were accrued at 28 February 2005 totalled £1,967,000. In the year ended 28 February 2006 the deferred consideration payable was reduced by £381,000, goodwill was also reduced by £381,000 and shares totalling £781,000 were issued to the vendor. The transaction has been accounted for using the acquisition method of accounting. The total goodwill arising has been capitalised and will be subjected to annual impairment reviews in accordance with FRS 10 Goodwill and Intangible Assets and FRS 11 Impairment of Fixed Assets and Goodwill.

The following table sets out the book values of the identifiable assets and liabilities acquired and their provisional fair values to the Group:

	Ebiox Limited £'000	Fair value adjustment £'000	Total fair value to the Group £'000
Fixed assets	8	–	8
Development costs	–	124	124
Stock	24	–	24
Debtors	131	–	131
Cash at bank and in hand	–	–	–
Creditors and provisions	(511)	–	(511)
Net liabilities	**(348)**	**124**	**(224)**
Goodwill			2,226
Purchase consideration and costs of acquisition			**2,002**
Satisfied by:			
Shares issued			1,717
Cash			251
Deferred consideration			34
			2,002

Notes to the financial statements for the year ended 28 February 2006 continued

26. Acquisitions and disposals (continued)

(e) Adjustment of deferred consideration and fair value of assets acquired for Crest Medical Limited

Effective 1 November 2004 Healthcare Enterprise Group PLC acquired the entire share capital of Crest Medical Limited. Total consideration, including costs of acquisition and deferred consideration payments which were accrued at 28 February 2006 date totalled £7,853,230. At 28 February 2006 the deferred consideration provided for the acquisition of Crest Medical Limited has been reduced by £1,127,000 leading to a decrease in goodwill of the same amount. The fair value of certain assets acquired has been reduced by £346,000 leading to an increase in goodwill of the same amount. In the year ended 28 February 2006 £243,000 deferred consideration was paid. The transaction has been accounted for using the acquisition method of accounting. The total goodwill arising has been capitalised and will be subjected to annual impairment reviews in accordance with FRS 10 Goodwill and Intangible Assets and FRS 11 Impairment of Fixed Assets and Goodwill.

The following table sets out the book values of the identifiable assets and liabilities acquired and their provisional fair values to the Group:

	Crest Medical UK Limited £'000	Fair value adjustment £'000	Total fair value to the Group £'000
Fixed assets	128	–	128
Stock	1,857	(680)	1,177
Debtors	1,097	(7)	1,090
Cash at bank and in hand	112	–	112
Creditors and provisions	(2,196)	(19)	(2,215)
Net assets	**998**	**(706)**	**292**
Goodwill			6,439
Purchase consideration and costs of acquisition			**6,731**
Satisfied by:			
Shares issued			4,500
Cash			596
Deferred consideration			1,635
			6,731

Deferred consideration of £1,631,000 (2005: £3,000,000) was accrued at 28 February 2006.

27. Reconciliation of operating loss to net cash outflow from operating activities

	2006 £'000	2005 £'000
Operating profit/(loss)	**(19,761)**	881
Amortisation of intangible fixed assets	**12,077**	22
Depreciation of tangible fixed assets	**209**	125
Decrease/(increase) in stocks	**835**	(373)
Decrease/(increase) in debtors	**1,868**	(2,137)
Increase/(decrease) in creditors	**(1,291)**	304
Movement in provision for share options	**(289)**	125
Exceptional costs	**1,522**	(1,333)
Profit on sale of fixed assets	**–**	(248)
Investments written off	**(10)**	–
Exchange differences	**(28)**	–
Net cash outflow from operating activities	**(4,868)**	(2,634)

28. Analysis of movement in net funds/(debt)

	1 March 2005 £'000	Cash flow £'000	Disposals £'000	Other non cash changes £'000	28 February 2006 £'000
Cash at bank and in hand	1,010	(1,853)	–	1,332	489
Debt due after one year	(1,025)	(100)	–	–	(1,125)
Debt due within one year	(1,351)	377	–	(1,332)	(2,306)
Hire purchase contracts	(56)	22	13	(25)	(46)
Net debt	**(1,422)**	**(1,554)**	**13**	**(25)**	**(2,988)**

Disposals

During the year the Group disposed of its subsidiary undertaking, Medical Development Specialists Inc. (see note 26c).

29. Reconciliation of net cash flow to movement in net debt

	2006 £'000	2005 £'000
Decrease in cash in the year	**(1,853)**	(1,329)
Cash outflow from change in debt and lease financing	**287**	1,596
Change in net funds resulting from cash flows	**(1,566)**	267
Loans and hire purchase contracts acquired with subsidiaries	**–**	(1,225)
Exchange difference	**–**	–
Movement in net debt	**(1,566)**	(958)
Net debt at the beginning of the year	**(1,422)**	(464)
Net debt at the end of the year	**(2,988)**	(1,422)

Major non cash transactions

During the year the Group entered into finance lease arrangements in respect of assets with a total capital value at the inception of the leases of £25,000. In addition shares were issued as part of the consideration for a number of acquisitions made during the year, the full details of which are set out in Note 21.

