MEYER RALPH H
Form 4
April 08, 2005

FORM 4

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

OMB APPROVAL

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Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
MEYER RALPH H

(Last) (First) (Middle)

333 FULTON STREET

(Street)

SOUTH WAVERLY, PA 18840

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
CHEMUNG FINANCIAL CORP [CHMG]

3. Date of Earliest Transaction (Month/Day/Year)
04/07/2005

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director _____ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock								4,190	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Pr Deri Secu (Inst
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares	
Phantom Stock	(1)	03/31/2005	04/07/2005	A		177.69		(2)	(2)	Common Stock	177.69	$

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
MEYER RALPH H 333 FULTON STREET SOUTH WAVERLY, PA 18840	X			

Signatures

Jane H. Adamy Power of Attorney dated November 8, 2000	04/08/2005
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) Security converts to common stock on one-for-one basis.

(2) Phantom Stock Units are to be settled 100% in Issuer's Common Stock in accordance with the terms of the Company's Deferred Directors Fee Plan and at the director's election.

(3) Includes dividends reinvested periodically under Issuer's Dividend Reinvestment Plan.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. t;width:4.65pt;">

At December 31, 2004

21.1

18.2

0.9

0.5

0.2

40.9

At December 31, 2003

22.0

17.0

3.0

0.8

0.2

43.0

All depreciation charges in the year have been charged through administrative expenses.

Included in freehold property is an amount of £4.9 million (2004: £5.1 million) in respect of land which is not depreciated.

At December 31, 2005, the carrying amount of the Group s laboratory equipment and machines includes an amount of £Nil (2004: £1.2 million) and motor vehicles an amount of £0.1 million (2004: £0.1 million) in respect of assets held under finance leases and hire purchase arrangements.

At December 31, 2005, the net book value of the tangible assets pledged as collateral in the framework of various borrowing agreements (disclosed in Note 22; Borrowings) was £1.9 million (2004: £2.1 million). The Group did not identify any tangible assets temporarily idle as at the balance sheet date.

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15 Investments in associates

	As at December 31, 2004 £m	As at December 31, 2005 £m
Beginning of the year		14.3
Reclassification of investment as associate	14.2	
Additions	0.1	3.0
Share of loss		(0.8)
Impairment		(16.3)
End of the year	**14.3**	**0.2**

The investment in Astralis Limited was recorded at £0.2 million at December 31, 2005 (2004: £14.3 million) and had a market value of £0.4 million (2004: £9.6 million). Following the Strategic Review and the Group s decision to focus on its core oral and pulmonary products and to divest its injectable business, the Group no longer views its collaboration with Astralis as strategic. This combined with the current uncertainties concerning Astralis financial position resulted in the Group impairing its investment to its estimated fair value.

16 Available for sale financial assets

	As at December 31, 2004 £m	As at December 31, 2005 £m
Beginning of the year	22.0	5.2
Exchange		0.1
Reclassification as associate	(14.2)	
Additions	2.0	0.1
Disposal	(0.6)	(1.8)
Impairments	(3.5)	(2.6)
Revaluation (deficit)/surplus transfer	(0.5)	0.6
End of the year	5.2	1.6

Available for sale financial assets comprise the following unlisted securities:

Vectura Group plc

Vectura is a UK emerging pharmaceutical company traded on the Alternative Investment Market. Vectura is developing a range of inhaled drugs for the treatment of lung diseases and conditions where delivery via the lungs can provide significant benefits, such as rapid onset of action, improved efficacy and improved tolerability compared with current therapies. During 2005 the Group sold 2 million ordinary shares in Vectura for £1.6 million. As at December 31, 2005 the remaining holding was 1.2 million ordinary shares. The investment was recorded at £1.0 million at December 31, 2005 (2004: £2.0 million). In January 2006 the Group sold the remaining 1.2 million ordinary shares.

Vital Living Inc

Vital Living primarily develops and markets evidence-based nutriceuticals. These are developed for incorporation by physicians into a standard physician/ patient program, supported by a specially designed compliance regimen. Vital Living is based in the US. During 2005 the Group received 2,101,422 Vital Living common shares with a value of £68,000 ($120,000) in lieu of interest due on the 12% senior secured convertible notes. As at December 31, 2005 the total SkyePharma holding was 16,993,599 common shares, 1 million series D convertible preferred shares, $1 million 12% senior secured convertible notes due 2008 and 4 million warrants expiring 2008, representing approximately 17.2% of the common shares. The investment in Vital Living was recorded at £0.4 million at December 31, 2005 (2004: £1.7 million). Following the Strategic Review and the Group s decision to focus on its core oral and pulmonary products and to divest its injectable business, the Group no longer views its collaboration with Vital Living as strategic and this investment has therefore been impaired.

Micap plc

Micap plc is a UK science-based technology company traded on the Alternative Investment Market. As at December 31, 2005 the total SkyePharma holding was 5,238,334 ordinary shares and 1,830,000 convertible shares, representing approximately 9.4% of the ordinary share capital. The investment in Micap recorded at £0.2 million at December 31, 2005 (2004: £1.5 million). Following the Strategic Review and the Group s decision to focus on its core oral and pulmonary products and to divest its injectable business, the Group no longer views its collaboration with Micap as strategic and this investment has therefore been impaired.

Cade Struktur Corp

Cade Struktur was formerly a drug delivery company engaged in research and development and worldwide commercialisation of pharmaceutical formulations. The current business is the development, financing and completion of industrial and infrastructure projects in Europe. As at December 31, 2005, the total SkyePharma holding of Cade Struktur, a Canadian company, was 869,086 shares, representing approximately 10.1% of the ordinary share capital. The shares were originally acquired consequent upon the acquisition of the assets of Hyal Pharmaceutical Corp. SkyePharma has not attributed a fair value to these shares and they have been recorded at £Nil (2004: £ Nil).

17 Inventories

	As at December 31, 2004 £m	**As at December 31, 2005 £m**
Raw materials and consumables	1.2	2.1
Work in progress	0.2	1.0
Finished goods	0.1	1.0
	1.5	4.1
Inventory provisions		(0.5)
	1.5	3.6

The cost of inventories recognized as an expense and included in cost of sales is disclosed in Note 6; Operating expenses.

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18 Trade and other receivables

	As at December 31, 2004 £m	As at December 31, 2005 £m
Trade receivables	3.5	2.4
Less provision for impairment		(0.1)
Net trade receivables	3.5	2.3
Other receivables	1.9	2.2
Interest receivable	0.4	0.6
Prepayments and accrued income	12.4	9.1
	18.2	14.2

19 Financial assets at fair value through profit and loss

	As at December 31, 2004 £m	As at December 31, 2005 £m
Beginning of the year	1.0	1.1
Revaluation to fair value	0.1	(0.7)
End of the year	1.1	0.4

Financial assets at fair value through profit or loss comprise 5% convertible loan notes due at par in June 2007. The notes were received from GeneMedix plc in 2002 as an initial payment under an agreement to jointly develop an extended release formulation of Interferon alpha-2b using SkyePharma s DepoFoam technology. The notes are convertible at any time, at SkyePharma s option, into between approximately 8.3 million and 11.2 million GeneMedix ordinary shares. There are no restrictions or a lock-up period on conversion of the notes. GeneMedix can elect to redeem in cash some or all of the notes on conversion. The notes were designated as at fair value through profit or loss on initial recognition.

20 Cash and cash equivalents

	As at December 31, 2004 £m	As at December 31, 2005 £m
Cash at bank and in hand	15.3	26.8
Short term deposits		7.5
	15.3	34.3

The short term deposit is a dual currency deposit of sterling versus US dollars, which earns an effective interest rate of 10.5%. If the sterling/US dollar spot rate is at or above 1.75 at expiry, the £7.5 million deposit will be returned in US dollars at 1.75 ($13.1 million), otherwise it will be returned in sterling.

