

**30 June 2011**

**Phorm, Inc. (“Phorm” of the “Company”)**

**Annual Report and Financial Statements – Year Ended 31 December 2010**

Phorm (AIM: PHRM and PHRX), the personalisation technology company, today announces its audited financial statements for the year ended 31 December 2010.

**Highlights:**

**Year to date 2011**

- Start of revenue generation in Brazil
- Commercial offering proven following validation of key assumptions including opt-in rates, advertising pricing, inventory cost and performance of targeted adverts
- Oi implementing plans to roll out the service across Brazil, following success of initial results
- Appointment of experienced Business Development executives, particularly in Asia and South America to address strong interest in the region
- Excellent progress in China, currently negotiating contracts with a number of ISPs
- Launch of service with a European ISP anticipated before the end of the year
- Issuance of secured convertible loan note raising £10.0 million of new funds before expenses
- Active exploration of further funding to meet near term working capital requirements

**Year to 31 December 2010**

- Operating losses for the year were \$27.9 million (2009: \$29.7 million)
- Commercial launch of operations in Brazil with Oi and Telefonica
- Opt-in rates achieved significantly ahead of forecast, reinforcing commercial potential
- Validation of the technology in terms of performance and ability to scale
- Initial results highlight potential with 400% to 1,000% uplift in response
- Slower roll-out than anticipated during 2010 but expected to accelerate in 2011
- Issuance of secured convertible loan note raising £6.075 million of new funds before expenses
- Continued focus on cost savings and efficiencies

**Enquiries:**

**Phorm, Inc.**

Andy Croxson: +44 (0)20 7297 2326 (analysts and investors)

Alex Laity +44 (0)20 7297 2710 (press)

**Canaccord Genuity Limited**

(Nominated Advisor)

Mark Williams: +44 (0)20 7050 6500

Andrew Chubb: +44 (0)20 7050 6500

**Evolution Securities Limited**

(Joint Broker)

Stuart Andrews: +44 (0)20 7071 4300

**Mirabaud Securities LLP**

(Joint Broker)

Rory Scott: +44 (0)20 7321 2508

## **Chairman and chief executive's statement**

### *Operational performance*

2010 and 2011 to date has seen Phorm achieve substantial results, although progress has been slower than we had hoped.

In Brazil, where we launched the Open Internet Exchange with Oi and Telefonica, we have reached the point where we have effectively proven our commercial offering. We have done so by operating the system, end to end, with the hundreds of thousands of users who have accepted our explicit opt-in invitation to participate in receiving free personalized content and advertising.

Although the scale of the operation has been insufficient to generate substantial revenues, it has been sufficient to persuade our partners, both in Brazil and elsewhere, of the value of the opportunity. To date we have served more than 7 million impressions across multiple advertising campaigns to a user base accounting for 1.25% of broadband-enabled Brazilian households. The response to these campaigns has met or exceeded our expectations, and they have yielded data suggesting uplifts in response of between 4 times and 10 times, as a result of the early stage targeting functionality that had been applied to them.

Albeit at small scale, we have been able to achieve superior returns for publishers relative to solutions which were previously available to them. By showing advertising which is based more on the interests of the person reading a web page than solely on the content of the web page itself, we have been able to allow previously low-value pages to access substantially higher-value advertising than they had previously been able to access.

In terms of advertisers, we have been able to achieve results across a number of campaigns which are superior in terms of response to other solutions which are available. When we combine measures such as direct response rates with the lower cost of offering the response (which showing adverts on low-value pages affords), the ROI of these campaigns relative to other solutions grows. We have been able to do this for both display and text advertisers.

These results however, only point to a willingness of partners to contribute both advertising space and advertising campaigns as we scale. They do not yet translate into substantial

revenue, which we believe will come as the number of activated users grows to a level that can make a meaningful contribution to our partners' bottom-line.

**Chairman and chief executive's statement (continued)**

*Operational performance (continued)*

At present, these partners in Brazil continue to grow the number of accessible users according to their internal network development plans. We are confident that as the number of accessible users continues to grow during the course of 2011, Phorm Brazil will move towards generating positive cash flows. Based upon what we know of the metrics achieved to date relative to our assumptions starting out, at full scale, we expect Brazil alone to make the Group substantially profitable in due course as the expansion continues. That being said, while we have had excellent results in terms of opt-in rates, it remains true that we have been disappointed by the pace, but not the direction of the roll-out to more users and this remains the major risk to our future profitability. Nevertheless, we have grounds for believing that the pace will accelerate in the months to come.

