Mereo BioPharma

Building on our momentum

MEREO BIOPHARMA GROUP PLC
ANNUAL REPORT 2017

Building
a rare disease business

Mereo is an innovative leader in the biopharma sector currently developing a portfolio of four medicines designed to improve outcomes in areas of significant unmet medical need in rare and specialty diseases.

Mereo was established to acquire, develop and commercialize innovative therapeutics.

OUR MISSION

Mereo BioPharma is a multi-asset biopharmaceutical company focused on the acquisition, development and commercialization of innovative therapeutics that aim to improve outcomes for patients in rare and specialty diseases.

OUR VISION

Our vision is to build a rare disease business by directly commercializing our existing rare disease products and by seeking to selectively acquire additional product candidates that have already received significant investment from pharmaceutical companies and that have substantial pre-clinical, clinical and manufacturing data packages.

For more information please visit our website.

WWW.MEREOBIOPHARMA.COM

AT A GLANCE ON P2–3

BUSINESS MODEL ON P4–5

Gross cash proceeds from financing

£35.0m

17	£35.0m
16	£71.3m
15	£20.0m

Investment in R&D

£34.6m

17	£34.6m
16	£24.6m
15	£5.4m

Year-end cash resources

£52.5m

17	£52.5m
16	£53.6m
15	£12.2m

Loss per share

56p

17	56p
16	63p
15	101p

OPERATIONAL HIGHLIGHTS

Rare and Orphan Diseases

BPS-804 for Osteogenesis Imperfecta (OI)

- BPS-804 was accepted into the adaptive pathways program in the E.U. in February 2017 and admitted to the PRIME scheme of the EMA in November 2017.
- In May 2017, the Company initiated a randomized, double-blind, placebo-controlled Phase 2b clinical trial of BPS-804 in approximately 120 adults in the U.S., Europe and Canada.
- Mereo also intends to commence a Phase 2b/3 clinical trial of BPS-804 in approximately 150 children with OI in the second half of 2018 in Europe and Canada with fracture rate as the primary endpoint.

AZD-9668 for Alpha-1 Antitrypsin Deficiency (AATD)

- In October 2017, the Company announced an exclusive license agreement, together with an option to acquire the IP, with AstraZeneca for AZD-9668.
- Mereo intends to initiate a Phase 2 proof-of-concept clinical trial in patients with severe AATD in the second half of 2018.

Specialty Diseases

BCT-197 for Acute Exacerbations of Chronic Obstructive Pulmonary Disease (AECOPD)

- In December 2017, the Company announced positive top-line data from the AETHER study, a Phase 2 double-blind, randomized, placebo-controlled trial investigating the use of BCT-197 on top of standard of care, for the treatment of patients with AECOPD.
- Mereo has initiated partnering discussions for future development and commercialization of BCT-197.

BGS-649 for Hypogonadotropic Hypogonadism (HH)

- The Company recently announced positive top-line data from a dose-ranging Phase 2b double-blind, randomized, placebo-controlled clinical trial with BGS-649 for the treatment of obese men with HH.
- Results of a six-month safety extension study are expected in Q4 2018 and these, plus additional data analysis, will help guide the next stage of the Company's clinical development strategy for BGS-649.

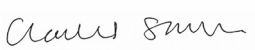
Corporate

- In December 2017, the Company announced plans to conduct a registered initial public offering in the U.S. in the first half of 2018.
- Since the year end, the Company recently appointed Alexandra "Wills" Hughes-Wilson as Head of Patient Access and Commercial Planning.

Full Year 2017 Financial Highlights

- Loss after tax of £38.8 million (2016: £28.4 million) or 56 pence per ordinary share (2016: 63 pence per ordinary share).
- Net cash, short-term deposits and short-term investment balance of £52.5 million at December 31, 2017 (2016: £53.6 million).
- Total development spend increased to £34.6 million (2016: £24.6 million) reflecting increased clinical development activity in the period, including the commencement of the adult Phase 2b study for BPS-804.
- A total of £35 million of cash proceeds from financing was raised during 2017 by way of (i) an equity placing in April which raised £15 million (gross) and (ii) a new loan facility of £20 million agreed in August which was fully drawn by December 31, 2017.

* The Strategic Report, which has been prepared in accordance with the CA 2006, has been approved and signed by order of the Board on March 22, 2018.



Charles Sermon
Company Secretary

At a glance

A diversified portfolio

OUR PRODUCTS

Since our inception in March 2015, we have acquired in total four clinical-stage products from Novartis Pharma AG (or Novartis) and AstraZeneca AB (or AstraZeneca).

BPS-804 (SETRUSUMAB)

BPS-804 is a fully humanized monoclonal antibody targeting sclerostin, which is being developed to improve bone quality and thereby reduce fractures in the orphan disease osteogenesis imperfecta (OI).

AZD-9668 (ALVELESTAT)

AZD-9668 is a novel, oral small molecule we are developing for the treatment of severe Alpha-1 Antitrypsin (AATD), a potentially life-threatening, rare genetic condition.

BGS-649 (LEFLUTROZOLE)

BGS-649 is a novel once-weekly oral aromatase inhibitor being developed as a first-line therapy for the treatment of obese men with hypogonadotropic hypogonadism (HH).

BCT-197 (ACUMAPIMOD)

BCT-197 is an oral p38 MAP kinase inhibitor being developed as a first-line therapy for acute exacerbations of chronic obstructive pulmonary disease (AECOPD).

INVESTMENT THESIS

BUILDING AND ACQUIRING

Plan to build a commercial business with a focus on rare diseases based on products acquired from major pharmaceutical companies

DIVERSIFIED LATE STAGE PORTFOLIO

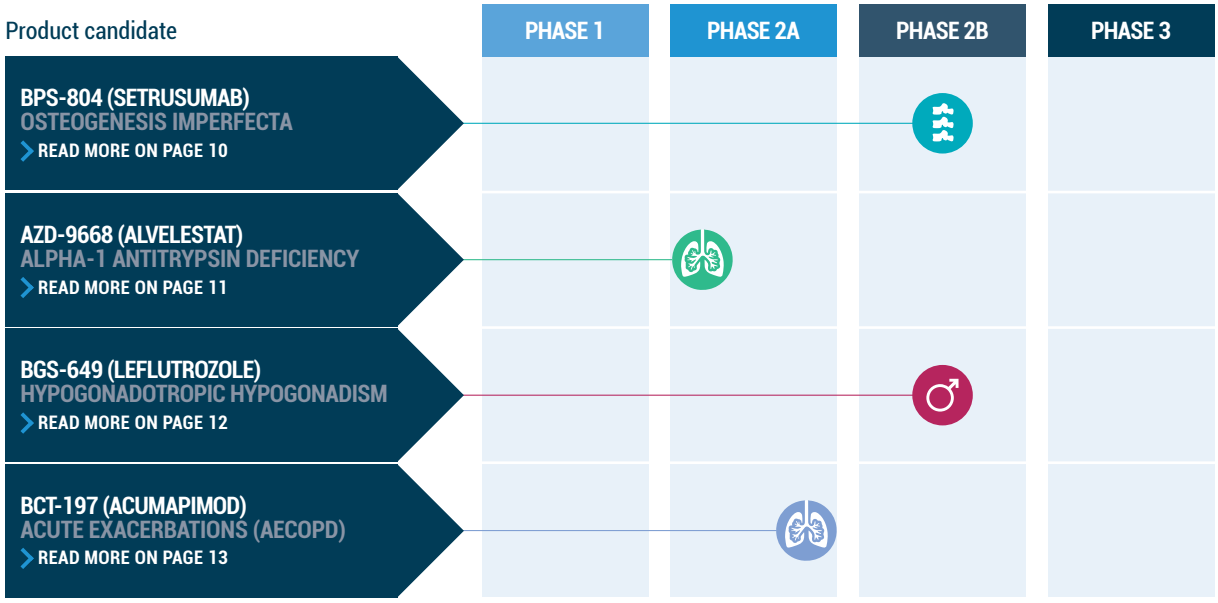
Three initial Phase 2 products acquired from Novartis and one Phase 2 product from AZ

ONGOING PROGRESS

Multiple Phase 2/2b data points recently and within the next 18 months

PRODUCT PIPELINE

We have a well diversified and late stage pipeline of products and we have commenced or completed large, randomized, placebo-controlled Phase 2 clinical trials for three of our product candidates.



COMMERCIALIZATION

Current pipeline of rare products includes BPS-804 and AZD-9668 due to be commercialized, if developed successfully, in the medium term

EXPERIENCED TEAM

Experienced management team and Board with strong balance sheet. £126 million raised since July 2015

ACTIVE BUSINESS DEVELOPMENT

Active business development pipeline with multiple opportunities to expand portfolio

Business model and strategy

Improving outcomes for patients with rare and specialty diseases

OUR BUSINESS MODEL

We are a multi-asset biopharmaceutical company focused on the acquisition, development and commercialization of innovative therapeutics.

Acquisition
We have to date completed the acquisition of four products from large pharmaceutical companies.

Development
We have rapidly developed our products through clinical development and have reported positive top-line data for two of our products.

Commercialization
We intend to establish our own sales and marketing organization with a focus on our rare disease portfolio.