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21 Trade and other payables

	As at December 31, 2004 £m	As at December 31, 2005 £m
Trade payables	6.7	6.8
Other taxation and social security costs	1.2	2.0
Accruals	12.7	12.2
	20.6	21.0

22 Borrowings

	As at December 31, 2004 £m	As at December 31, 2005 £m
Current		
Convertible bonds due June 2005	9.4	
Bank borrowings	3.5	2.3
Property mortgage	0.3	0.3
Paul Capital funding liabilities		0.7
Finance lease liabilities	0.1	0.1
Other current borrowings	**3.9**	**3.4**
Total current borrowings	**13.3**	**3.4**
Non-current		
Convertible bonds due May 2024	50.4	50.8
Convertible bonds due June 2025		12.8
	50.4	**63.6**
Bank borrowings		0.6
Property mortgage	7.1	6.6
Paul Capital funding liabilities	44.7	43.9
Finance lease liabilities	0.1	
Other non-current borrowings	**51.9**	**51.1**
Total non-current borrowings	**102.3**	**114.7**
Total borrowings	**115.6**	**118.1**

Bank borrowings

At December 31, 2005 bank borrowings include two amounts due to the Basellandschaftliche Kantonalbank of £0.9 million (CHF 2 million) and £0.7 million (CHF 1.5 million) (2004: £0.9 million (CHF 2 million) and £0.7 million (CHF 1.5 million)). Both loans can be terminated with six weeks notice by either party and bear interest at 6.5% and 6.0% respectively. Both loans are secured on the assets of Jago and the £0.7 million (CHF 1.5 million) loan is guaranteed by SkyePharma PLC.

The Group had a loan as at December 31, 2005 with GE Capital Corp of £1.4 million ($2.4 million) (2004: £1.9 million ($3.7 million)). The loan is secured by certain assets of SkyePharma Inc, SkyePharma US Inc and SkyePharma PLC. The loan bears interest at 8.0% and is repayable by instalments until September 2007.

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Convertible bonds

Convertible bonds are disclosed in Note 23; Convertible bonds.

Property mortgage

At December 31, 2005, the Group had a property mortgage facility with the Basellandschaftliche Kantonalbank of £6.9 million (CHF 15.5 million) (2004: £7.4 million (CHF 16.1 million)). The mortgage is in two tranches, both secured by the assets of Jago. The first tranche of £2.7 million (CHF 6.2 million) bears interest at 2.75% and is repayable by instalments over 20 years semi-annually. The second tranche of £4.1 million (CHF 9.3 million) bears interest at 2.75% and is repayable by instalments over 50 years semi-annually.

Paul Capital funding liabilities

The Group entered into two transactions with Paul Capital Royalty Acquisition Fund (Paul Capital) in 2000 and 2002. Under these transactions Paul Capital provided a total of $60 million in return for the sale of a portion of the potential future royalty and revenue streams on a selection of the Group s products.

Whilst the contractual arrangement with Paul Capital is a royalty agreement under which royalties are payable on revenues earned and payments received, the proceeds received from Paul Capital meet the definition of a financial liability under IAS 39, and are treated as a financial liability. Royalties paid to Paul Capital are treated as repayment of the liability and interest is charged on the liability using the effective interest rate at inception of each agreement. The estimated future payments to Paul Capital are discounted using each contract s original effective interest and any adjustment is recognized as income or expense in the income statement

Finance lease liabilities

Obligations under hire purchase and finance leases are secured upon the assets to which they relate and as at December 31, 2005 £Nil (2004: £0.1 million (SKR 0.9 million)) is guaranteed by SkyePharma PLC.

Maturity analysis of non-current borrowings

	As at December 31, 2005			
	1 to 2 Years £m	**2 to 5 Years £m**	**Over 5 Years £m**	**Total £m**
Convertible bonds			63.6	**63.6**
Bank borrowings	0.6			**0.6**
Property mortgage	0.3	0.8	5.5	**6.6**
Paul Capital funding liabilities	4.9	22.1	16.9	**43.9**
Non-current borrowings	**5.8**	**22.9**	**86.0**	**114.7**

	As at December 31, 2004			
	1 to 2 Years £m	**2 to 5 Years £m**	**Over 5 Years £m**	**Total £m**
Convertible bonds			50.4	**50.4**
Property mortgage	0.3	0.8	6.0	**7.1**
Paul Capital funding liabilities	10.6	21.5	12.6	**44.7**
Finance lease liabilities	0.1			**0.1**
Non-current borrowings	**11.0**	**22.3**	**69.0**	**102.3**

Currency analysis of borrowings

	As at December 31, 2005 Sterling £m	$US £m	Swiss francs £m	Total £m
Convertible bonds	63.6			**63.6**
Bank borrowings		0.6		**0.6**
Property mortgage			6.6	**6.6**
Paul Capital funding liabilities		43.9		**43.9**
Total borrowings	**63.6**	**44.5**	**6.6**	**114.7**

	As at December 31, 2004 Sterling £m	$US £m	Swiss francs £m	Total £m
Convertible bonds	50.4			**50.4**
Property mortgage			7.1	**7.1**
Paul Capital funding liabilities		44.7		**44.7**
Finance lease liabilities			0.1	**0.1**
Total borrowings	**50.4**	**44.7**	**7.2**	**102.3**

Interest rate analysis

	As at December 31, 2005 Sterling %	$US %	Swiss francs %
Convertible bonds	8.9/ 9.5/ 13.3		
Bank borrowings		8.0	
Property mortgage			2.8
Paul Capital funding liabilities		24.0/ 30.0	

	As at December 31, 2004 Sterling %	$US %	Swiss francs %
Convertible bonds	8.9/ 9.5		
Property mortgage			2.8
Paul Capital funding liabilities		24.0/ 30.0	
Finance lease liabilities			6.5

Fair values

At December 31, 2005, the carrying amount of non-current liabilities, compared with the fair value was as follows:

	Carrying Amount £m	Fair Value £m
Convertible bonds	63.6	83.5
Bank borrowings	0.6	0.6
Property mortgage	6.6	6.6
Paul Capital funding liabilities	43.9	43.9
	114.7	**134.6**

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Explanation of Responses:

At December 31, 2004, the carrying amount of non-current liabilities, compared with the fair value was as follows:

	Carrying Amount £m	Fair Value £m
Convertible bonds	50.4	75.9
Property mortgage	7.1	7.1
Paul Capital funding liabilities	44.7	44.7
Finance lease liabilities	0.1	0.1
	102.3	**127.8**

Undrawn facility

At December 31, 2005 the Group had an overdraft facility of £1.3 million (CHF 3 million) (2004: £1.4 million, CHF 3 million) with the Basellandschaftliche Kantonalbank secured on the assets of Jago.

23 Convertible bonds

In June 2005 the Group issued £20 million 8% convertible bonds, with a first put after five years by the holder of the bonds, and a final maturity of June 2025. The bonds are convertible at the option of the holder into SkyePharma Ordinary Shares at an initial conversion price of 77 pence at any time prior to maturity. The bond contains a price reset feature such that if on June 3, 2006 the Company s average share price for the preceding 10 days (reset price) is less than the conversion price, then the conversion price shall be adjusted to the reset price subject to a maximum reduction of 25% in the conversion price. The conversion price was reset to 58 pence on June 3, 2006. Unless previously redeemed or converted, the bonds will be redeemed by the Group at their principal amount in June 2025. The convertible bonds existing at December 31, 2005, due in May 2024, were not affected by this transaction.

On June 19, 2005 £9.8 million of convertible bonds due June 2005 were redeemed in full by the Company at their principal amount.