We note that the financial undertaking that we have received with respect to the contracted revenue of \$1.6 million (Brazilian Real ("R\$") R\$2.88 million) largely remains to be fulfilled. To that end, we are very pleased that in parallel to our commercial operations with Oi in the state of Rio de Janeiro, Oi has completed the planning for the roll-out to the rest of its network in Brazil and is now in the execution phase. Oi's representative said: "we are very excited by the potential of Phorm's platform and have been very encouraged by the results that we have seen. We are now working with Phorm to achieve the scale necessary to deliver long-term commercial viability". In the meantime, we have been able to use the time to refine our internal operational processes. The Open Internet Exchange effectively represents a new model for the internet advertising and content ecosystem and a complex technical achievement. In order for the system to operate as designed with seamless integration into our partners' existing legacy systems, we have been refining our operational procedures to the point where we are satisfied that we will be able to operate at scale both in Brazil and other markets.

## **Chairman and chief executive's statement (continued)**

### *Business development*

Outside of the Brazilian market, we continue to progress very well. In 2010, we commented that we were at the final approval stage with a number of ISPs worldwide and we expect to secure further agreements before the end of the year. In constructing these agreements, we have tried to address the principal risk to our operating model described above, namely the speed of roll-out to an ISP's user base such that there is a contractual commitment from the ISP in this regard. In addition, we have worked closely with ISPs and regulatory authorities to demonstrate how our opt-in model is compliant with both current and anticipated privacy legislation on a global basis. In addition, we are making excellent progress in Asian markets including China where we are currently negotiating agreements with a number of ISPs. The results that we have seen so far in Brazil have helped our potential ISP partners to better appreciate the mechanics of the Open Internet Exchange, the results which they can expect in their market as well as the likelihood of participation of consumers, advertisers and websites.

It has also made it possible for us to demonstrate how, by embracing the highest possible standards of privacy, we have been able to successfully anticipate concerns that consumers or regulatory authorities might raise and we have been very pleased by the response that we have received. Indeed, our efforts have been repeatedly recognized by those authorities with whom we have engaged as groundbreaking and solving some of the toughest problems facing the online advertising industry.

In order to address the increasing levels of interest that we are seeing around the world, we have hired a number of highly experienced Business Development executives who have given us the ability to engage globally simultaneously.

### *Appointments*

We were also very pleased this year to be joined on our Board by Mark Schneider and on our Advisory Board by Juan Villalonga, the former CEO of Telefonica. Juan Villalonga has held a number of prominent positions in his career. In addition to his position within Telefónica S.A., he was a partner at McKinsey & Company (1980-1989), CEO for Credit Suisse First Boston in Spain (1993-1994), and CEO of Bankers' Trust in Spain (1995-1996). In 2010, Harvard Business Review named Mr. Villalonga one of the world's 100 best performing CEOs.

## **Chairman and chief executive's statement (continued)**

### *Funding and going concern*

In terms of funding, the poor performance of our stock has led us to debt-based funding sources. The details of this funding are set out in the Financial Report below. This funding has provided the Company with further time to validate its business model and has enabled us to meet our working capital requirements to date. Nevertheless, based on current projections, further funding will be necessary within the next 5 months, and we are actively engaged in discussions with potential investors. Whilst we are moving in the right direction to reach sufficient scale to break-even at the local subsidiary and, ultimately, parent company level, the timeframe in which we expect to achieve this is dependent on a number of key factors, including the speed of deployment by ISPs, subscriber take-up rates and the level of advertising campaigns and publisher agreements secured.

Further information in respect of the directors' assessment of going concern, including the material uncertainties identified, is set out in the footnotes to the preliminary announcement.

## **Financial report**

### *Results for the year*

The Company did not report any revenue for the year ended 31 December 2010 (2009 - \$nil). The Group has commenced serving advertisements in 2011 and will report revenues in 2011.