OUR PORTFOLIO

Four clinical-stage product candidates, each of which we acquired from large pharmaceutical companies:

BPS-804 (setrusumab)
Novartis

AZD-9668 (alvelestat)
AstraZeneca

BGS-649 (leflutrozole)
Novartis

BCT-197 (acumapimod)
Novartis

OUR STRATEGY

We intend to become a leading rare disease focused biopharmaceutical company aiming to improve outcomes for patients with rare and specialty diseases.

1

Rapidly develop and directly commercialize our rare disease product candidates

We have commenced a Phase 2b clinical trial of BPS-804 for the treatment of OI in adults in the U.S., Canada and Europe. If the results from this trial are favorable and our use of HRPqCT as a biomarker for fracture is validated, we intend to submit a CMA to the EMA for the treatment of OI in adults in the E.U. We also intend to commence a Phase 2b/3 clinical trial of BPS-804 for the treatment of OI in children in 2018 in Europe and Canada. We expect that the results from this trial, if favorable, will be sufficient to validate our use of HRPqCT and support the submission of a CMA to the EMA for BPS-804 for the treatment of children with severe OI in the E.U. We intend to initiate a Phase 2 clinical trial of AZD-9668 for the treatment of severe AATD in 2018 and, if the results are favorable and pending regulatory feedback, continue to develop AZD-9668 toward approval and commercialization. We plan to establish our own sales and marketing organization in the U.S. and Europe for BPS-804 and AZD-9668 and any future rare disease product candidates.

2

Efficiently advance our specialty disease product candidates and explore strategic relationships with third parties for further clinical development and/or commercialization

We reported positive top-line Phase 2 data for BCT-197 in December 2017. We have commenced discussions with potential partner(s) to further develop BCT-197 towards commercialization. We also recently reported positive top-line Phase 2b data for BGS-649. Whilst we do not anticipate commercializing BGS-649, in order to maximize shareholder value, we believe we are well positioned to retrieve its late stage clinical development.

3

Leverage our expertise in business development to expand our pipeline of product candidates

Our senior management team has extensive relationships with large pharmaceutical and biotechnology companies, as evidenced by the acquisition of our four clinical-stage product candidates. We intend to leverage these relationships to grow our pipeline with a focus on rare diseases. We intend to continue to identify, acquire, develop, and ultimately commercialize novel product candidates that have received significant investment from large pharmaceutical companies. We will continue to focus on acquiring product candidates with either proof-of-concept clinical data in our target indication or with clinical data in a related disease and a strong scientific rationale that supports development in our target indication. Using a disciplined approach, we intend to continue building a diverse portfolio of product candidates that we believe have compelling market potential, robust pre-clinical, clinical and manufacturing data packages, and a clear regulatory pathway.

4

Continue to be a partner of choice for large pharmaceutical and biotechnology companies

We believe that we are a preferred partner for large pharmaceutical and biotechnology companies as they seek to unlock the potential in their development pipelines and deliver therapeutics to patients in areas of high unmet medical need. We have strong relationships with these companies, as evidenced by our agreements with Novartis and AstraZeneca, and a track record of structuring transactions that enable us to leverage our core development capabilities while creating value for all stakeholders. We intend to continue to enter into strategic relationships that align our interests with those of large pharmaceutical and biotechnology companies and that we believe to be mutually beneficial.

Chairman and CEO's statement

Strong progress

in executing against our strategy, delivering data and continuing to build our portfolio

"This has been a pivotal period for Mereo. We announced positive top-line data with BCT-197 for AECOPD, initiation of a Phase 2b study with BPS-804 for the orphan disease OI and the in-licensing of AZD-9668 from AstraZeneca for the rare disease AATD. We also recently announced positive top-line data for BGS-649 for HH."

DR. DENISE SCOTS-KNIGHT
CHIEF EXECUTIVE OFFICER

"As a company we have now demonstrated the sustainability of our business model with a new in-licensed product and our ability to select product candidates with successful Phase 2 studies on our first two product candidates. We continue to review a large number of opportunities to further diversify our portfolio and look forward to reporting further significant milestones in 2018."

DR. PETER FELLNER
CHAIRMAN

2017 and early 2018 have seen significant delivery with successful top-line data from two of our Phase 2 studies and the acquisition of a fourth product from a second pharmaceutical company.

Introduction

We are a multi-asset biopharmaceutical company focused on the acquisition, development and commercialization of innovative therapeutics that aim to improve outcomes for patients with rare and specialty diseases. Our strategy is to selectively acquire product candidates that have already received significant investment from pharmaceutical companies and that have substantial pre-clinical, clinical, and manufacturing data packages. Since our inception in March 2015, we have successfully executed on this strategy by acquiring our current product candidates from Novartis Pharma AG, or Novartis, and AstraZeneca AB, or AstraZeneca. During 2017 we continued to review a large number of product opportunities from a range of pharmaceutical companies, each of which are evaluated against our stringent selection criteria.

Our current portfolio consists of four clinical-stage product candidates, each of which had already generated positive clinical data for our target indication or for a related indication prior to our acquisition or licensing. We are developing BPS-804 for the treatment of osteogenesis imperfecta, or OI, AZD-9668 for the treatment of severe alpha-1 antitrypsin deficiency, or AATD, BCT-197 for the treatment of acute exacerbations of chronic obstructive pulmonary disease, or AECOPD, and BGS-649 for the treatment of hypogonadotropic hypogonadism, or HH, in obese men. We believe our portfolio is well diversified because each of our product candidates employs a different mechanism of action and targets a separate indication. We intend to develop and directly commercialize our rare disease product candidates. For our specialty disease product candidates, we intend to develop them through late stage clinical milestones and then seek strategic relationships for further clinical development and/or commercialization.

In 2017, we continued to execute on our strategy, with completion of enrolment in large randomized placebo-controlled Phase 2 studies for BCT-197 and BGS-649, initiation of a Phase 2b randomized, placebo-controlled dose ranging study for BPS-804, and reporting of positive top-line data for the Phase 2 dose ranging study of BCT-197, and validated our business model through the acquisition of AZD-9668 from AstraZeneca. After the end of the year we also reported positive top-line Phase 2b results for BGS-649.

Business Overview

BPS-804 (setrusumab)

BPS-804 is a novel antibody we are developing as a treatment for OI, a rare genetic disease that results in bones that can break easily and is commonly known as brittle bone disease. OI is a debilitating orphan disease for which there are no treatments approved by the U.S. Food and Drug Administration, or FDA, or European Medicines Agency, or EMA. It is estimated that OI affects a minimum of 20,000 people in the U.S. and approximately 32,000 people in the E.U. BPS-804 is designed to inhibit sclerostin, a protein that inhibits the activity of bone-forming cells. We believe BPS-804's mechanism of action is well suited for the treatment of OI and has the potential to become a novel treatment option for patients that could reduce fractures and improve patient quality of life. BPS-804 has Orphan Drug designation in OI in the U.S. and the E.U. BPS-804 was accepted into the adaptive pathways program in the E.U. in February 2017 and admitted to the PRIME scheme of the EMA in November 2017.

In May 2017, we initiated a randomized, double-blind, placebo-controlled Phase 2b clinical trial of BPS-804 in approximately 120 adults in the U.S., Europe and Canada. We intend to commence a Phase 2b/3 clinical trial of BPS-804 in approximately 150 children with OI in 2018 in Europe and Canada with fracture rate as the primary endpoint. We expect the results from this trial, if favorable, may be sufficient to validate our use of HRPqCT and support the submission of a CMA to the EMA for BPS-804 for the treatment of children with severe OI in the E.U.

Following regulatory feedback in the U.S., we are not currently planning to proceed with a paediatric study of BPS-804 in OI patients in the U.S.

and delivery

Business Overview continued

AZD-9668 (alvelestat)

In line with our strategy of diversifying the product portfolio with a focus on rare diseases, in October 2017, the Company announced an exclusive license agreement together with an option to acquire the IP with AstraZeneca for AZD-9668. AZD-9668 is a novel, oral small molecule we are developing for the treatment of severe AATD, a potentially life-threatening, rare genetic condition. There are an estimated 50,000 patients in North America and 60,000 patients in Europe with severe AATD. AATD is caused by a lack of alpha-1 antitrypsin, or AAT, a protein that protects the lungs from enzymatic degradation. This degradation leads to severe debilitating diseases, including early-onset pulmonary emphysema, a disease that irreversibly destroys the tissues that support lung function. AZD-9668 is designed to inhibit neutrophil elastase, or NE, a neutrophil protease and a key enzyme involved in the destruction of lung tissue. We believe the inhibition of NE has the potential to protect AATD patients from further lung damage.

Current treatment of AATD involves bronchodilators and inhaled corticosteroid medications or surgical options such as lung volume reduction surgery and lung transplantation. Intravenous augmentation therapy is available for AATD using a partially purified plasma preparation highly enriched for AATD. However, this therapy was approved by the FDA based on its biochemical efficacy but not based on clinical outcome data.