30. Financial instruments

The following analysis excludes short term debtors and creditors as permitted under FRS 13.

(a) Financial assets

Currency	**Fixed rate 2006 £'000**	**Floating rate 2006 £'000**	**Non-interest bearing 2006 £'000**	**Total 2006 £'000**	Fixed rate 2005 £'000	Floating rate 2005 £'000	Non-interest bearing 2005 £'000	Total 2005 £'000
Sterling	**–**	**–**	**436**	**436**	–	–	1,056	1,056
US Dollar	**–**	**–**	**–**	**–**	403	3	70	476
Euro	**–**	**–**	**2**	**2**	–	–	1	1
Other	**–**	**–**	**51**	**51**				
	–	**–**	**489**	**489**	403	3	1,127	1,533

The financial assets consist of cash at bank and in hand.

Notes to the financial statements
for the year ended 28 February 2006 continued

30. Financial instruments (continued)
(b) Financial liabilities

Currency	Fixed rate 2006 £'000	Floating rate 2006 £'000	Total 2006 £'000	Fixed rate 2005 £'000	Floating rate 2005 £'000	Total 2005 £'000
Sterling	**27**	**3,431**	**3,458**	41	2,376	2,417
US Dollar	**19**	**–**	**19**	15	–	15
	46	**3,431**	**3,477**	56	2,376	2,432

The floating rate liabilities incur interest at rates related to LIBOR.

The weighted average interest rate on fixed rate liabilities of £46,000 is 11% and is fixed for a period of 2 years.

(c) Currency exposure
Group companies operate in their functional currency and the impact of any currency exposure would not be material.

(d) Borrowing facilities
At the balance sheet date the Group had an undrawn invoice discounting facility of £1,569,000 which is subject to review in less than one year.

(e) Fair value of assets and liabilities
There is no material difference between the fair value of the Group's financial assets and liabilities and their book value as shown in the financial statements.

31. Financial commitments
At 28 February 2006, the Group had annual commitments under non-cancellable operating leases as follows:

Group	Land & buildings 2006 £'000	Other 2006 £'000	Land & buildings 2005 £'000	Other 2005 £'000
Operating lease which expire:				
Within one year	**–**	**3**	29	2
In two to five years	**–**	**161**	–	119
In more than five years	**405**	**–**	379	–
	405	**164**	408	121

32. Post balance sheet events
On 6 March 2006 the company issued 14,914,287 ordinary shares of 2.5p each at 14p each raising £2,004,480 net of expenses.

On 8 March 2006 the Company repaid the £1,000,000 Bridging Loan from Barclays Bank Plc.

On 8 June 2006 the Company renegotiated its £1,500,000 bank loan facility with Barclays Bank Plc as follows:

> The loan is repayable on 10 June 2007.

> The loan is secured over cross guarantees and debentures from the Company and certain of its subsidiaries and share pledges given by certain members of the Group.

Notice of Annual General Meeting

NOTICE IS HEREBY GIVEN that an Annual General Meeting of the Company will be held at Norton Rose, Kempson House, Camomile Street, London EC3A 7AN on Thursday 27 July 2006 at 9.30am for the following purposes:

As Ordinary Business:

1 To receive and adopt the report of the Directors and the audited accounts of the Company for the year ended 28 February 2006 together with the report of the auditors thereon.

2 To receive and adopt the Directors' remuneration report for the year ended 28 February 2006.

3 To re-elect Nicholas Brigstocke, who retires by rotation pursuant to Article 19.6 of the Company's Articles of Association and who, being eligible, offers himself for re-election, as a Director.

4 To re-appoint HLB Vantis Audit plc as auditors of the Company from the conclusion of this meeting until the conclusion of the next general meeting at which accounts are laid before the Company and to authorise the Directors to fix their remuneration.

As Special Business:

5 To consider and, if thought fit, to pass the following resolution as an ordinary resolution:

THAT the Directors be and they are hereby generally and unconditionally authorised in accordance with section 80 Companies Act 1985 ("CA 1985") and in substitution for any existing power to allot relevant securities to exercise all the powers of the Company to allot relevant securities (within the meaning of the said section 80) up to an aggregate nominal amount of £1,563,952 during the period commencing on the date of the passing of this resolution and expiring on the earlier of the conclusion of the annual general meeting of the Company in 2007 and 26 October 2007, but so that this authority shall allow the Company to make before the expiry of this authority offers or agreements which would or might require relevant securities to be allotted after such expiry and notwithstanding such expiry the Directors may allot relevant securities in pursuance of such offers or agreements.