Operating losses for the year were \$27.9 million (2009: \$29.7 million). The operating loss includes a non-cash share-based payment charge of \$1.9 million (2009: \$3.5 million).

For the six months ended 30 June 2010, we reported an operating loss (before non-cash share-based payment charges) of \$14.4 million; this compares to \$11.6 million in the second half of the year. The reduction in operating losses reflects a continuing focus on identifying cost savings and efficiencies and also the establishment of operations in Brazil which benefits from a lower cost base than the UK. Nevertheless the majority of our operating losses were incurred by the UK operation in its capacity of the global hub for the business.

Losses after taxation were \$28.7 million (2009: \$29.7 million). Loss per share was \$1.61 (2009: \$1.88).

The Group used \$24.8 million (2009: \$26.6 million) in funding its operating activities.

## **Chairman and chief executive's statement (continued)**

### **Financial report (continued)**

#### *Financial position*

Our balance sheet at 31 December 2010 showed net liabilities of \$4.3 million (2009: net assets of \$20.3 million) with cash and cash equivalents of \$5.7 million (2009: \$19.7 million). The year on year movement of \$24.6 million is attributable to the loss for the year of \$28.7 million, foreign exchange losses on translation of overseas subsidiaries of \$0.7 million, offset by new share subscriptions of \$2.9 million and a share-based payment credit of \$1.9 million. The reduction in the cash position primarily reflects the lower fundraising undertaken in 2010, compared to 2009.

#### *Funding*

During the course of 2010, the Company has raised additional funds through issuing new equity in July 2010, resulting in a cash inflow of \$2.9 million, net of expenses, and through the issuance of £6.075 million of convertible loan notes in November 2010, resulting in a cash inflow of \$9.1 million, net of cash expenses.

In March 2011, the Company announced the placing of £16.075 million secured convertible loan notes, raising new monies of £10.0 million (approximately \$15.5 million), before expenses. These loan notes were secured on the non-cash assets and intellectual property of the Company. As stated above, the placing brought in £10.0 million of new finance into the Company, before expenses, and modified the terms of £6.075 million of secured convertible loan notes announced in December 2010 such that all £16.075 million of secured convertible loan notes are on substantially the same terms.

The loan notes are repayable by 31 October 2013 and have an annualised coupon rate of 15% payable on redemption. The Company may elect to repay the loan notes at any time after issue prior to the redemption date, in which case the holders of the loan notes shall be entitled to a redemption premium (in the form of the issue of new shares of Common Stock of no par value in the Company). The minimum redemption premium that loan noteholders will receive is 235,000 new shares of Common Stock for every £1.0 million (or pro-rata to the actual amount repaid), equal to 20.4% of the shares in issue at 31 December 2010. The precise value of the return payable to the Noteholders at the point of redemption is determined by a formula, the details of which are disclosed in the Group's RNS announcement of 22 March 2011. The Company has structured the loan notes such that this return can be paid either in shares in Phorm, Inc. or cash.

## Chairman and chief executive's statement (continued)

### Financial report (continued)

#### *Funding (continued)*

The Company hopes and expects that commercial progress will result in improved stock price performance over the next 12-24 months, which will, in turn, make the loan notes significantly less dilutive. For example, if the loan notes are redeemed within the first 12 months and the share price returns to £4.68 or above (which was approximately the price when the Company announced the launch in Brazil) the total dilution arising from the redemption of the loan notes would be just 20%. If, however, the share price does not improve over the period of the loan notes and they run through to maturity there is a risk of significant dilution for existing shareholders. The timing and share price at the date of redemption will dictate the level of dilution to existing shareholders (based on the number of shares in issue at 31 December 2010) as shown in the following table:

Share Price (£)	Timing of redemption and dilution effect		
	< 1 Year	>1 Year <2 Years	Maturity
0.50	191%	418%	539%
1.00	96%	209%	270%
2.00	48%	104%	135%
3.00	32%	70%	90%
4.00	24%	52%	67%
5.00	20%	42%	54%
7.50	20%	28%	36%
10.00	20%	21%	27%

The above table includes the redemption premium shares and assumes that the loan notes and accrued interest are paid in cash.