As a result of these transactions the Group has £69.6 million convertible bonds due May 2024 at a conversion price of 95 pence, and £20 million convertible bonds due June 2025 at a conversion price of 58 pence.

24 Derivative financial instruments

	As at December 31, 2004 £m	As at December 31, 2005 £m
Interest rate swap	(0.2)	
Total derivative financial instrument liabilities	**(0.2)**	

The Group s policy is to hedge interest rate exposures through the use of interest rate swaps and currency exposures through the use of currency options, accrual forward options and forward currency contracts. None of these derivative financial instruments qualify to be treated as hedges and accordingly gains and losses are recorded in the income statement.

25 Provisions

Group	Pension £m	Restructuring £m	Total £m
At January 1, 2005	1.7	0.3	2.0
Actuarial losses	0.3		0.3
Charge for the year	(0.1)		(0.1)
Utilized		(0.3)	(0.3)
At December 31, 2005	1.9		1.9

	As at December 31, 2004 £m	**As at December 31, 2005 £m**
Current (restructuring)	0.3	
Non current (pension)	1.7	1.9
	2.0	**1.9**

Pension provision

The pension provision relates to the retirement commitments under its defined benefit schemes in respect of its employees in Switzerland and France.

Restructuring provision

The restructuring provision relates to the reorganization of research and development operations and other business functions involving reductions in staff at most sites.

26 Retirement benefit obligations

Defined contribution plans

The Group operates various defined contribution plans for its employees in the UK and US. The Group s contributions to these plans are charged to the income statement in the period to which they relate, and the assets are held in separate trustee administered funds. The income statement charge related to defined contribution plans is disclosed in Note 7; Staff costs.

Defined benefit plan

The Group operates unfunded defined benefit schemes in respect of its employees in Switzerland and France.

The liabilities of the defined benefit schemes operated by the Group are presented below:

	As at December 31, 2004 £m	**As at December 31, 2005 £m**
Balance sheet obligations for:		
Defined benefit pension benefits	**1.7**	**1.9**

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The amounts recognized in the balance sheet are determined as follows:

	As at December 31, 2004 £m	As at December 31, 2005 £m
Present value of funded obligations	6.3	6.4
Fair value of plan assets	(5.3)	(5.3)
	1.0	1.1
Present value of unfunded obligations	0.7	0.8
Liability in the balance sheet	**1.7**	**1.9**

The amounts recognized in the income statement are as follows:

	Year ended December 31, 2004 £m	Year ended December 31, 2005 £m
Current service cost	0.2	0.3
Interest cost	0.3	0.3
Expected losses on assets	(0.2)	(0.2)
Total included in staff cost	**0.3**	**0.4**

The actuarial return on plans assets was £0.2 million (2004: £0.2 million).

The movement in the defined benefit obligation over the year is as follows:

	Year ended December 31, 2004 £m	Year ended December 31, 2005 £m
Beginning of the year	6.7	7.0
Exchange adjustment	(0.1)	(0.1)
Current service cost	0.2	0.3
Contributions	(0.3)	(0.3)
Interest on pension scheme liabilities	0.3	0.3
Expected losses on assets	(0.2)	(0.2)
Actuarial losses recognized in equity	0.4	0.2
End of the year	**7.0**	**7.2**

The movement in the fair value of the plan assets over the year is as follows:

	Year ended December 31, 2004 £m	Year ended December 31, 2005 £m
Beginning of the year	4.7	5.3
Exchange adjustment	0.3	(0.1)
Current service cost	0.2	0.3
Interest on pension scheme liabilities	0.3	0.3
Benefits paid	(0.5)	(0.7)
Actuarial gains recognized in equity	0.3	0.2
End of the year	**5.3**	**5.3**

At December 31, 2005 and 2004 actuarial valuations were performed by professionally qualified actuaries on the present value of the accrued liabilities calculated under the projected unit method. The principal assumptions made by the actuaries were:

	2004 % per annum	2005 % per annum
Inflation rate	2.0	1.9
Rate of increase in salaries	2.5	2.3
Discount rate	4.0	3.7
Expected return on plan assets	2.4	2.0

Assumptions regarding future mortality experience are set based on advice in accordance with published statistics and experience in Switzerland and France.

	2004 years	2005 years
Male	17.3	17.3
Female	20.8	20.8

	2004 £m	2005 £m
Actuarial gains recognized in equity	(0.1)	(0.1)
Cumulative actuarial gains recognized in equity	(0.1)	(0.1)

Plan assets are comprised as follows:

	2004 £m	2005 £m
Equity	4.3	4.7
Other	1.0	0.6
	5.3	**5.3**

Expected contributions to post employment benefit plans for the year ending December 31, 2006 are £0.6 million.

27 Share capital

	December 31, 2004 Number of shares	December 31, 2005 Number of shares	December 31, 2004 £m	December 31, 2005 £m
Authorized				
Ordinary Shares of 10p each	1,102,000,000	1,102,000,000	110.2	110.2

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	Ordinary Shares of 10p each Number	Nominal value £m	Deferred B Shares of 10p each Number	Nominal value £m	Total nominal value £m
At January 1, 2004	618,669,940	61.9	12,000,000	1.2	63.1
Exercise of share options	478,803				
Issue of shares to Research Development Foundation	3,250,000	0.3			0.3
At January 1, 2005	622,398,743	62.2	12,000,000	1.2	63.4
Rights issue	125,627,357	12.6			12.6
Acquisition of shares in Astralis	5,482,238	0.6			0.6
Exercise of share options	255,808				
At December 31, 2005	753,764,146	75.4	12,000,000	1.2	76.6

The Group raised £34.8 million net of expenses by means of a rights issue of 125,627,357 new Ordinary Shares.

The Group also issued 5,482,238 Ordinary Shares to two former Astralis Directors to acquire 11,160,000 common shares in Astralis.

Deferred B shares

In July 2000, 12 million deferred A and 12 million deferred B shares were issued to Dr Gonella, the vendor of Jago, under a settlement agreement that established the full and final settlement of the deferred consideration payable on the acquisition of Jago. The holders of deferred A and B shares have no rights to participate in the profits of the Company, no voting rights and on a winding up or other return of capital only receive the nominal value of their shares if the holders of Ordinary Shares in the capital of the Company have received the sum of £1 million per Ordinary Share. Under the terms of the settlement agreement, following the US launch and first commercial sale of Paxil CR by GlaxoSmithKline in 2002, the 12 million deferred A shares were automatically converted into 12 million Ordinary Shares.

The 12 million deferred B shares automatically convert to 12 million Ordinary Shares on the Company s receipt of a royalty statement under the current license agreement stating that reported sales of Paxil CR have exceeded $1,000 million during any calendar period prior to January 1, 2006 or exceeded $337 million between January 1, 2006 and May 3, 2006. The conditions have not been met and the deferred B shares have been transferred to the Company Secretary for no consideration for him to hold as custodian.

Warrants

The Company has the following warrants outstanding:

(a) D and E warrants

The D and E warrants were issued in March 2002 as part of the consideration for the agreement with Paul Capital to fund new product development. The D and E warrants entitle the holders to subscribe for a total of 5 million Ordinary Shares at any time during the period to December 31, 2008 at an exercise price of 73.75 pence per Ordinary Share. A value of £0.3 million, deemed to be the fair value of the D and E warrants, has been recorded in Other Reserves.

(b) F warrants

The F warrants were issued in December 2003 as part of the £2.7 million ($5 million) loan with GE Capital Corp. The F warrants entitle the holders to subscribe for a total of 300,000 Ordinary Shares at any

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time until the repayment date of the loan at an exercise price of £1.20 per Ordinary Share. A value of £39,000, deemed to be the fair value of the F warrants, has been recorded in Other Reserves.