Prior to our license of AZD-9668, AstraZeneca conducted 12 clinical trials involving 1,776 subjects. Although these trials were conducted in other indications, we believe the data demonstrated potential clinical benefit and biomarker evidence of treatment effect for AATD patients. In particular, we believe the results from two Phase 2 clinical trials conducted for the treatment of bronchiectasis and cystic fibrosis, or CF, are most relevant in assessing AZD-9668's potential to treat severe AATD. AstraZeneca conducted a double-blind, placebo-controlled Phase 2 clinical trial in bronchiectasis in a total of 38 patients, 22 of whom were treated with AZD-9668. The results of this four-week trial showed a statistically significant improvement in the amount of air that can be forcibly exhaled in one second, or FEV1, a standard measure of exhalation against placebo, and a clinically meaningful improvement of slow vital capacity, which measures the volume of air on a slow exhale. We believe that bronchiectasis and AATD share common pathological features that support the potential for AZD-9668 to treat severe AATD. Additionally, we believe that data from the Phase 2 CF trial provides proof of concept for mechanistic effect and the use of a biomarker of lung degradation in diseases of high or unopposed NE, such as severe AATD.

We intend to initiate a Phase 2 proof-of-concept clinical trial in patients with severe AATD in 2018. We intend to enrol approximately 150 patients. If the results are favorable, we intend to seek regulatory advice on the design of, and commence, a pivotal trial.

BCT-197 (acumapimod)

BCT-197 is an oral inhibitor of p38 MAP kinase that is aimed at treating the inflammation associated with Acute Exacerbations of Chronic Obstructive Pulmonary Disease (AECOPD).
On December 11, 2017 the Company announced positive top-line data from the AETHER study, a Phase 2 double-blind, randomized, placebo-controlled trial investigating the use of BCT-197, a novel, orally active p38 MAP kinase inhibitor, on top of standard of care, for the treatment of AECOPD which enrolled 282 patients.

The primary endpoint was met on an ITT basis for both BCT-197 high and low dose regimens ($p= 0.012$, $p\leq0.001$) with no significant change from baseline ($p=0.102$) shown for standard of care plus placebo. One of the study objectives was the comparison between all three groups. This was not statistically significant; however, the treatment arms were numerically superior to the standard of care plus placebo arm.

Positive clinical and health economic outcomes were supported by other secondary measures; specifically, the study showed a statistically significant reduction of more than 50% ($p\leq0.027$ to 0.05) in the number of clinical treatment failures in the high dose group compared to standard of care plus placebo, as measured by the number of re-hospitalizations for the treatment of COPD at days 90 through 150, and there was a trend seen as early as day 30. BCT-197 was reported to be safe and well tolerated in both high and low dose regimens.

The Company now intends to seek a partner for future development and commercialization of BCT-197.

BGS-649 (leflutrozole)

BGS-649 is a once-weekly oral treatment for hypogonadotropic hypogonadism (HH) in obese men that restores a patient's own testosterone. It is a novel aromatase inhibitor that inhibits conversion of the patient's own testosterone to oestradiol, thereby increasing testosterone levels. On 1 March 19, 2018, the Company announced positive top-line data from a Phase 2b double-blind, randomized, placebo-controlled trial investigating the use of BGS-649 for the treatment of HH which enrolled 271 patients.

The study met its primary endpoint, normalizing total testosterone levels in over 75% of subjects after 24 weeks of treatment ($p<0.001$ versus placebo for each of the three doses tested), and its secondary endpoint of normalizing testosterone in at least 90% of patients after 24 weeks, which occurred at the two highest doses. All three doses met all the other secondary endpoints, including the improvement of testosterone luteinizing hormone (LH) and follicle stimulating hormone (FSH) levels. The study demonstrated a clear dose response in both the primary and secondary endpoints. The exploratory endpoint of improvement in total motile sperm count was also met. A positive trend of treatment effect was also observed on reduction of fatigue in the exploratory patient reported outcomes (PROs) of the PROMIS short fatigue score.

Whilst we do not anticipate Mereo commercializing BGS-649, in order to maximize shareholder value, we believe we are well positioned to continue its late stage clinical development. We plan to clarify our clinical development strategy once we have received data from the six-month safety extension safety study, expected in Q4 2018.

Our strategy

Rapidly develop and directly commercialize our rare disease product candidates.

We have commenced a Phase 2b clinical trial of BPS-804 for the treatment of OI in adults in the U.S., Canada and Europe. If the results from this trial are favorable and our use of HRPqCT as a biomarker for fracture is validated, we intend to submit a CMA to the EMA for the treatment of OI in adults in the E.U. We also intend to commence a Phase 2b/3 clinical trial of BPS-804 for the treatment of OI in children in 2018 in Europe and Canada. We expect that the results from this trial, if favorable, will be sufficient to validate our use of HRPqCT and support the submission of a CMA to the EMA for BPS-804 for the treatment of children with severe OI in the E.U. We intend to initiate a Phase 2 clinical trial of AZD-9668 for the treatment of severe AATD in 2018 and, if the results are favorable and pending regulatory feedback, continue to develop AZD-9668 toward approval and commercialization. We plan to establish our own sales and marketing organization in the U.S. and Europe for BPS-804 and AZD-9668 and any future rare disease product candidates.

Efficiently advance our specialty disease product candidates and explore strategic relationships with third parties for further clinical development and/or commercialization.

Based on the top-line results from our Phase 2 clinical trial of BCT-197, we plan to enter into one or more strategic relationships with third parties for BCT-197 to undertake the next phase of clinical development and, if approved, commercialization. We intend to continue late stage development of BGS-649 and plan to enter into strategic relationships with third parties for commercialization. We may also enter into strategic relationships with third parties to complete the clinical development of BGS-649.

Leverage our expertise in business development to expand our pipeline of product candidates.

Our senior management team has extensive relationships with large pharmaceutical and biotechnology companies, as evidenced by the acquisition of our four clinical-stage product candidates. We intend to leverage these relationships to grow our pipeline with a focus on rare diseases. We intend to continue to identify, acquire, develop and ultimately commercialize novel product candidates that have received significant investment from large pharmaceutical companies. We will continue to focus on acquiring product candidates with either proof-of-concept clinical data in our target indication or with clinical data in a related indication and a strong scientific rationale that supports development in our target indication. Using a disciplined approach, we intend to continue building a diverse portfolio of product candidates that we believe have compelling market potential, robust pre-clinical, clinical and manufacturing data packages, and a clear regulatory pathway.

Continue to be a partner of choice for large pharmaceutical and biotechnology companies.

We believe that we are a preferred partner for large pharmaceutical and biotechnology companies as they seek to unlock the potential in their development pipelines and deliver therapeutics to patients in areas of high unmet medical need. We have strong relationships with these companies, as evidenced by our agreements with Novartis and AstraZeneca, and a track record of structuring transactions that enable us to leverage our core capabilities while creating value for all stakeholders. We intend to continue to enter into strategic relationships that align our interests with those of large pharmaceutical and biotechnology companies and that we believe to be mutually beneficial.

Our people

In 2017, our total headcount increased from 24 to 31 full-time employees. In January 2017, Richard Jones was appointed CFO and in May 2017 we appointed Jerome Dauvergne as Head of Pharmaceutical Development. In addition to these key hires, we further strengthened our clinical, business development and central administrative teams during the year.

We also recently announced the appointment of Wills Hughes-Wilson as Head of Patient Access and Commercial Planning. In her role, Ms. Hughes-Wilson will be responsible for leading and optimizing Mereo's patient access and commercialization strategies, initially in a part-time role as the Company builds out its rare disease commercial infrastructure.

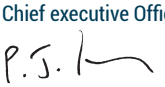
We continue to attract highly experienced, skilled and motivated individuals at all levels within the organization which is critical to our success in our mission to deliver innovative medicines to patients.

Recent developments and outlook

We look forward to reporting on additional key milestones during 2018. These include the initiation of both the Phase 2 proof-of-concept study of AZD-9668 in alpha-1 antitrypsin deficient patients and the Phase 2b/3 study with BPS-804 in children with severe OI disease in Europe and Canada. We also expect to report on progress with enrolment in the Phase 2b study with BPS-804 in adult OI patients in Europe, Canada and the U.S., on the partnering process for further development and commercialization of BCT-197 and on the additional data for BGS-649 from the six-month extension study that will guide the late stage clinical development for this program.

We plan to continue to seek further product opportunities to further diversify our product portfolio with a focus on rare diseases. We believe that our rigorous selection approach, our experience to structure and successfully close these transactions in a mutually beneficial manner and our skills in executing comprehensive clinical development plans will continue to consolidate our position as a partner of choice for large pharmaceutical and biotechnology companies as they seek to unlock the potential in their product pipelines.

Dr. Denise Scots-Knight
Chief executive Officer



Dr. Peter Fellner
Non-executive Chairman
March 22, 2018

Our products

Unlocking the potential of **BPS-804 (setrusumab)**

BPS-804 is a human monoclonal antibody targeting sclerostin, which is being developed to improve bone strength and thereby reduce fractures in the orphan disease osteogenesis imperfecta (OI).

OI is a rare genetic disorder, commonly known as brittle bone disease, which is characterized by fragile bones that fracture easily. In addition to fractures, individuals with OI often have muscle weakness, hearing loss, fatigue, joint laxity, curved bones, scoliosis and short stature. The majority of cases of OI (up to 90%) are caused by a dominant mutation in the genes coding for type I collagen, a key component of healthy bone. Current treatment of OI is based on supportive care, focusing on treating fractures and maximizing mobility. To date, there are no FDA or EMA approved treatments.