The Company intends to redeem these loan notes before they reach maturity either by re-financing or through cash generated from operations once the business reaches scale. To achieve this, the Company is continuing to pursue the strategy that it outlined in last year's annual report namely, seeking to fund each market at the local level rather than at the parent level. We have received a positive reaction to this approach both in Brazil and in China and anticipate that we will be able to announce a funding round based on this model in the next few months.



**Chairman and chief executive's statement (continued)**

**Financial report (continued)**

*Funding (continued)*

The Group has continued to incur operating cash costs of approximately \$1.7 million per month during 2011, and as at 31 May 2011, the Group's cash position stood at \$10.4 million.

Kent Ertugrul

Chairman and Chief Executive

30 June 2011

## Consolidated income statement

Year ended 31 December 2010

	Year ended 31 December 2010			Year ended 31 December 2009		
	Before share based payment expense \$	Share based payment expense \$	After share based payment expense \$	Before share based payment expense \$	Share based payment expense \$	After share based payment expense \$
<b>Continuing operations</b>						
Revenue	-	-	-	-	-	-
Cost of sales	(484,086)	-	(484,086)	(1,540,568)	-	(1,540,568)
<b>Gross loss</b>	<u>(484,086)</u>	<u>-</u>	<u>(484,086)</u>	<u>(1,540,568)</u>	<u>-</u>	<u>(1,540,568)</u>
Research and development	(6,203,263)	(506,018)	(6,709,281)	(5,892,142)	(732,540)	(6,624,682)
Sales and administrative expenses	(19,355,320)	(1,356,810)	(20,712,130)	(18,852,531)	(2,730,078)	(21,582,609)
<b>Operating loss</b>	<u>(26,042,669)</u>	<u>(1,862,828)</u>	<u>(27,905,497)</u>	<u>(26,285,241)</u>	<u>(3,462,618)</u>	<u>(29,747,859)</u>
Investment income			18,198			97,563
Financing expense			(786,039)			(2,089)
<b>Loss before tax</b>			<u>(28,673,338)</u>			<u>(29,652,385)</u>
Tax on loss on ordinary activities			-			-
<b>Net loss for the year</b>			<u><u>(28,673,338)</u></u>			<u><u>(29,652,385)</u></u>
Attributable to equity holders of the parent			<u><u>(28,673,338)</u></u>			<u><u>(29,652,385)</u></u>
Basic and diluted loss per share (\$)			(1.61)			(1.88)

**Consolidated statement of comprehensive income**  
**Year ended 31 December 2010**

	<b>Year ended 31 December 2010 \$</b>	<b>Year ended 31 December 2009 \$</b>
<b>Loss for the year attributable to equity shareholders</b>	(28,673,338)	(29,652,385)
Exchange (loss)/gain on translation of foreign operations	<u>(704,866)</u>	<u>768,526</u>
<b>Total comprehensive loss for the year</b>	<u><u>(29,378,204)</u></u>	<u><u>(28,883,859)</u></u>
Attributable to equity holders of the parent	<u><u>(29,378,204)</u></u>	<u><u>(28,883,859)</u></u>

## Consolidated statement of changes in equity

Year ended 31 December 2010

	Share capital \$	Additional paid in capital \$	Warrants \$	Own shares \$	Translation reserve \$	Accumulated deficit \$	Total \$
At 1 January 2010	17,294	139,091,603	-	(341,837)	(12,883,039)	(105,624,915)	20,259,106
Total comprehensive loss for the year	-	-	-	-	(704,866)	(28,673,338)	(29,378,204)
Share-based payment charge	-	-	-	-	-	1,862,828	1,862,828
Issue of new stock	1,186	2,893,065	49,840	-	-	-	2,944,091
Own shares acquired	-	-	-	-	-	-	-
At 31 December 2010	<u>18,480</u>	<u>141,984,668</u>	<u>49,840</u>	<u>(341,837)</u>	<u>(13,587,905)</u>	<u>(132,435,425)</u>	<u>(4,312,179)</u>