(c) Other warrants

Warrants were issued in December 1999 as part of the acquisition of DepoTech and entitle the holders to subscribe for 371,353 Ordinary Shares at any time during the period beginning December 31, 1999 and ending on February 25, 2005 at an exercise price of $1.142 (59.5 pence) per Ordinary Share. All of these warrants lapsed unexercised on February 25, 2005.

Potential Issues of Ordinary Shares

(a) Employee share schemes

The Group encourages employee participation in its shares through ownership and continues to operate various incentive schemes whereby Directors and employees are to able to acquire shares, and potential shares, in the Company. Further details are provided in Note 28; Share based payments.

(b) Deferred consideration on acquisition of Krypton

The deferred consideration on the acquisition of Krypton provides that a maximum of 37.5 million Ordinary Shares would be issued contingent on a change in control of the Company at a share price of not less than 80 pence compounded at an annual rate of 10% (£2.08 as at December 31, 2005), or satisfaction of various conditions and hurdles which lapsed on December 31, 2003. No provision for deferred consideration has been recognized as at December 31, 2005.

(c) Paul Capital Royalty Acquisition Fund

In March 2002 the Group announced a second transaction with Paul Capital Royalty Acquisition Fund under which SkyePharma would issue Ordinary Shares up to a value of $7.5 million if royalties and milestones received by SkyePharma in respect of those products included in the transaction were not in excess of minimum annual payments required to be made to Paul Capital. During 2005 the royalties received by SkyePharma were substantially in excess of the minimum payments required to be made to Paul Capital, consequently the Company has not recognized a provision.

28 Share based payments

The Group operates various share based compensation plans as follows:

Option schemes

Options granted to UK and European employees are only exercisable between the third and tenth anniversary of the date of grant, and are subject to the Company s Code of Business Conduct and Ethics for dealing in Shares, and the Model Code. Options granted to US employees prior to 2001 vest at 25% per annum from the date of grant and there were no performance criteria. UK and European options granted prior to 2001 may only be exercised if the growth in the Company s share price over a consecutive three-year period exceeds the growth over the same period in the FTSE All Share Index. This criteria was satisfied for the first time in March 2000. Employees with options that are within their exercise period are now able to exercise those options within any one-year period from the date the performance condition is satisfied. Super Options are exercisable after five years and are subject to higher performance conditions in accordance with those recommended by the Association of British Insurers.

Following changes to the option plans approved at the Annual General Meeting in June 2001, options granted to Directors and senior employees since that date are subject to performance conditions linked to the total shareholder return of a comparator group of companies, and are not subject to retesting. Options granted to other US employees continue to vest at 25% per annum with no performance criteria, and other European employees who are not Directors or senior employees can exercise their options after three years and are not subject to performance conditions. The Group s option plans are detailed further in Part I, Item 6: Directors, Senior Management and Employees. It is the intention of the Group that no further options grants will be made under any of the option plans.

The following table summarizes the activity in share options for the year to December 31, 2005:

	Share options	Option price
At January 1, 2004	**52,345,218**	**44.8p 93.0p**
Exercised	(478,803)	44.8p 66.5p
Cancelled or expired	(3,883,170)	46.5p 91.3p
At December 31, 2004	**47,983,245**	**44.8p 93.0p**
Exercised	(255,808)	46.5p 55.6p
Forfeited	(9,654,453)	46.5p 92.0p
Cancelled or expired	(2,171,974)	46.5p 92.0p
Rights issue adjustment (see below)	1,596,534	1.8p 3.7p
At December 31, 2005	**37,497,544**	**43.0p 89.3p**
Exercisable	22,180,175	43.0p 89.3p

The weighted average exercise price as at December 31, 2005 was 58.6 pence.

The market value of Ordinary Shares as at December 31, 2005 was 49.75 pence. The market value of Ordinary Shares during 2005 ranged from the lowest closing mid-price of 34.25 pence to the highest closing mid-price of 66.75 pence per share. No options were granted during the current year.

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At December 31, 2005 the following Ordinary Shares were under option to employees or former employees of the Group:

Normal expiry date	Option price for each Ordinary Share of 10p	Number of options over Ordinary Shares of 10p
April, 26 2006	72.0p	930,937
April 7, 2007	63.8p	529,100
January 28, 2008	49.0p	129,254
March 31, 2008	89.3p	829,615
October 5, 2008	43.0p	570,128
April 19, 2009	66.7p	2,272,318
May 25, 2009	54.4p	5,076,891
September 7, 2009	54.6p	199,044
June 6, 2010	87.6p	442,185
November 3, 2010	78.4p	1,411,387
June 12, 2011	77.4p	4,066,007
October 31, 2011	53.4p	913,309
April 12, 2012	69.4p	4,847,662
May 24, 2012	75.4p	447,637
September 25, 2012	49.6p	1,114,377
April 7, 2013	44.6p	13,570,809
September 26, 2013	59.5p	146,884
		37,497,544

Following completion of the Company s Rights Issue announced on September 28, 2005 the number and exercise price applicable to options were adjusted to take account of the dilution in the value of options caused by the Rights Issue. The number of options was increased by 4% and the exercise price was reduced by 4%.

As stated above, no options were granted to employees in 2004 or 2005. For those options granted in prior years which impact the income statement, fair values were determined using an option pricing model based on Black-Scholes but adjusted to model the particular features of the options. The fair value of these options is consistent with the values previously disclosed for SEC filing purposes.

The Rights Issue had no effect on the fair value of options.

The total expense relating to share based payments, which are all equity settled transactions, is disclosed in Note 7; Staff costs.

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Deferred Share Bonus Plan (DSB)

Under the rules of this plan, Directors and senior employees receive conditional rights to acquire Ordinary Shares in the Company, at the prevailing market rates at the time of grant. Eligible employees are awarded rights to acquire a maximum number of shares at the beginning of a three year period, a proportion of which they will be entitled to receive at the end of that period depending on the extent to which the performance conditions set by the Remuneration Committee at the time the allocation is made are satisfied. If the performance conditions are not satisfied the share award will lapse. Awards are either linked to the deferral of annual bonus (DSB Matching Share Awards) or stand alone share awards (LTIP Awards). Further information on awards and performance conditions are detailed in Part I, Item 6: Directors, Senior Management and Employees.

	LTIP Awards	**DSB Matching Share Awards**
Outstanding At January 1, 2005	**3,679,499**	**2,046,093**
Granted	3,979,684	640,103
Rights Issue Adjustment	301,830	90,299
Forfeited		
Cancelled or expired	518,084	88,801
Released		434,395
At December 31, 2005	**7,442,929**	**2,253,299**

Following completion of the Company s Rights Issue announced on September 28, 2005 the number of shares comprising the LTIP Awards and DSB Matching Share Awards was adjusted to take account of the dilution in the value of conditional shares caused by the Rights Issue. The number of shares under award was increased by 4%.

For the purposes of IFRS 2 the fair values of LTIP Awards and DSB Matching Shares Awards have been determined using a Monte Carlo Simulation model. The Monte Carlo Simulation model takes into account the comparative total shareholder return performance element attaching to these share awards. The following table sets out the assumptions used in determining the fair value of these share awards:

	LTIP Awards		DSB Matching Share Awards
Model	Monte Carlo Simulation		
Rationale	This model takes into account the market based performance conditions (comparative TSR) attaching to the LTIP Awards and DSB Matching Share Awards.		
Date of Grant	June 3, 2005	June 9, 2005	February 2, 2005
Share Price on Grant (£)	0.54	0.53	0.64
Exercise Price	nil	nil	nil
Expected Dividend Yield	n/a	n/a	n/a
Expected Volatility	47.23%	47.18%	48.96%
Risk Free Interest Rate	4.22%	4.73%	4.57%
Expected Life	3 years	3 years	3 years
Fair Value (£)	0.40	0.40	0.57

The excepted volatility is calculated as the historic volatility of the Company share return over the three years prior to each grant date.