~6.2
OI cases per 100,000 population in the U.S.

~10
OI cases per 100,000 population in the E.U.

85–90%
are linked to a gene mutation that produces abnormal type 1 collagen

72–77%
OI types I, III and IV in 72–77% of total OI population

Symptoms:

- Frequent bone fractures and loose joints
- Early hearing loss
- Respiratory problems
- Brittle teeth

Actively working with patients and their OI advocacy groups, including the development of an OI specific Quality of Life Patient Reported Outcome Tool

HISTORICAL STUDIES:

- 83 patients have received BPS-804, including patients with moderate OI
- Statistically significant improvement on bone mineral density and bone biomarkers in OI
- Safe and well tolerated in target population

Current study

Estimated enrolment

120

OI type I, III and IV adult subjects

Adult Phase 2B

- Confirmed defect in the COL 1A1/2 by genetic test
- >1 fracture in 24 months

Study design

- Randomized
- Double-blind
- Placebo-controlled

Trial arms:

Three different BPS-804 doses
VS
Placebo

Study duration:

52 weeks

Commenced: June 2017

Paediatric study is due to start in 2018 once our Paediatric Investigation Plan is approved by the EMA

Unlocking
the potential of **AZD-9668 (alvelestat)**

AZD-9668 is an oral neutrophil elastase inhibitor being developed as an innovative new therapy for the treatment of alpha-1 antitrypsin deficiency (AATD).

AATD is a genetic disorder that causes a deficiency of alpha-1 antitrypsin. There are approximately 50,000 and 60,000 severe patients in North America and Europe, respectively, who are either ZZ or Null. It can cause pulmonary emphysema, a life-threatening lung disease, resulting in severe shortness of breath and wheeze.

The lung damage in AATD results from the loss of the normally protective effect of alpha-1 antitrypsin against damaging enzymes released during inflammation, specifically neutrophil elastase, that lead to the irreversible destruction of the lungs' supportive elastic tissues. The aim is to use AZD-9668 (alvelestat) to inhibit neutrophil elastase activity and prevent further damage to patients' lungs.

Estimated prevalence of Pi*ZZ and Nulls:

~50,000
AATD cases in North America

~60,000
AATD cases in the E.U.

Genetic mutation produces deficiency through abnormal folding of the protein or zero production of the protein

Mutations in SERPPINA1 gene chromosome 14

Homozygotes (ZZs) and Nulls have severe disease

Symptoms:

- Age 20–50 – shortness of breath, wheeze and reduced exercise tolerance
- Pi*ZZ and Null adults develop early onset emphysema
- Pi*ZZ mutation can cause cirrhosis in children
- Reduced life expectancy

HISTORICAL STUDIES:

- 12 clinical trials and >1,100 subjects treated
- Phase I and II studies in related indications:
  - Bronchiectasis: PoC achieved with statistically significant improvement in FEV1
  - Cystic fibrosis: reduction in elastin degradation biomarker (desmosine) consistent with MoA
- Four COPD studies were also carried out
- Safe and well tolerated across the studies

Planned study

Proof-of-concept study
in patients with severe AATD is due to start in
2018
Phase 2

Our products

Unlocking
the potential of **BGS-649 (leflutrozole)**

BGS-649 is a novel once-weekly oral aromatase inhibitor being developed as a first-line therapy for the treatment of obese men with hypogonadotropic hypogonadism (HH).

HH is a clinical syndrome that results from inadequate levels of testosterone, and can cause increased obesity, cardiovascular disease, hypertension, insulin resistance, type 2 diabetes, depression, osteoporosis and infertility. In the obese, the decrease in testosterone is driven by high levels of the aromatase enzyme in the fat tissue.

The aim is to use BGS-649 to normalize testosterone levels and improve the related conditions.

35.5%
adult males in the U.S. are obese

21.9%
OI cases per 100,000 population in the E.U.

~15.8%
HH prevalence in obese men

~12 million
obese men with HH in the U.S. and the E.U.

Symptoms:

- Reduced or loss of libido
- Erectile dysfunction
- Fatigue
- Impaired physical endurance and strength
- Loss of vitality or motivation

Testosterone deficiency remains significantly under-treated

Treatment rate:
<13%
in the U.S. and lower in Europe

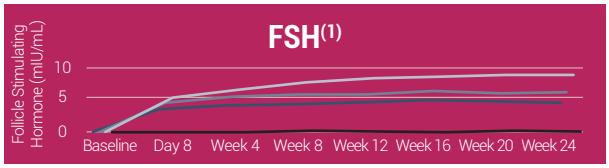
HISTORICAL STUDIES:

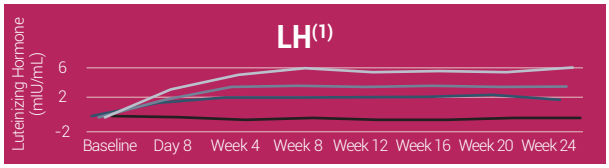
- 131 patients had previously received BGS-649
- Statistically significant rise in testosterone levels, with once-weekly dosing
- Normalization of testosterone levels was accompanied by rises in LH and FSH
- Safe and well tolerated in the target population

PHASE 2B TOP-LINE DATA (MARCH 2018)

271
obese men with HH

- **Primary endpoint met with all three doses normalizing testosterone in 75% of subjects at 24 weeks (p<0.001) for each dose versus placebo**
- All secondary endpoints met, including statistically significant increase in LH and FSH at week 24 (p<0.001)





BGS low dose BGS medium dose BGS high dose Placebo

(1) Least squared mean change from baseline.

Unlocking
the potential of **BCT-197 (acumapimod)**

BCT-197 is an oral p38 MAP kinase inhibitor being developed as first-line acute therapy for acute exacerbations of chronic obstructive pulmonary disease (AECOPD).

An AECOPD is characterized by a sudden worsening in the COPD patient's symptoms of dyspnoea, cough and sputum production. These episodes typically last for several days and often require hospitalization of the patients and an increase in medication. The number of acute exacerbations is directly related to mortality. AECOPDs occur in the natural course of the disease but are commonly triggered by infections and air pollution. Acumapimod aims to address the airway and systemic inflammation that are characteristic drivers of the disease and to reduce the length of hospital stay.

16 million
COPD cases diagnosed in the U.S.

13 million
COPD cases estimated in the E.U.

>1.5 million
hospital visits per year due to COPD

62.5%
of all hospital admissions related to COPD are AECOPD patients

Symptoms:

- Sustained increase in cough
- Sputum production or dyspnoea (shortness of breath)

Each episode of AECOPD poses significant risk to the patient, including potential hospitalization and an increased risk of death.

HISTORICAL STUDIES:

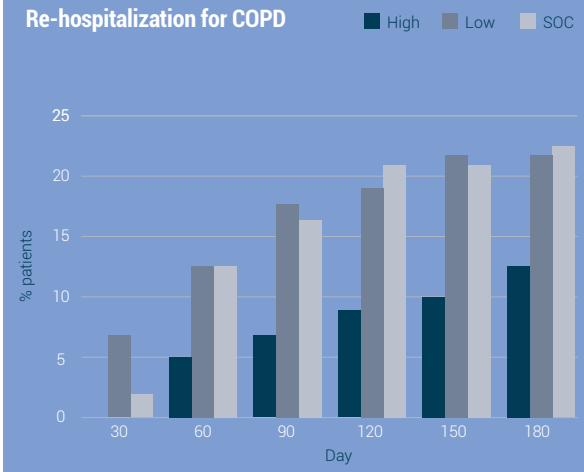
- 327 subjects have received BCT-197
- Clinically meaningful improvement on FEV1 throughout the exacerbation period
- Safe and well tolerated in the target population

PHASE 2 TOP-LINE DATA (DECEMBER 2017)

- 282 AECOPD patients received two different BCT-197 dosing regimes vs placebo (on top of standard of care) over five-day period
- **Primary endpoint met on an ITT basis for both BCT-197 high and low dose regimens (p=0.012, p≤0.001) in addition to Standard of Care. Improvement of 84 mls and 115 mls respectively**
- No significant change from baseline (p=0.102) shown for Standard of Care plus placebo

SECONDARY ENDPOINT

Re-hospitalization for COPD



Statistically significant reduction in re-hospitalization rates up to 150 days following treatment

Risk factors

Mitigating our principal risks

Risk factors

We are a multi-asset clinical-stage biopharmaceutical company that was formed in 2015 and we therefore have a limited operating history. In common with other businesses in our sector, we face significant risks and uncertainties relevant to our operations. The Board has adopted a strategy designed to identify, quantify and manage and mitigate the risks we face, whilst recognizing that no risk management strategy can provide absolute assurance against loss and that drug development is inherently uncertain.

The Audit and Risk Committee reviews risks and receives presentations from risk owners at its regular meetings to oversee the management and mitigation of the principal risks faced by the Group, and reports its findings to the Board. Members of the Executive Committee routinely attend meetings. The Board reviews risks at its regular Board meetings, including, but not limited to, an update on progress with our clinical trials and manufacturing, our patents, our financial results and projections, and corporate development activities. Progress against objectives is measured by financial and non-financial key performance indicators (KPIs).