## Consolidated statement of changes in equity

Year ended 31 December 2009

	Share capital \$	Additional paid in capital \$	Warrants \$	Own shares \$	Translation reserve \$	Accumulated deficit \$	Total \$
At 1 January 2009	13,815	115,442,602	-	-	(13,651,565)	(79,435,148)	22,369,704
Total comprehensive loss for the year	-	-	-	-	768,526	(29,652,385)	(28,883,859)
Share-based payment charge	-	-	-	-	-	3,462,618	3,462,618
Issue of new stock	3,479	23,649,001	-	-	-	-	23,652,480
Own shares acquired	-	-	-	(341,837)	-	-	(341,837)
At 31 December 2009	<u>17,294</u>	<u>139,091,603</u>	<u>-</u>	<u>(341,837)</u>	<u>(12,883,039)</u>	<u>(105,624,915)</u>	<u>20,259,106</u>

## Consolidated balance sheet

31 December 2010

	2010	2009
	\$	\$
<b>Assets</b>		
<b>Non-current assets</b>		
Property, plant and equipment	332,835	791,594
<b>Total non-current assets</b>	332,835	791,594
<b>Current assets</b>		
Other receivables	1,428,474	1,881,811
Cash and cash equivalents	5,691,895	19,713,788
	7,120,369	21,595,599
<b>Total assets</b>	7,453,204	22,387,193
<b>Current liabilities</b>		
Trade payables	(1,076,264)	(457,294)
Other payables	(1,147,856)	(1,555,517)
Obligations under finance leases	(4,004)	(11,234)
Provisions	(1,218)	(100,038)
<b>Total current liabilities</b>	(2,229,342)	(2,124,083)
<b>Non-current liabilities</b>		
Obligations under finance leases	-	(4,004)
Secured convertible loan notes	(9,536,041)	-
<b>Total non-current liabilities</b>	(9,536,041)	(4,004)
<b>Total liabilities</b>	(11,765,383)	(2,128,087)
<b>Net (liabilities)/assets</b>	(4,312,179)	20,259,106
<b>Equity</b>		
Common shares	18,480	17,294
Additional paid in capital	141,984,668	139,091,603
Own shares	(341,837)	(341,837)
Warrants	49,840	-
Translation reserve	(13,587,905)	(12,883,039)
Accumulated deficit	(132,435,425)	(105,624,915)
<b>Stockholders' (deficit)/equity</b>	(4,312,179)	20,259,106

**Consolidated cash flow statement**  
**Year ended 31 December 2010**

	<b>Year ended 31 December 2010 \$</b>	<b>Year ended 31 December 2009 \$</b>
<b>Net cash used in operating activities</b>		
Net cash used in operating activities	(24,815,332)	(26,614,183)
Income tax paid	-	-
	<u>(24,815,332)</u>	<u>(26,614,183)</u>
<b>Net cash used in operating activities</b>		
<b>Cash flows used in investing activities</b>		
Interest received	18,198	97,563
Proceeds on disposal of property, plant and equipment	-	80,828
Purchase of property, plant and equipment	(219,740)	(1,087,335)
	<u>(201,542)</u>	<u>(908,944)</u>
<b>Net cash used in investing activities</b>		
<b>Cash flows from financing activities</b>		
Finance lease interest paid	(923)	(2,089)
Repayment of obligations under finance leases	(11,234)	(10,068)
Purchase of own shares	-	(341,837)
Proceeds from issue of common shares	2,894,251	23,652,480
Proceeds from issue of secured convertible loan notes	9,060,635	-
	<u>11,942,729</u>	<u>23,298,486</u>
<b>Net cash inflows from financing activities</b>		
<b>Net decrease in cash and cash equivalents</b>	<u>(13,074,145)</u>	<u>(4,224,641)</u>
Cash and cash equivalents brought forward	19,713,788	23,246,726
Effect of foreign exchange changes	(947,748)	691,703
	<u>5,691,895</u>	<u>19,713,788</u>
<b>Cash and cash equivalents carried forward</b>		

Purchases of property, plant and equipment during the year amounting to \$nil (2009: \$nil) were financed by new finance leases.

## **Notes to the consolidated financial statements**

### **Year ended 31 December 2010**

#### *Basis of preparation*

The preliminary announcement for the year ended 31 December 2010 is an abridged statement of the full annual report which was approved by the Board of Directors on 30 June 2011. While the financial information included in this preliminary announcement has been prepared in accordance with the recognition and measurement criteria of International Financial Reporting Standards (IFRSs), this announcement does not itself contain sufficient information to comply with IFRSs. The Company will publish full financial statements that comply with IFRSs on 30 June 2011.