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In determining the charge to the income statement, the Company has assumed that the number of share awards that will ultimately vest is reduced by 5% per annum.

The Rights Issue had no effect on the fair value of LTIP Awards and DSB Matching Share Awards.

The total expense relating to share based payments, which are all equity settled transactions, is disclosed in Note 7; Staff costs.

International Share Purchase Plan (ISPP)

All employees are eligible to participate in the ISPP whereby employees buy shares in the Company. These shares are called Partnership Shares and are held in trust on behalf of the employee. For every Partnership Share bought by the employee the Company will give the employee one share free of charge (Matching Shares). The employees have to take their shares out of the plan on leaving the Company and will not be entitled to the Matching Shares if they leave within three years of buying the Partnership Shares. In addition, the Company can also award employees rights to acquire up to a maximum of £3,000 of shares (Free Shares). There are no vesting conditions attaching to the Free Shares other than being continuously employed by a Group company on the third anniversary of the date of grant.

	Matching Shares	Free Shares
Outstanding At January 1, 2005	**348,831**	**30,411**
Granted	211,460	
Rights Issue Adjustment	n/a	2,723
Forfeited		
Cancelled or expired	41,109	7,855
Released	88,347	
At December 31, 2005	**430,835**	**25,279**

Following the completion of the Company s Rights Issue announced on September 28, 2005 the number of shares applicable to Free Shares was adjusted to take account of the dilution in the value of conditional shares caused by the Rights Issue. The number of shares under award was increased by 4%.

For the purposes of IFRS 2 the fair value of these Matching Shares and Free Shares is determined as the market value of the shares at the date of grant. In determining the charge to the income statement, the Company has assumed that the number of share awards that will ultimately vest is reduced by 10% per annum.

The Rights Issue had no effect on the fair value of the Free Shares.

The total expense relating to share based payments, which are all equity settled transactions, is disclosed in Note 7; Staff costs.

29 Reserves

	Share premium £m	Translation reserve £m	Fair value reserve £m	Retained losses £m
At January 1, 2004	**319.3**	**1.6**		**(364.3)**
On issue of shares to Research Development Foundation	1.5			
Exercise of share options	0.2			
Exchange adjustments		(2.5)		
Revaluation deficit transfer			(0.5)	
Loss for the year				(18.6)
Share based payments charge				4.1
Pension actuarial losses				(0.1)
At December 31, 2004	**321.0**	**(0.9)**	**(0.5)**	**(378.9)**
Rights issue	25.1			
Expenses of rights issue	(2.9)			
Acquisition of shares in Astralis	2.3			
Exercise of share options	0.1			
Exchange adjustments		(0.3)		
Impairments			0.5	
Revaluation surplus transfer			0.2	
Loss for the year				(50.9)
Share based payments charge				2.4
Purchase of own shares				(0.4)
Repayment of convertible bonds due June 2005				0.7
At December 31, 2005	**345.6**	**(1.2)**	**0.2**	**(427.1)**

30 Other reserves

	Merger reserve £m	Warrants reserve £m	Equity of convertible bonds £m	Total other reserves £m
At January 1, 2004	**9.0**	**0.4**	**0.7**	**10.1**
Exchange and issue of convertible bonds due May 2024			22.3	22.3
At December 31, 2004	**9.0**	**0.4**	**23.0**	**32.4**
Issue of convertible bonds due June 2025			6.1	6.1
Repayment of convertible bonds due June 2005			(0.7)	(0.7)
At December 31, 2005	**9.0**	**0.4**	**28.4**	**37.8**

The merger reserve relates to the acquisition of Krypton Limited during 1996. The warrant reserve relates to the D , E and F warrants described in Note 27; Share capital. The equity element of the convertible bonds reserve relates to the convertible bonds due May 2024 and June 2025.

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31 Commitments

	As at December 31, 2004 £m	As at December 31, 2005 £m
Commitments under operating leases		
Operating leases on land and buildings:		
In one year or less	2.5	2.3
In two to five years	10.7	10.4
In five years or more	15.6	14.6
	28.8	**27.3**
Other operating leases:		
In one year or less		0.1
		0.1

In addition the Group has committed to undertake certain clinical trials on behalf of its partners under development and licensing agreements.

The Group is committed to make certain payments to third parties contingent upon future events such as the approval and launch of products.

32 Contingencies

At December 31, 2005 the Company had provided guarantees on various bank borrowings of its subsidiaries as set out in Note 22; Borrowings.

In common with most business enterprises, Group companies are subject to a number of claims from third parties, the outcome of which cannot at present be determined but which are not considered to be material in the context of these financial statements. Provisions have been made in these financial statements for any liabilities which are expected to materialize from such claims.

33 Related Parties

At the end of December 1998, Ian Gowrie-Smith (through a family-owned trust) acquired a 51% interest in 10 East 63rd Street Inc., the company which owns 10 East 63rd Street, a property in New York. In December 2002 Mr. Gowrie-Smith acquired a further 49% interest. SkyePharma PLC has been in occupation of approximately half of that property since January 1997, subject to tenancy agreements based upon independent valuation. In August 2003 the Company took occupation of the entire building under an eight-year tenancy agreement, at which time the annual rent was increased from $420,000 per annum to $720,000 per annum until August 2008, and $942,500 per annum from August 2008 to August 2011. A portion of these premises is currently sub-let by the Group.

34 Principal subsidiaries

Subsidiary undertakings

Company	**Country of incorporation**	**% held of nominal value and voting rights**	**Principal activities**
SkyePharma Canada Inc.*	Canada	100%	Research and development
SkyePharma Production SAS*	France	100%	Manufacturing of pharmaceuticals
SkyePharma (Jersey) Limited*	Jersey	100%	Issue of bonds
Krypton Limited	Gibraltar	100%	Exploitation of intellectual property
SkyePharma AB*	Sweden	100%	Research and development
Jago Holding AG	Switzerland	100%	Holding company
Jagotec AG	Switzerland	100%	Exploitation of intellectual property
SkyePharma AG	Switzerland	100%	Research and development
SkyePharma Holding AG*	Switzerland	100%	Holding company
SkyePharma Holding Inc.*	US	100%	Holding company
SkyePharma Inc.	US	100%	Development of pharmaceuticals
SkyePharma US Inc.	US	100%	Development of pharmaceuticals and licensing

* Directly held by the Company.

Associates

Company	**Country of incorporation**	**% held of nominal value and voting rights**	**Principal activities**
Astralis Limited	US	40%	Research and development

35 Subsequent event

In May 2006 SkyePharma announced that it had entered into an agreement with Kos Pharmaceuticals Inc to jointly develop Flutiform . Kos will have exclusive rights to market Flutiform in the US and a right of first negotiation in Canada. SkyePharma could receive up to $165 million in milestone payments on achievement of all regulatory and revenue targets (of which $25 million has been paid up front) together with royalties starting in the mid teens on sales by Kos.

36 Transition from accounting practices generally accepted in the UK to International Financial Reporting Standards

The Group reported under UK GAAP in its financial statements for the year ended December 31, 2004. The Group is required under the Listing Rules to report under IFRS for the year ending December 31, 2005 and present comparatives for the year ended December 31, 2004. Consequently, the Group s date of transition to IFRS is January 1, 2004.

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Set out below are reconciliations of total equity and reserves and income from UK GAAP to IFRS.