Financial KPIs

The directors consider:

- our cash balances and future cash runway; and
- committed and planned expenditure on research and development (R&D),

to be the Group's key financial KPIs at its current stage of development. These are detailed in the Financial Review on pages 18 and 19.

The directors consider that the most important non-financial KPIs are:

- progress with our R&D pipeline including our clinical studies and related manufacturing activities;
- the management and development of our patent portfolio; and
- business development including acquiring new products and partnering activities relating to our specialty products.

These activities are discussed in the Chairman and CEO's Statement and our product overview.

We set out below our key risk factors that have been identified through our risk management review process. Some of these risk factors are specific to us and others are more generally applicable to the biopharmaceutical industry in which we operate.

RISK	DESCRIPTION	MITIGATION	CHANGE
Research and development (R&D)	Our R&D activities are focused on the progression of our four product candidates, BPS-804, AZD-9668, BGS-649 and BCT-197. Our ability to successfully develop these product candidates could be influenced by a number of factors, including the ability to demonstrate satisfactory safety and efficacy in clinical trials; delays in completing clinical trials which may cause us to incur additional costs; delays or difficulties in the enrolment of patients into clinical trials; unforeseen adverse events in connection with clinical trials; reliance on the completeness and accuracy of data packages provided by the product originator; reliance on third-party contract research organizations (CROs) for the conduct of clinical trials; and reliance on contract manufacturing organizations (CMOs) for the manufacturing of product candidates in sufficient quantity and in compliance with good manufacturing practice (GMP).	During the year we announced positive results from a Phase 2 study for BCT-197. Since the year end in March 2018 we also announced positive Phase 2b results for BGS-649. We continue to develop BPS-804 and are planning to commence a Phase 2 study for AZD-9668 this year. During the year we also diversified our CRO and CMO contractors to assist us in our ongoing and planned development.	

CHANGE KEY

- Increase
- No change
- Decrease
- New risk

RISK	DESCRIPTION	MITIGATION	CHANGE
Manufacturing	The Group does not have its own manufacturing infrastructure but relies on third parties for the production of its product candidates. Mereo's ability to commence or continue its development activities could be impacted by a failure to meet expectations in terms of quality, scheduling scale-up, reproducibility, yield, purity, cost, potency or quality or the failure to adhere to regulatory requirements. In addition, BPS-804 is a large molecule monoclonal antibody which has a more complex manufacturing process than our other products which are all small molecules.	The Group is working with a number of experienced manufacturers in respect of its drug manufacturing capabilities and requirements for the transfer of manufacturing operations from the pharma companies from which they were acquired, with this process completed during 2017, for the three initial products acquired from Novartis. During 2017 we completed selection of new drug substance and drug product manufacturers for BPS-804 and commenced the qualification of these manufacturers for supply of clinical trial material. We also completed the extension of the product life of the existing BPS-804 product to support the current clinical study.	Decrease
Commercial	Mereo does not currently have any approved products. Its future success is dependent on obtaining a commercial return from its product candidates, either by entering into arrangements with third parties for commercialization or commercializing certain product candidates itself. Mereo's ability to obtain a commercial return on product candidates could be influenced by a number of factors, including the ability to establish sales and marketing capabilities; the ability to enter into product divestment or licensing agreements with third parties; competition that may lead to third parties developing or commercializing products earlier or more successfully than Mereo; the ability to achieve commercially reasonable rates for product reimbursement for product candidates commercialized by Mereo; and physician and patient acceptance of product candidates approved for commercial sale.	Following successful reporting of Phase 2 data for BCT-197 we have commenced partnering discussions with a number of pharma companies for this product and do not intend to undertake significant further development work for this product. We continue to consider longer-term plans for building a commercial business focused on our rare disease products and, since the year end, have recruited an experienced Head of Patient Access and Commercial Planning to act as the focus for this activity going forward.	No change
Regulatory	Mereo operates in a highly regulated industry, giving rise to a number of risks that could affect the development and commercialization of its product candidates, including the ability to obtain required regulatory marketing approvals; the ability to maintain orphan drug status for its product candidate BPS-804; and the impact of changes to current legislation and potential future legislation as they relate to regulatory matters.	During 2017 BPS-804 was accepted onto the adaptive pathway with the EMA and also onto the PRIME scheme in November 2017. We commenced a clinical study under a European CTA and U.S. IND for an adult Phase 2b study in July 2017. Since the year end we have submitted our paediatric investigation plan (PIP) to the EMA for BPS-804 and plan to commence a paediatric Phase 2b/3 study in Europe and Canada during H2 2018. In the U.S., the FDA has proposed we do not yet submit a protocol for a paediatric study until it has favorably resolved risk/benefits of sclerostin inhibitors. We believe the FDA's position does not impact our ongoing adult OI study in the U.S., Canada and Europe and planned paediatric OI study in Europe and Canada.	Decrease
Corporate	We face an ever-increasing burden of corporate regulation as a publicly traded company based in the U.K. During the year we have seen increased focus on the risks associated with Brexit, both generally and being faced by the pharmaceutical industry. This has the potential to impact our business as we are engaged with drug development in Europe where we are currently subject to regulation by the European Medicines Agency. In 2017 the Criminal Finances Act introduced new corporate criminal offences (CCO) and in May 2018 the E.U. General Data Protection Regulation (GDPR) becomes directly applicable in the U.K. In addition, the threat to data privacy and cybersecurity continues to increase and become more complex for all companies and we are no exception.	In 2017 we formed a Brexit working group, which included outside counsel, to review our readiness for and to consider what steps we need to take to prepare for Brexit in 2019. We have commenced a review of our policies and procedures in line with the guidance issued by HMRC on CCO. In 2017 we appointed a Data Protection Officer and undertook a review of our data protection guidelines, training and processes to ensure we are ready for the implementation of GDPR in 2018. In early 2018 we appointed a new Head of IT, who has commenced a review of our IT and cybersecurity and who has already implemented several updates to our security protocols and IT procedures.	N

Risk factors *continued*

CHANGE KEY

- Increase
- No change
- Decrease
- New risk

RISK	DESCRIPTION	MITIGATION	CHANGE
Intellectual property (IP)	Our ability to successfully license, divest or commercialize its product candidates depends in large part on our ability to obtain and maintain effective patent protection for our products in the U.S., Europe and other territories. If we are unable to obtain or maintain patent protection for our product candidates, or if the scope of the patent protection is not sufficiently broad, competitors could develop and commercialize similar products which would materially affect our potential commercial return from our products. We are subject to additional risks, including infringement of patent rights and inability to protect the confidentiality of our know-how, which could have an adverse effect on the competitive advantage of our product candidates.	We have had a dedicated Head of IP since 2015 and, in addition, we utilize expert external counsel in the prosecution and maintenance of our IP portfolio. During the year we acquired a license for AZD-9668 with IP prosecution and management transferred to us. We have continued to expand our IP portfolio during the year. Our key BPS-804 patents include claims directed to the BPS-804 antibody as well as the antibody's use as a medicament. Patents in this family will expire in 2028. The BPS-804 antibody also has orphan drug status in both the U.S. and the E.U. Two families of AZD-9668 patents have been licensed under our agreement with AstraZeneca. The first family includes claims to the AZD-9668 compound and its uses and these patents will expire in 2024. The second family includes claims to the specific tosylate salt form of the compound and these patents will expire in 2030. The BGS-649 patent portfolio includes claims directed to BGS-649 formulations and to the use of BGS-649 in treating hypogonadism according to a specific dosing regimen, with expiry dates in 2032. The first patent family of our BCT-197 patent portfolio relates to the BCT-197 compound and other 5-membered heterocycle-based p38 kinase inhibitors and these patents will expire in 2024. The second patent family relates to the use of pyrazole derivatives in the treatment of AECOPD and these patents will expire in 2033. Across all of the products, we have a comprehensive IP strategy to protect, defend and explain our patent portfolio.	→
Financial	We have a limited operating history, have incurred losses since our inception and do not have any approved or revenue-generating products. We expect to incur losses for the foreseeable future, and there is no certainty that it will ever generate a profit. We may not be able to raise additional funds that will be needed to support development or commercialization of its product candidates, and any additional funds that are raised could cause dilution to existing investors. Our financial situation could be adversely impacted by any future changes in U.K. taxation legislation, including the R&D tax credit regime. Mereo has significant expenditures in U.S. Dollars and Euros; consequently, our financial results could be adversely impacted by foreign currency movements.	We have a strong balance sheet with cash reserves at December 31, 2017 of £52.5 million. During 2017 we completed an equity placing to raise £15 million (gross) and put in place and drew down a £20 million bank debt facility with an extended interest-only period to October 2018. The Board is confident that we have sufficient cash resources to fund the Group through to and beyond the next significant clinical development milestones for BPS-804 and AZD-9668. In addition we announced in December 2017 our intention to conduct a registered initial public offering in the U.S. which we are aiming to complete during H1 2018. We review our foreign currency demand for the next 12 months and purchase currency to cover these requirements on a rolling basis.	→
Operational	Our future success depends upon our ability to retain key employees, including the executive directors and executive officers, and to attract, retain and motivate qualified individuals. We anticipate expanding our operational capabilities, and there is a risk that we may encounter difficulties in managing this growth which could disrupt our business. Our growth plans are dependent upon our ability to identify further product candidates and to integrate such products into its business. Our operations may be adversely impacted if it is unable to comply with the terms of licensing or acquisition agreements and applicable laws and regulations, including data privacy.	We continue to attract highly experienced people and continued to expand our team. During the year we grew from 23 to 31 full-time employees in total and since the year end have made several important new hires in commercial, business development, CMC and central support functions. We have in place a good mix of short and long-term incentives via cash bonus and share option schemes and our remuneration policies are regularly reviewed to ensure we are able to attract and retain the talent we need to execute our plans.	→

Protecting and enhancing
our intellectual property

Our key BPS-804 patents include claims directed to the BPS-804 antibody as well as the antibody's use as a medicament. Patents in this family will expire in 2028. The BPS-804 antibody also has orphan drug status in both the U.S. and the E.U.