The consolidated financial statements for the year ended 31 December 2010 have been prepared on a going concern basis. The directors' assessment as to the appropriateness of the going concern basis of preparation is set out below.

The auditors' report on the consolidated financial statements for the year ended 31 December 2010 is unmodified but includes reference to matters to which the auditors draw attention by way of emphasis, without modifying their report, in respect of a material uncertainty with respect to going concern. Further information in respect of the material uncertainty is set out below.

## **Notes to the consolidated financial statements**

### **Year ended 31 December 2010**

#### *Going concern*

The directors have considered the appropriateness of the going concern basis, which has been used in the preparation of the consolidated financial statements.

During 2010 and up to the date of approval of the financial statements, the Group has made significant progress in the development and deployment of its technology and services. In particular, the commercial launch in Brazil in March 2010 represented a new chapter in the Group's development. The Directors expect that cash flows from Brazil, if realised as forecast, together with the Group's financial strategy of seeking funding in local markets, will enable the Group to grow in a controlled and sustainable manner.

To date, the Group has incurred cumulative losses of \$132.4 million. The Group has funded these losses and its operations through equity provided by its shareholders and the issue of secured convertible loan notes.

The Directors have approved a business plan which forecasts continuing cash outflows in the near term. The Group, however, has forecast significant revenues for FY11 and FY12 sufficient to cover the operating costs in Brazil and to provide significant cash flows for the Group to fund other costs incurred as it seeks to achieve further deployments internationally. These forecasts include a number of key assumptions which have been validated through our market trials but have yet to be confirmed at scale due to the early stage of the Group's commercial deployment.

The principal risk with respect to achieving the results anticipated by the business model is the roll-out of the service in Brazil. Where the service has been deployed the business has significantly out-performed its original forecasts particularly with respect to opt-in rates and pricing.

## **Notes to the consolidated financial statements (continued)**

### **Year ended 31 December 2010**

#### *Going concern (continued)*

In the near term, the principal risk to the business is to ensure that the Group has sufficient working capital to allow the business in Brazil to reach full commercial scale. At this scale, the Group's forecast shows that the business would be generating significant operating profits. At the date of approval of these financial statements, the Group has yet to secure the additional funding requirements set out in the business plan and is, therefore, not fully-funded at the current time. Nevertheless, the Group is in discussions with a number of parties regarding funding; its strategy is to pursue a number of financing alternatives in parallel to ensure that it has sufficient funds to sustain operations. Discussions have been progressing extremely well on a number of fronts, and the Group expects to be able to make an announcement with respect to funding in the next few months.

In preparing the financial statements, the Directors have assumed that sufficient further funding will be made available to the Group to enable it to execute its business plan and realise the forecast inflows following commercial launch and roll-out of its technology.

In making this going concern assessment, the Directors have had regard to the following matters:

- the Group's track record of successful fund raising from shareholders and other investors, as evidenced in 2008, 2009, 2010 and 2011 to date;
- being in advanced discussions with a number of existing and potential new investors in Brazil, Asia and Europe;
- the potential to secure revenue commitments from new ISP partners;
- the potential opportunity to raise further finance in local markets; and
- the commercial progress being made internationally.

In common with similar businesses at this stage of their development, and in light of the Group's dependence on further financing being made available to it from its shareholders or other providers of finance, the Directors consider the combination of these circumstances represent a material uncertainty that may cast significant doubt upon the Group's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

**Notes to the consolidated financial statements (continued)**

**Year ended 31 December 2010**

*Going concern (continued)*

Nevertheless, after making enquiries, and considering the uncertainties described above, the directors have a reasonable expectation that the Group will have access to adequate resources to continue in operational existence for the foreseeable future. For these reasons, they continue to adopt the going concern basis in preparing the financial statements.

The financial statements do not reflect any adjustments that would be required if the Group were unable to secure such financing to enable the Group to achieve profitability and positive cash flow, such that the going concern basis of preparation ceased to be appropriate.

The full audited financial statements for the year ended 31 December 2010 can be found on the Investor section of the Phorm website.

-Ends-