Total equity and reserves

	Notes	January 1, 2004 £m	December 31, 2004 £m
Total equity and reserves as reported under UK GAAP		**84.9**	**63.6**
Adjustments to conform to IFRS			
Revenue recognition	(a)	(19.6)	(6.7)
Sale of royalty interests to Paul Capital	(b)	(36.1)	(39.0)
Goodwill amortization	(d)		4.1
Convertible bonds	(e)	1.5	16.4
Fixed assets investments	(f)		(0.5)
Other financial instruments	(g)	0.4	(0.2)
Pensions	(h)	(1.3)	(1.2)
Total equity and reserves under IFRS		**29.8**	**36.5**

Loss for the year

	Notes	Year ended December 31, 2004 £m
Loss for the year as reported under UK GAAP		**(24.3)**
Adjustments to conform to IFRS		
Revenue recognition	(a)	13.1
Sale of royalty interests to Paul Capital	(b)	(1.7)
Share based payments	(c)	(2.8)
Goodwill amortization	(d)	4.1
Convertible bonds	(e)	(6.5)
Other financial instruments	(g)	(0.5)
Loss for the year under IFRS		**(18.6)**

Cash flow statement

The transition from UK GAAP to IFRS does not change any of the cash flows of the Group. The IFRS cash flow statement is similar to UK GAAP, but presents various cash flows in different categories and in a different order from the UK GAAP cash flow statement. All of the IFRS accounting adjustments net out within cash generated from operations, except for the inclusion of the repayment of the Paul Capital funding liabilities.

The IFRS adjustments set out in the reconciliations are explained below:

(a) Revenue recognition

Under UK GAAP SkyePharma has generally recognized up front payments immediately in full where there are no material future obligations and the payments are non-refundable, on the basis that the up front payment relates to past services. Under IFRS up front payments will generally be deferred and amortized on a systematic basis over the period of product development to filing. However, the accounting for each agreement will continue to be determined on an individual basis.

The IFRS restatement increases revenue in the year to December 31, 2004 by £13.1 million so reducing operating and retained loss by £13.1 million. This relates to up front payments that have been

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previously recognized in the UK GAAP financial statements in earlier years but which under IFRS would not have been recognized in full, but deferred across the period of development to filing. The restatement increases deferred income at December 31, 2004 by £6.7 million (2003: £19.6 million).

(b) Sale of royalty interests to Paul Capital

The Group entered into two transactions with Paul Capital Royalty Acquisition Fund (Paul Capital) in 2000 and 2002. Under these transactions Paul Capital provided a total of $60 million in return for the sale of a portion of the potential future royalty and revenue streams on a selection of the Group s products. Under UK GAAP the proceeds received from Paul Capital are treated as a sale and recorded as operating income and the royalties are expensed when incurred.

Under IFRS the proceeds received from Paul Capital meet the definition of a financial liability under IAS 39, and are treated as such. No operating income is recognized, royalties paid to Paul Capital are treated as repayment of the liability and in addition interest is imputed on the liability using the effective rate as at inception of the agreement. The contractual arrangement with Paul Capital is unaffected by this change in accounting and the arrangement remains a royalty agreement under which royalties are payable on revenues earned and payments received. The liability has no face amount but represents the net present value of royalties we expect to pay Paul Capital over the term of the agreement, discounted at the effective rate at inception of the agreement.

The IFRS restatement increases the loss in the year to December 31, 2004 by £1.7 million and decreases net assets at December 31, 2004 by £39.0 million (2003: £36.1 million).

(c) Share based payments

IFRS 2 requires that for share option awards to employees, the fair value of the employee services received should be measured by reference to the fair value of the share option at the grant date. This differs significantly from the treatment under UK GAAP where the charge to the profit and loss account was based on the difference between the fair value of the shares at the date of grant and the exercise price. Since SkyePharma has historically granted employee options where the share price at the date of grant equals the exercise price, there has been no charge recorded under UK GAAP.

SkyePharma has adopted full retrospective application of IFRS 2. The IFRS restatement results in an additional charge to the income statement in the year to December 31, 2004 of £2.8 million, increasing both operating and retained loss. The restatement has no impact on net assets.

(d) Goodwill amortization

Under UK GAAP goodwill has been amortized over its estimated expected useful life which the Directors determined as 20 years. Under IFRS, goodwill is considered to have an indefinite life and so is not amortized, but is subject to annual impairment testing. Therefore the annual goodwill charge made under UK GAAP will not be recorded under IFRS from January 1, 2004, the IFRS transition date. The IFRS restatement results in a reduction in the amortization charge in the year to December 31, 2004 of £4.1 million thereby reducing both operating and retained loss.

(e) Convertible bonds

Under UK GAAP the total net proceeds of the convertible bond issues in 2000 (due in 2005) and 2004 (due in 2024) were recorded as debt. Under IFRS the conversion feature of each of the bonds must be split from the debt and classified as equity. The net impact of the changes to IFRS and in particular the split of the equity component of each bond has led, at December 31, 2004, to a reduction in the carrying value of convertible debt of £16.4 million (2003: £1.5 million) and a corresponding increase in equity. While the carrying value of the convertible debt in the balance sheet is reduced, the amount of debt repayable at maturity is unchanged and consequently under IFRS the Group records higher interest charges in each year to maturity or conversion.

In the year to December 31, 2004, the impact of these factors led to an additional interest charge of £0.3million. The terms of the debt are unaffected and the physical cash payments due remain the same; as such the cost of the debt in cash terms is unaffected.

During the year to December 31, 2004 the Group exchanged £49.6 million of the convertible bonds due 2005 for bonds due 2024 in the same amount, leaving £9.8 million 2005 bonds outstanding. Under UK GAAP no gain or loss arose on the exchange. However un-amortized issue costs of £0.3 million were written off under UK GAAP as exceptional interest charge. Under IFRS the refinancing of the £49.6 million convertible is treated as an extinguishment of the original debt and the issue of new debt recorded at fair value since the discounted present value of the cash flows of the two instruments differ by more than 10% (2005 Bond replaced by a 2024 Bond). The extinguishment and debt issue costs lead to the additional charge of £6.2 million recorded in the IFRS income statement in 2004.

In total the IFRS adjustments on the convertible bonds result in an additional interest charge in the 2004 income statement of £6.5 million and an increase in net assets at December 31, 2004 by £16.4 million. Of the £6.5m additional interest charge, £0.3m relates to the IFRS accounting for convertible bonds in general and £6.2 million is an additional charge caused by the 2004 refinancing of SkyePharma s convertible bond due 2005.

(f) Fixed assets investments

Under UK GAAP fixed asset investments are stated at the lower of cost and net realisable value. Under IFRS most of SkyePharma s investments are classified as Available-for-sale financial assets and as such stated at fair value with any unrealized gains or losses recorded in equity. The IFRS restatement reduces net assets at December 31, 2004 by £0.5 million (2003: £Nil) and does not effect the income statement.

(g) Other financial instruments

Under UK GAAP, periodic gains and losses on interest and foreign currency derivatives designated as hedges are not recognized until the operational transactions to which they are linked occur. No derivatives have qualified as hedges under IFRS and therefore in accordance with IAS 39 such instruments have been recognized at fair value at the balance sheet date with gains and losses being recorded in the income statement.

SkyePharma is adopting full retrospective application of IAS 32 and IAS 39 and has therefore restated its opening balance and 2004 result accordingly. This restatement has led to an additional charge in the year to December 31, 2004 of £0.5 million, increasing both operating and retained loss. As at December 31, 2004 the IFRS restatement reduces net assets by £0.2 million (2003: £0.4 million increase).

(h) Pensions

The IFRS adjustment on pensions relates to the Company s pension schemes in Switzerland and France. In accordance with IFRS 1, the Group has fully recognized all actuarial gains and losses on its pension schemes in Switzerland and France at January 1, 2004, its transition date. Ongoing actuarial gains and losses will be recognized in the Statement of Recognized Income and Expenditure.