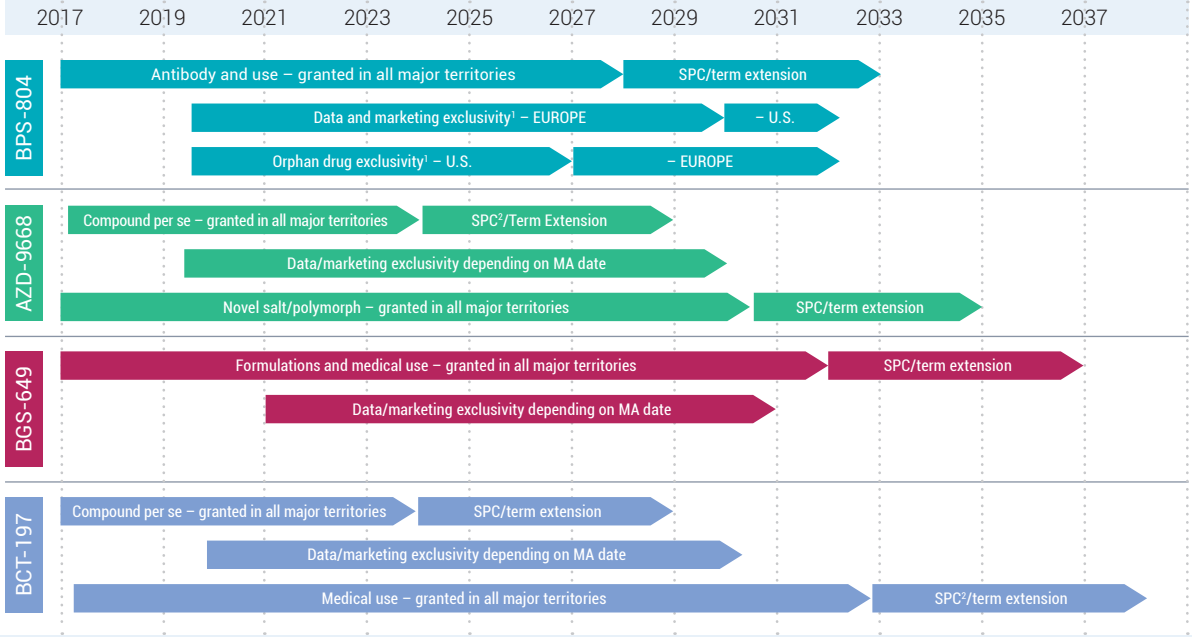
The BGS-649 patent portfolio includes claims directed to BGS-649 formulations and to the use of BGS-649 in treating hypogonadism according to a specific dosing regimen, with expiry dates in 2032.

Two families of AZD-9668 patents have been licensed under our agreement with AstraZeneca. The first family includes claims to the AZD-9668 compound and its uses and these patents will expire in 2024. The second family includes claims to the specific tosylate salt form of the compound and these patents will expire in 2030.

The first patent family of our BCT-197 patent portfolio relates to the BCT-197 compound and other 5-membered heterocycle-based p38 kinase inhibitors and these patents will expire in 2024. The second patent family relates to the use of pyrazole derivatives in the treatment of AECOPD and these patents will expire in 2033.

Across all of our products, further patent applications have and are being filed to ensure a strong IP portfolio is in place.

Robust intellectual property portfolio



1 Assuming accelerated approval/adaptive pathway.
2 Alternative SPC extension.

Financial review

Maintaining
a strong cash runway

> Well positioned to fund our current development programs through to their key milestones."

RICHARD JONES
CHIEF FINANCIAL OFFICER

The financial statements are presented on a consolidated Group basis prepared in accordance with IFRS as issued by the IASB and adopted by the E.U. for the year ended December 31, 2017. Comparative data is shown on the same basis for the year ended December 31, 2016.

Research and development (R&D)

Our total R&D expenses increased by £10.0 million, or 40%, from £24.6 million in 2016 to £34.6 million in 2017. This was a result of increased spending on clinical development as we continued the Phase 2 programs for BCT-197 and BGS-649 and commenced the adult Phase 2b program for BPS-804.

Total R&D expenses included payments we made to CROs and other suppliers for the ongoing clinical development of each of BPS-804, BCT-197 and BGS-649, which increased from £17.9 million in 2016 to £22.8 million in 2017, reflecting the inclusion of expenses relating to the adult Phase 2b study for BPS-804. Additionally, our R&D employee-related costs increased from £3.1 million in 2016 to £4.1 million in 2017, reflecting increased headcount, higher other employee-related expenses, including travel, and higher bonus amounts earned in 2017. Our payments to CMOs for the provision of drug substance and drug product and associated manufacturing development to support our clinical trials and the transfer of manufacturing of drug substance and drug product from Novartis to third-party manufacturers increased from £2.9 million in 2016 to £7.6 million in 2017, reflecting ongoing manufacturing activity primarily due to the manufacture of additional clinical trial materials in respect of BPS-804.

General and administrative (G&A) expenses

G&A expenses decreased by £0.9 million, or 7.8%, from £11.6 million in 2016 to £10.7 million in 2017. This decrease was due to a decrease in share-based payment expenses of £2.8 million, reflecting the lower level of share option awards in 2017, partially offset by a rise in other general and administrative costs of £1.9 million, reflecting an increase in payroll-related costs due to a higher headcount and higher bonus amounts earned in 2017, together with additional legal and professional fees in connection with the equity financing in April 2017, the entering into a credit facility in August 2017 and the acquisition of AZD-9668 in October 2017.

Finance income and charges

Interest earned on our short-term cash deposits increased from £0.4 million in 2016 to £0.8 million in 2017, reflecting higher cash balances held in deposit in 2017. Finance charges increased from £0.2 million in 2016 to £1.1 million in 2017, reflecting interest costs on additional borrowings under our credit facility during 2017 and lower costs related to the Novartis Notes after the exercise of a portion of these Notes in April 2017. Finance charges in 2017 also included £0.3 million of losses on short-term deposits.

Net foreign exchange gain/(loss)

In 2016, the net foreign exchange gain was £2.3 million, primarily as a result of the unrealized gain on translation of cash deposits held primarily in U.S. Dollars at year end, reflecting a strengthening of the U.S. Dollar against Pounds Sterling during the year. In 2017, the net foreign exchange loss was £1.4 million, reflecting a weakening of the U.S. Dollar against Pounds Sterling during the year which negatively impacted the translation of our foreign deposits and investments at December 31, 2017.

Taxation

We recorded a tax credit of £8.2 million in 2017 (2016: £5.3 million). The tax credit represents the cash rebate from the U.K. tax authorities we qualified for in respect of eligible R&D activities during the year. Due to the increase in qualifying R&D expenditure in 2017, the 2017 tax credit increased by £2.9 million from the 2016 tax credit. The 2016 tax credit was received in May 2017. We expect to receive the 2017 tax credit of £8.2 million in 2018.

Loss per share

Basic loss per share for the year was 56 pence (2016: 63 pence). On an adjusted non-GAAP basis, excluding one-off items and share-based payments, loss per share was 47 pence (2016: 51 pence).

Liquidity and capital resources

Since we were incorporated, we have raised a total of £102.8 million in gross proceeds from private and public placements of our ordinary shares to institutional investors and £3.5 million from the issuance of the Novartis Notes. This included an equity placing to institutional investors in April 2017 which raised £15 million in gross proceeds. As of December 31, 2017, we had cash and short-term deposits and short-term investments (cash resources) of £52.5 million (2016: £53.6 million).

On August 7, 2017, we entered into a loan agreement with Silicon Valley Bank and Kreos Capital V (UK) Limited, which provides for total borrowings of £20.0 million. We borrowed £10.0 million on each of August 21, 2017 and December 29, 2017 for general working capital purposes. We are obligated to make interest-only payments on the loan amount until September 30, 2018 and thereafter we are obligated to pay interest and principal in 30 equal monthly instalments until March 31, 2021, the maturity date. The loan bears interest at an annual fixed rate equal to 9.0%. In addition, a final payment of 7.5% of the principal loan amount is due upon the earlier of the maturity date, prepayment in whole of the loan amount, mandatory repayment, acceleration of the loan and the loan becoming immediately due and payable due to an event of default. The loan is secured by substantially all of our assets, including intellectual property rights owned or controlled by us.

In connection with the loan agreement, we issued to the lenders warrants to subscribe for 363,156 of our ordinary shares at an exercise price of £3.029 per ordinary share and warrants to subscribe for 333,334 of our ordinary shares at an exercise price of £3.30 per ordinary share.