6 To consider and, if thought fit, to pass the following resolution as a special resolution:

THAT

(a) the Directors be and they are hereby empowered, pursuant to section 95 Companies Act 1985 ("CA 1985"):
(i) subject to the passing of Resolution 5 set out in the notice of this meeting, to allot equity securities (within the meaning of section 94 CA 1985) for cash consideration pursuant to the authority given by the said Resolution; and

(ii) to transfer equity securities (within the meaning of section 94 CA 1985) which are held by the Company in treasury;

as if section 89(1) CA 1985 did not apply to any such allotments or transfers, provided that this power shall be limited to the allotment or transfer of equity securities:

(A) in connection with or the subject of an offer or invitation, open for acceptance for a period fixed by the Directors, to holders of ordinary shares and such other equity securities of the Company as the Directors may determine on the register on a fixed record date in proportion (as nearly as may be) to their respective holdings of such securities or in accordance with the rights attached thereto (including equity securities which, in connection with such offer or invitation, are the subject of such exclusions or other arrangements as the Directors may deem necessary or expedient to deal with fractional entitlements that would otherwise arise or with legal or practical problems under the laws of, or the requirements of any recognised regulatory body or any stock exchange in, any territory);

(B) pursuant to the grant or exercise of any share options pursuant to any share scheme of the Company in force from time to time and any shares acquired or held by the Company in treasury may be transferred in satisfaction of the exercise of such options;

(C) (otherwise than pursuant to sub paragraphs (A) and (B) above) up to an aggregate nominal amount of £469,185 (representing approximately 10 per cent. of the issued share capital of the Company);

and shall expire at the earlier of the conclusion of the annual general meeting of the Company in 2007 and 26 October 2007, except that the Company may before such expiry make offers or agreements which would or might require equity securities to be allotted after such expiry and notwithstanding such expiry the Directors may allot equity securities in pursuance of such offers or agreements; and

(b) all authorities previously conferred under section 95 CA 1985 be and are hereby revoked, provided that such revocation shall not have retrospective effect.

Notice of Annual General Meeting
continued

7 To consider and, if thought fit, to pass the following resolution as a special resolution:

THAT in substitution for any existing power under section 166 CA 1985, but without prejudice to the exercise of any such power prior to the date hereof, the Company generally be and is hereby generally and unconditionally authorised for the purposes of section 166 CA 1985 to make market purchases (as defined in section 163 CA 1985) of fully paid ordinary shares of 2.5p each provided that:

(a) the maximum aggregate number of ordinary shares hereby authorised to be purchased is 18,767,435 (being approximately 10 per cent. of the issued ordinary share capital of the Company as at the date of the passing of this resolution);

(b) the minimum price which may be paid for any such ordinary share is 2.5p being the nominal value thereof;

(c) the maximum price (exclusive of expenses) which may be paid for such shares for so long as the ordinary shares of the Company are listed on AIM shall be 5 per cent. above the average of the middle market quotations for an ordinary share in the Company taken from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which such share is contracted to be purchased;

(d) the authority hereby conferred shall expire on whichever is the earlier of the conclusion of the next annual general meeting of the Company in 2007 or 26 January 2008; and

(e) the Company may make a contract to purchase its ordinary shares under the authority hereby conferred prior to the expiry of such authority, which contract will or may be completed or executed wholly or partly after the expiry of such authority, and may purchase its ordinary shares in pursuance of any such contract.

By Order of the Board
LJ Gaborit
Secretary
21 June 2006

Registered office:
2nd Floor
College House
272 King's Road
London SW3 5AW

Notes:

1 A member entitled to attend and vote at the Meeting may appoint one or more proxies to attend and (on a poll) vote instead of him. A proxy need not be a member of the Company.

2 A form of proxy is provided with this notice. Completion and return of such a proxy will not prevent a member from attending the Meeting and voting in person.

3 To be effective, the form of proxy and any power of attorney or other authority under which it is signed (or a notarially certified copy of such authority) must be deposited with the Company's registrars, Capita Registrars, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU not less than 48 hours before the time of the holding of the Meeting or any adjournment thereof.

4 Pursuant to regulation 41(1) of the Uncertificated Securities Regulations 2001 (2001 No. 3755), the Company has specified that only those members registered on the register of members of the Company at 9.30am on 25 July 2006 shall be entitled to attend and vote at the Meeting in respect of the number of Shares registered in their name at that time. Changes to the register of members after 9.30am on 25 July 2006 shall be disregarded in determining the rights of any person to attend and vote at the Meeting.

5 The following documents will be available for inspection at the registered office of the Company during usual business hours on any weekday (Saturdays, Sundays and public holidays excluded) until the date of the annual general meeting and also on the date and at the place of the meeting from 9.30am until the conclusion of the meeting:
(a) copies of the Directors' service contracts and letters of appointment; and
(b) the Register of Directors' Interests required to be kept by CA 1985.

Company information

Non-executive Chairman	HJM Tompkins
Executive Deputy Chairman	LJ Gaborit
Executive Director	GA Wood
Non-executive Directors	NO Brigstocke NW Wray
Secretary	LJ Gaborit
Company Number	3627383
Registered Office	College House 272 King's Road London SW3 5AW
Auditors	HLB Vantis Audit plc 66 Wigmore Street London W1U 2SB
Nominated Advisers and Stockbroker	Numis Securities Limited Cheapside House 138 Cheapside London EC2V 6LH
Solicitors	Norton Rose Kempson House Camomile Street London EC3A 7AN
Bankers	Barclays Bank plc 1 Churchill Place London E14 5HP
Registrars	Capita Registrars Plc The Registry 34 Beckenham Road Beckenham Kent BR3 4TU

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