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(i) Other

Under IFRS the Group is required to capitalize research and development costs when the criteria laid out in IAS 38 are met. The Group has reviewed its historical research and development projects and determined that no expenditure incurred to date meets the criteria for capitalization in IAS 38. However the Group will continue to review its development expenditure against the relevant criteria and will capitalize such expenditure when it is appropriate.

37 Summary of Material Differences between IFRS and U.S. GAAP

SkyePharma adopted International Financial Reporting Standards as adopted in the European Union (IFRS) as of January 1, 2004. SkyePharma s consolidated financial statements, presented elsewhere in this document, have been prepared in accordance with IFRS, which differ in certain material respects from U.S. generally accepted accounting principles (U.S. GAAP). Application of U.S. GAAP would have affected the results of operations and balance sheets for the years ended and as of December 31, 2004 and 2005. The material differences between IFRS and U.S. GAAP as they relate to SkyePharma are discussed in further detail below.

	Notes	**Year to December 31, 2004 £m**	**Year to December 31, 2005 £m**
Loss under IFRS		(18.6)	(50.9)
U.S. GAAP adjustments:			
Business combinations			
Amortization of other intangible assets	(1b)	(0.4)	(0.4)
Depreciation of property, plant and equipment	(1c)	1.0	0.6
Deferred taxes	(1d)	(0.1)	0.2
Investments in associates	(4)	(3.8)	11.1
Convertible bonds	(5)	4.6	0.3
Paul Capital funding liabilities	(6)	(5.2)	(3.1)
Share based compensation	(7)	1.8	
Revenue recognition	(8)		(5.0)
Other	(9)	(0.1)	(2.0)
Net loss under U.S. GAAP		(20.8)	(49.2)
Net loss per Ordinary Share under U.S. GAAP (pence)		(3.4p)	(7.9p)

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	Notes	December 31, 2004 £m (restated)	December 31, 2005 £m
Shareholders funds under IFRS		36.5	31.9
U.S. GAAP adjustments:			
Business combinations			
Goodwill	(1a)	59.4	62.5
Other intangible assets	(1b)	4.0	4.1
Property, plant and equipment	(1c)	(7.0)	(6.2)
Deferred taxes	(1d)	(1.6)	(1.5)
Contingent consideration recorded within shareholders funds	(1e)	22.6	22.6
Shares issued relating to contingent consideration	(2)	(11.3)	(11.3)
Deferred shares to be issued	(3)	(11.3)	(11.3)
Investments in associates	(4)	(11.1)	
Convertible bonds	(5)	(18.3)	(24.1)
Paul Capital funding liabilities	(6)	(4.3)	(10.3)
Revenue recognition	(8)		(5.0)
Other	(9)	1.3	(1.4)
Shareholders funds under U.S. GAAP		58.9	50.0

Description of U.S. GAAP Adjustments

(1) Business combinations

SkyePharma had entered into business combinations prior to the January 1, 2004 date of adoption of IFRS. Under IFRS, these business combinations have not been restated to conform with the requirements of IFRS 3; Business Combinations, as permitted by the exemption provided by IFRS 1, which SkyePharma elected to apply. As a result, such transactions under IFRS differ from U.S. GAAP.

Differences between IFRS and amounts recorded for U.S. GAAP as a result of the exemption provided by IFRS 1 are as follows:

(a) Goodwill

On IFRS transition goodwill has been fixed at its historic carrying value in accordance with IFRS 1 and certain balances remain recorded in shareholders funds. Prior to the adoption of IFRS, SkyePharma amortized the goodwill recorded within non-current assets over a suitable period, not normally exceeding 20 years. However, the goodwill recorded in shareholders funds was not amortized.

Under U.S. GAAP goodwill is not amortized, but tested annually for impairment. No goodwill impairments have been recognized under IFRS or U.S. GAAP for the years ended December 31, 2004 and 2005.

Amounts previously reported for our consolidated shareholders funds in accordance with U.S. GAAP differ from those amounts shown for the fiscal years ended December 31, 2004 as presented in this Annual Report. Prior to the introduction of IFRS, under UK GAAP, in a purchase business combination amounts recorded in excess of assets acquired and liabilities assumed were recorded as goodwill in the accounts of the acquiring entity. Upon consolidation of the newly acquired subsidiary there was no need to translate the goodwill from the subsidiary currency to the reporting entity currency. Under U.S. GAAP this goodwill is recorded as an asset acquired in the purchased entity and the goodwill is recorded in the newly acquired entity. Upon consolidation of the acquired entity all assets and liabilities of the subsidiary, including the goodwill amounts, are required to be translated at the balance sheet date. In prior years we had made no adjustment for this difference in accounting

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treatment between UK and U.S. GAAP in our U.S. GAAP reconciliation. Consequently, we have restated our net assets and shareholders funds under U.S. GAAP at December 31, 2004 to reflect the impact of the adjustments made to our goodwill. As a result, our restated U.S. GAAP shareholders funds reflect a decrease in net assets of £25.8 million in 2004 (from £84.7 million to £58.9 million).

(b) Other intangible assets

Prior to the adoption of IFRS, no intangible assets had been separately identified and recognized as a result of purchase accounting. This is because the intangible assets were considered to be an integral part of the business acquired and were included within goodwill and eliminated against shareholders funds.

Under U.S. GAAP the purchase consideration was allocated to identifiable intangible assets, including any resulting from research and development. Identifiable intangible assets are reflected as assets and amortized over their estimated revenue earning life.

(c) Property, plant and equipment

Prior to the adoption of IFRS, where the aggregate of the fair values of the net assets acquired exceeded the cost of the acquired net assets resulting in goodwill, such excess was credited directly to reserves. Negative goodwill arising on the acquisition of Jago Production SAS has been accounted for according to this policy.

Under U.S. GAAP such excess is eliminated by proportionately reducing the value of the non-current assets acquired.

(d) Deferred taxes

Prior to the adoption of IFRS, no deferred taxation was recorded on business combinations.

Under U.S. GAAP deferred taxation associated with certain purchase accounting differences was recorded.

(e) Contingent consideration recorded within shareholders funds

Prior to the adoption of IFRS, the contingent consideration issued in connection with Jago was estimated and recognized within shareholders funds as deferred shares. The shares were recorded using the market price at the date of issuance of the deferred shares. The contingent consideration is described in Note 27; Share capital.

Under U.S. GAAP contingent consideration is only recognized when determinable beyond reasonable doubt. As a result the contingent consideration was not recognized on the date of acquisition.

(2) Shares issued relating to contingent consideration

Prior to the adoption of IFRS, the deferred A shares were automatically converted into Ordinary Shares as described in Note 27; Share capital.

Under U.S. GAAP these shares were recorded within shareholders funds at the market price at the date of conversion.

(3) Deferred shares to be issued

Prior to the adoption of IFRS, the deferred B shares were recognized within shareholders funds using the market price at their date of issuance as described in Note 27; Share capital.

Under U.S. GAAP contingent consideration is recognized only when determinable beyond reasonable doubt. As a result, the contingent consideration has not been recognized and the deferred shares have

been reversed out of shareholders funds. The conditions have not been met and the deferred B shares have been transferred to the Company Secretary for no consideration for him to hold as custodian.

(4) Investments in associates

Under IFRS the Company has accounted for its investment in Astralis as an associated undertaking from December 2004, when it gained significant influence.

Under U.S. GAAP the ability to exercise significant influence resulted in a change in classification from an available for sale investment to an equity method investment under APB 18; Equity method of accounting for investments in common stock. On initial application of the equity method the Group retroactively restated the investment, results of operations and retained earnings in a manner consistent with the accounting for a step acquisition of a subsidiary which is different to the treatment under IFRS. This constituted a change in accounting principle. In consideration of this change in status, the investment in Astralis has been adjusted for increases in ownership interest according to the accounting for a step acquisition and reduced to recognize the Group s share of the losses of Astralis after the date of initial acquisition.