We expect that our existing cash resources will enable us to fund our currently committed clinical trials and operating expenses and capital expenditure requirements for at least the next 12 months.

Acquisition of AZD-9668

In October 2017, our wholly owned subsidiary Mereo BioPharma 4 Limited entered into an exclusive license and option agreement, or the License Agreement, to obtain from AstraZeneca an exclusive worldwide, sub-licensable license under AstraZeneca's intellectual property rights relating to certain products containing a neutrophil elastase inhibitor, including products that contain AZD-9668, with an option to acquire such intellectual property rights, following commencement of a pivotal trial and payment of related milestone payments, or the Option, together with the acquisition of certain related assets.

Upon entering into the License Agreement, we made an upfront payment of $3.0 million to AstraZeneca in cash and issued 490,798 new ordinary shares, for a total upfront payment equal to $5.0 million. Including the net present value of future deferred cash payments and the value of deferred equity consideration, the total acquisition cost of £7,192,288 was capitalized as an intangible asset.

Financial outlook

With a strong balance sheet which includes cash resources of £52.5 million at January 1, 2018 we are well positioned to fund our current development programs through to their key milestones. We have also announced plans to pursue a registered initial public offering in the U.S. and look forward to updating shareholders on these plans in due course.

Richard Jones
Chief Financial Officer
March 22, 2018

Board of directors and executive officers

NON-EXECUTIVE DIRECTORS

Peter has been Chairman of our Board of directors since July 2015. In addition to Mereo, Peter also serves as Chairman of the biotech and medtech companies Vernalis plc and Consort Medical plc. He has previously served on the boards of a wide range of life science companies, including as Chairman of Ablynx NV, Vice-Chairman of Astex Pharmaceuticals Inc. until its sale to Otsuka in 2013, Chairman of Optos plc until its acquisition by Nikon Corporation, Director of the global biopharmaceutical company UCB SA from 2005 to 2014 and Chairman of Acambis plc from 2006 until its acquisition by Sanofi in 2008. He was Chairman of Celltech Group plc until its acquisition by UCB in 2004, having been CEO from 1990. Before joining Celltech he was CEO of Roche UK from 1986 to 1990. He served as a member of the Medical Research Council from 2000 to 2007.

Anders has served on our Board of directors since October 2015. He has extensive experience as an executive and leader with broad business knowledge from senior roles in the biopharmaceutical industry, with global experience delivering products, projects, productivity and change management. He is currently Chairman of the board at Karolinska University Hospital and Chairman/non-executive board member of several biotech companies. During two decades at AstraZeneca, he was a member of global executive teams including Executive VP Global Drug Development, EVP Global Medicines Development, Global Head Clinical Development, Global Therapy Area Head, Global Head Science & Technology Integration, and CEO AstraZeneca AB Sweden. Anders is also a board-certified MD (anaesthesiology and intensive care), PhD, DDS and Associate Professor at Karolinska Institute, Stockholm, Sweden, and a fellow of the Royal Swedish Academy of Engineering Sciences.

Paul has served on our Board of directors since October 2015. He has over 40 years of experience in the field of finance. He has previously held the positions of Senior Vice President Strategic Finance Projects and Financial Controller at GSK, gaining extensive emerging markets, corporate finance and change experience. He also served on the GSK Audit and Risk Committee. He is currently a board member of Syngene International and is also a member of Syngene's Audit and Risk and Stakeholder Relationships Committees. He holds a BSc in Management Sciences from Warwick University and also a professional accounting qualification from the Chartered Institute of Management Accountants.

Frank has served on our Board of directors since July 2015. He has served as CEO to a number of healthcare and biopharmaceutical companies including CuraGen Corporation, and Fulcrum Pharma. He held senior management positions including Executive VP Product Development at Bayer AG, Senior VP Medical Research at Zeneca Pharmaceuticals (now AstraZeneca) and Senior VP at Merck Serono. Frank holds an MBChB from the University of Edinburgh and became a member of the Royal College of Physicians in 1984. He was elected Fellow of the Royal College of Physicians, Edinburgh, in 1993 and also Fellow of the Faculty of Pharmaceutical Physicians in 1994. Frank is currently non-executive Chairman of Caldan Therapeutics, Summit Therapeutics and Faron Pharma.

Peter has served on our Board of directors since July 2015. He has nearly three decades of experience in the pharmaceutical industry encompassing strategic and operational leadership expertise across global geographies, functions and business segments. He is currently Representative Executive Officer and Chief Executive Officer of Sosei Group Corporation, a Tokyo-listed biotech company. Previously, he was Chief Executive Officer of Syngene International, which he successfully took public on the Mumbai exchange in 2015. He also currently serves as non-executive director for Phase4 Partners and MiNA, and is also non-executive Chairman of Fermenta Biotech, a subsidiary of DIL, a Mumbai-listed company. Previously, he had a 23-year career at GlaxoSmithKline, where he held multiple senior roles. Peter received a BSc Combined (Honours) in Physiology/Zoology from Sheffield University.

Kunal has served on our Board of directors since July 2015. He is a Chartered Accountant and is currently Chairman and Managing Director of Allegro Capital Advisors, a leading Indian investment bank. Kunal has a deep understanding of the life sciences industry, built over two decades of advising companies in the industry on fundraising, IPOs, mergers and acquisitions, and IP licensing. He is an independent director of GlaxoSmithKline Consumer Healthcare Ltd and Phase4 Partners. He was also founder and executive director of Celstream Technologies, a leading software product engineering organization. From 1994–2000 he was a global partner at Arthur Andersen responsible for building and developing the firm's practice in Southern India.

EXECUTIVE DIRECTORS

Denise has over 25 years' experience in the biopharmaceutical industry both in R&D management and as a venture capitalist. She started her career in R&D management at Amersham and Fisons and as a senior executive at Scientific Generics before joining Rothschild Asset Management as an Investment Manager. In 1999 she joined Nomura and became a Managing Director after heading the life science investment team investing globally in biotechnology companies. She led the Phase4 Partners MBO from Nomura in 2010. Denise has served on many U.S. and European private and public boards including Idenix (prior to its acquisition by Merck for $3.85 billion), Nabriva (NRBV) and Albireo (ALBO). She is currently a board member of OncoMed (OMED). Denise has a PhD and a BSc (Hons) from Birmingham University and was a Fulbright scholar at UC Berkeley.

Richard joined the Company as Chief Financial Officer and an executive director on 30 January 2017. Richard was previously at Shield Therapeutics plc where he was Chief Financial Officer and Company Secretary. He was initially appointed as a non-executive director at Shield in 2010 before moving to CFO in 2011 where he had a leading role establishing the finance operations and guiding Shield through its private funding and recent IPO, during which time the group raised over £60 million from both institutional, private and venture capital investors to fund both clinical development and commercialization activities. Prior to this, Richard had a career in investment banking, holding senior positions at Investec and Brewin Dolphin Securities, where he advised healthcare clients on a wide range of transactions and fundraisings including IPOs, M&A and fundraisings. Richard qualified as a Chartered Accountant with PwC in 1991.

EXECUTIVE OFFICERS

Alastair is our Chief Medical Officer and a co-founder of Mereo. Prior to Mereo, he was a Partner at Phase4 Partners, a global life science venture capital firm. He was also involved in Phase4's MBO in 2010 having originally joined Nomura in 2005. Before Nomura, he was a practising physician in the U.K. for ten years. Alastair received a BSc and MBBS from King's College London, is a Member of the Royal College of Surgeons of Edinburgh (MRCS) and has a Diploma in Corporate Finance from the London Business School. Alastair is a board member of Phase4 Partners.

John is our Head of Corporate Development and a co-founder of Mereo. Prior to Mereo, he worked with the co-founders at Nomura then Phase4 Partners since 2000. He has significant corporate, operational and transactional experience, having served in various executive, director and advisory roles throughout his career. He is a board member of Vaxart, Inc., Phase4 Partners, QUE Oncology and Catalyst Biosciences. Previously, he was Executive VP Business Development at SEQUUS, where he was responsible for negotiating SEQUUS's acquisition by ALZA. John also headed business development for VIVUS and Genome Therapeutics, where he established numerous alliances. John holds an MBA from Harvard Business School and a BS from Stanford University.

Charles is our General Counsel and Company Secretary and a co-founder of Mereo. He has over 20 years' experience in corporate law and biopharmaceuticals. He started his career as a corporate lawyer at Freshfields before joining Nomura as an associate director in 1998 where he worked for Nomura's life science investment team investing globally in biotechnology companies. Charles was part of Phase4 Partners' MBO from Nomura in 2010. Charles has an LLB (Hons) from Hull University.

- (A) Audit and Risk Committee
- (R) Remuneration committee
- (N) Nomination committee
- (+) Research and development committee
- ◆ Chairman of committee

Key management

Fiona is the Head of Intellectual Property for Mereo BioPharma and is based in London having previously been Mylan's Vice President and Global Head of Regional IP. Fiona graduated in Natural Sciences from Cambridge University before going on to do a PhD at the Medical Research Council, U.K., and then a post-doctorate at Harvard Medical School, U.S. She started her career as a patent attorney at SmithKline Beecham (later GlaxoSmithKline) qualifying and working as a U.K. and European patent attorney. She spent two years in private practice before joining Teva and then Mylan. Fiona is also qualified as a U.K. patent attorney litigator and has substantial experience of U.K. High Court litigation and litigation in other jurisdictions. She is a Principal Examiner for the Patent Examination Board, a member of the BIA IP Advisory Committee and a regular speaker at conferences.