(5) Convertible bonds

Under IFRS the conversion feature of each convertible bond is split from the debt and classified as equity.

Under U.S. GAAP the convertible bonds do not contain a beneficial conversion feature as specified in EITF 98-5, Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios and therefore each convertible bond has not been split between debt and equity. Consequently the carrying value of the convertible bonds is higher and the interest charges are lower than under IFRS.

(6) Paul Capital funding liabilities

Under IFRS the estimated payments to Paul Capital are discounted using each contract s original effective interest rate. Any change in the estimated future payments to Paul Capital is recognized immediately as an income or expense in the income statement.

Under U.S. GAAP the proceeds received from Paul Capital are treated as a floating rate financial liability. Any change in the estimated future payments to Paul Capital is effectively spread forward and reflected in a reduced implicit interest cost in future years. Consequently the carrying value of the Paul Capital funding liabilities and finance costs are higher than under IFRS.

(7) Share based compensation

The Group s accounting for share based payments under IFRS is disclosed in Note 1; Accounting policies.

Under U.S. GAAP SkyePharma adopted the Modified Prospective Application transition method of SFAS 123R; Share Based Payment (revised 2004) (SFAS 123R), as of January 1, 2005, having previously applied APB 25; Accounting for Stock Issued to Employees. There were no material differences between IFRS and U.S. GAAP for the year ended and as of December 31, 2005.

(8) Revenue recognition

Under IFRS the Company accounts for revenues in accordance with IAS 18 and allocates revenue to the separate elements of each contract after consideration of the fair values and commercial substance of the contracts. The basis of such allocation differs from the allocation made under U.S. GAAP which, following the more prescriptive guidance in EITF 01-9; Accounting for Consideration Given by a Vendor

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to a Customer, EITF 00-21; Accounting for Revenue Arrangements with Multiple Deliverables and SAB 104; Revenue recognition, for determining the deliverable elements, the fair values of these deliverables and the allocation of consideration received.

Under U.S. GAAP, the Company has accounted for contingent marketing contributions as a reduction of up-front consideration received in determining the revenue to be recognized. If the contingent marketing contributions do not reach the contractually agreed reimbursements, the difference would be recognized as revenue at the time further marketing contributions are no longer required. Under IFRS, marketing contributions are expensed as incurred, in line with the timing of the resulting expected product sales. Furthermore, under EITF 00-21, pre-launch samples are considered a separate unit of accounting to which revenue is allocated, with such allocated revenue recognized as samples are delivered. Under IFRS, the samples are accounted for as a marketing contribution and expensed upon delivery.

(9) Other

Other differences relate to the treatment of purchases of intellectual property and retirement benefit obligations.

(10) U.S. GAAP developments

Recent developments in U.S. financial reporting standards are outlined below:

SFAS 154; Accounting changes and Error Corrections, a replacement of APB Opinion No. 20 and FAS 3.

In June 2005, the Financial Accounting Standards Board issued SFAS 154; Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FAS 3 (SFAS 154). This statement replaces Opinion 20 and FAS 3, and changes the requirements for the accounting for, and reporting of, a change in accounting principle. APB Opinion No. 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS 154 requires retrospective application to prior periods financial statements of changes in accounting principle. SFAS 154 is effective for SkyePharma for the period beginning January 1, 2006. SkyePharma is currently reviewing this issue to measure the potential impact on the consolidated results of operations, financial position, and cash flows.

FSP No. FAS 115-1 and FSP FAS 124-1; The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments.

In November 2005, the Financial Accounting Standards Board issued this FASB Staff Position (FSP) which addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. This FSP also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The guidance in this FSP amends FASB Statements No. 115, Accounting for Certain Investments in Debt and Equity Securities, and No. 124, Accounting for Certain Investments Held by Not-for-Profit Organizations, and APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock. FSP FAS 115-1 is effective for SkyePharma for the period beginning January 1, 2006. SkyePharma is currently reviewing this issue to measure the potential impact on the consolidated results of operations, financial position, and cash flows.

Other recent accounting pronouncements issued by the FASB (including the Emerging Issues Task Force), the AICPA, and the SEC are not believed by management to have a material impact on SkyePharma s present or future consolidated financial statements.

INDEX OF EXHIBITS FILED WITH THE 2004 20-F

Item 19: Exhibits

1.1 Memorandum and Articles of Association of SkyePharma PLC

1.1.1	Memorandum of Association of SkyePharma PLC**
1.1.2	Articles of Association of SkyePharma PLC, as amended on May 30, 2002***

4.1 Solaraze® Agreements with Bioglan

4.1.1	Licensing and manufacturing agreement for Europe dated March 13, 2000 between JagoTech AG and Bioglan Pharma PLC**+
4.1.2	Addendum agreement for the U.S. dated December 28, 2000 between JagoTech AG and Bioglan Pharma PLC**+

4.2 **Directors and Officers Service Contracts**

4.2.1	Contract of employment between the Company and Donald Nicholson dated February 28, 1996**
4.2.2	Contract of employment between the Company and Frank Condella dated February 27, 2006
4.2.3	Contract of employment between the Company and Dr. Kenneth Cunningham dated March 1, 2006
4.2.4	Letter of appointment between the Company and Dr. Argeris (Jerry) Karabelas dated February 2, 2006
4.2.5	Proforma letter of appointment in respect of the appointment of Non-Executive Directors******

4.3 Share Purchase Plans

4.3.1	The SkyePharma PLC Deferred Share Bonus Plan***

4.4 Amendments to the 1996 Acquisition Agreement, dated April 7, 2000 and May 11, 2000, between Dr Jacques Gonella and SkyePharma PLC*

4.5 Development and Marketing Strategic Alliance Agreement among Endo Pharmaceuticals Inc., SkyePharma Inc. and SkyePharma Canada Inc. dated as of December 31, 2002 **+**

4.6 **License Agreement, dated March 20, 1998, between SmithKline Beecham plc (now part of GlaxoSmithKline plc), Jagotec AG and Jago Pharma AG*****+**

8.1 **List of SkyePharma PLC s subsidiaries (See Item 4: Information on the Company Business Operations Organizational Structure)**

12.1 **Certification of Michael Ashton filed pursuant to 17 CFR 240.13(a) 14(a)**

12.2 **Certification of Donald Nicholson filed pursuant to 17 CFR 240.13(a) 14(a)**

13.1 **Certification of Michael Ashton filed pursuant to 17 CFR 240.13(a) 14(b) and 18 U.S. C/1350(a) and (b)**

13.2 **Certification of Donald Nicholson filed pursuant to 17 CFR 240.13(a) 14(b) and 18 U.S. C/1350(a) and (b)**

15.1 **Consent of Independent Registered Public Accounting Firm**

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* Incorporated by reference to the Company s Annual Report on Form 20-F for the financial year ended December 31, 1999 (Commission File No. 0-29860)

** Incorporated by reference to the Company s Annual Report on Form 20-F for the financial year ended December 31, 2000 (Commission File No. 0-29860)

*** Incorporated by reference to the Company s Annual Report on Form 20-F for the financial year ended December 31, 2001 (Commision File No. 0-29860)

**** Incorporated by reference to the Company s Annual Report on Form 20-F for the financial year ended December 31, 2002 (Commision File No. 0-29860)

***** Incorporated by reference to the Company s Annual Report on Form 20-F for the financial year ended December 31, 2003 (Commision File No. 0-29860)

****** Incorporated by reference to the Company s Annual Report on Form 20-F for the financial year ended December 31, 2004 (Commision File No. 0-29860)

+ Confidential treatment has been granted for portions of this document. The information omitted pursuant to such confidential treatment order has been filed separately with the SEC in accordance with Rule 24b-2 under the Securities Exchange Act of 1934, as amended (Rule 24b-2)