Jerome has over 18 years' experience in discovery, development and manufacture of active pharmaceutical ingredients (API) and medicinal products (MP). He has held positions in chemistry, manufacturing and controls (CMC) in a wide range of pharmaceutical companies, including Pfizer and Ipsen Pharma, managing numerous projects at various stages of the development and commercialization lifecycle. In his previous role he served on the global quality leadership team at Ipsen Pharma. He has Master's degrees in both Chemical Engineering and Organic Chemistry as well as a PhD in Organic Chemistry from the University of Strasbourg, France, and an MBA from Warwick Business School, U.K.

Tony graduated from King's College London with first class honours in physiology and pharmacology before going on to study medicine at the Royal Free Hospital School of Medicine. He joined the pharmaceutical industry in 1994 and has spent many years working on the development of drugs for rare diseases. Immediately prior to joining Mereo, Tony worked at Prosensa/Biomarin on the development of antisense oligonucleotides for the treatment of Duchenne muscular dystrophy. He was also an integral part of the DevelopAKUre consortium, which raised money from the European Commission to develop a treatment for the ultra-rare genetic disease alkaptonuria. Tony speaks regularly at rare diseases conferences and is author of a number of articles and book chapters on orphan drugs, including his most recently published book entitled "The Patient Group Handbook: A Practical Guide for Research and Drug Development".

Ian has over 17 years in clinical development positions in small, medium and large pharma and CROs, including Takeda Oncology, Shire, Sanofi, Alcon and ICON. Working within clinical science and operational roles he has broad therapeutic and operations experience leading early and late-phase development to support successful registrations in the U.S., the E.U. and Japan. He has been successful in operationalizing several complex programs in orphan and specialty indications. Ian has a PhD in Medical Microbiology from the University of Edinburgh/ Queen Margaret, a BSc (Hons) from Reading University as well as two years of post-doctorate vaccine research.

Most recently, Wills served as Senior Vice President of Access & External Affairs and Chief Patient Access Officer of Swedish Orphan Biovitrum (Sobi), an international specialty healthcare company dedicated to rare diseases. In her role, Wills was responsible for Sobi's go-to-market commercialization approach and led the Company's pricing, reimbursement and access teams for Sobi's rare disease product portfolio. Prior to joining Sobi, Wills served as Vice President of Health and Market Access Policy at Genzyme Corporation (now part of Sanofi), where she was responsible for securing in-market availability of Genzyme's orphan drug, rare disease, and advanced therapies product portfolios. Earlier in her career, Wills served as Executive Director of European Biopharmaceutical Enterprises (EBE), a specialized group of the European Federation of Pharmaceuticals Industries & Associations (EFPIA) that represents the interest of biotechnology companies in Europe. Wills holds a Bachelor of Laws degree with honours from the University of Durham, U.K.

Julian has over ten years' experience in the life sciences industry. He joined Mereo in August 2015, helping to set up the finance operations and preparing the Company for admission to the AIM market of the London Stock Exchange. Prior to joining Mereo, Julian was Financial Controller at Immune Targeting Systems (ITS) Ltd, a venture capital-backed vaccine development company in London. As the head of finance, he was responsible for all finance and company secretarial matters, and worked with the directors and investors on several private financings through to the company's merger with Vaxin, INC. Previously, Julian held roles of increasing seniority at Group NBT plc and Hammersmith Medicines Research. He holds a BA (Hons) from Durham University and a professional accounting qualification from the Chartered Institute of Management Accountants.

Jackie is an academically trained physician with extensive technical, clinical and development capabilities from over 30 years' experience in clinical medicine and pharmaceutical R&D. Following senior clinical roles in London teaching hospitals where she led services for immunodeficiency, infectious and autoimmune diseases, she progressed her career by moving to GlaxoSmithKline. Rising to Vice President, she gained a breadth of experience across all phases of pharmaceutical discovery and development, leading to successful regulatory approvals with small molecule and biological medicines. Jackie joined Mereo in October 2015 as the Therapeutic Area Head for Endocrinology and Respiratory, leading the development of acumapimod for treatment of acute exacerbations of COPD, BGS-649 in hypogonadotropic hypogonadism and AZD-9668 for AATD.

Our values and our people

Passion
and in-depth experience

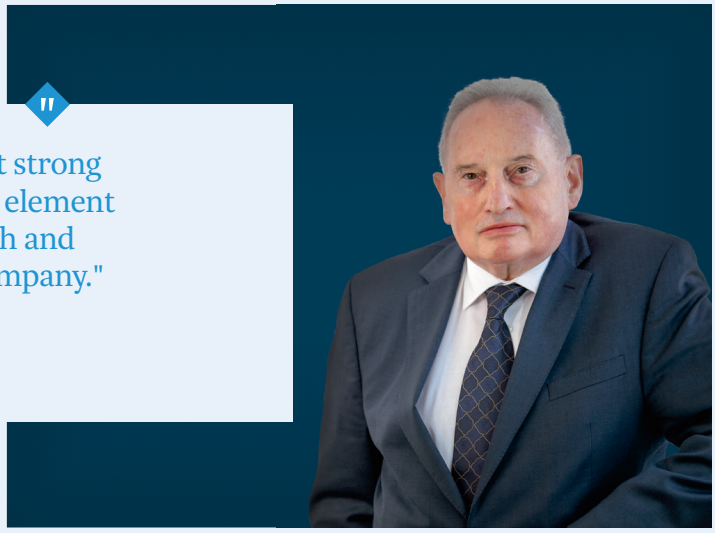
The team has grown significantly over the past three years and we now employ over 30 staff in our London headquarters. We are lucky to have been able to attract and retain highly experienced individuals in clinical development, clinical operations, manufacturing, intellectual property and quality assurance and support them with strong leadership at the executive and Board level. This internal expertise is leveraged with external organizations including contract research organizations (CROs) and contract manufacturers (CMOs). This combination has allowed the Group to efficiently and effectively transfer programs from large pharma and to make significant progress this year with a lean internal infrastructure. The successful growth to date is a result of the hard work, enthusiasm, experience and skills of all our employees who show a strong affiliation with Mereo and our mission to deliver innovative medicines to patients.

Our Board members have significant operational experience in large and small pharmaceutical companies and in clinical research organizations. They provide valuable strategic input into our development programs and into the overall direction of the Group.

From founding the Group around three years ago we have made outstanding progress, acquiring and integrating four programs, advancing them into the clinic and reporting topline data on two programs. We would like to thank Board members and our staff for their important contributions during this successful period, and also our shareholders for their continued support.

Corporate governance report

Governing successful growth



"The Board believes that strong governance is a central element of the successful growth and development of the Company."

DR. PETER FELLNER
CHAIRMAN

Chairman's governance overview

I am pleased to present the Corporate Governance Report for the year ended December 31, 2017.

The Board believes that strong governance is a central element of the successful growth and development of the Company. The Board and its committees play a key role in the Company's governance by providing an independent perspective to the executive team, and by seeking to ensure that an effective system of internal controls and risk management procedures is in place.

This section of the annual report describes our corporate governance structures and processes and how they have been applied throughout the year ended December 31, 2017. We are not required to comply with corporate governance standards in the U.K.; however, we have chosen to implement certain principles of good governance. This year I am pleased to include reports from the following committees:

- Audit and Risk Report (see page 29); and
- Remuneration Report (see pages 30 to 33).

The Board

We have a strong and settled Board with our non-executives all having been in place since 2015. At December 31, 2017 the Board comprised six non-executive directors and two executive directors.

Our non-executive directors (NEDs) currently have a limited number of share options, all of which were issued to them from the pre-IPO Share Plan (the "2015 Plan") and these options have a vesting period of three years. However, in light of the limited number of current options and relatively short remaining vesting period, the Board does not consider that these share options impact the independence of the NEDs. As set out on page 30 the Board intends to adopt new incentive arrangements during 2018 which will include the ability to grant share options to NEDs. One director, Kunal Kashyap, is not considered to be independent due to a common shareholding in Phase4 Partners Limited with Denise Scots-Knight, CEO of Mereo. At the date of this report, therefore, there are two executive directors, five independent NEDs and one non-independent NED. The biographies of the directors serving at the date of this report are shown on pages 20 and 21.

The Board considers there to be sufficient independence on the Board and that all the NEDs are of sufficient competence and calibre to add strength and objectivity to the Board, and bring considerable experience in scientific, clinical, operational and financial development of biopharmaceutical products and companies.

Name	Date of appointment
Non-executive directors	
Peter Fellner	July 29, 2015
Frank Armstrong	July 29, 2015
Peter Bains	July 29, 2015
Paul Blackburn	October 6, 2015
Anders Ekblom	July 29, 2015
Kunal Kashyap	July 29, 2015
Executive directors	
Denise Scots-Knight, Chief Executive Officer	July 1, 2015
Richard Jones, Chief Financial Officer	January 30, 2017

The Board is responsible to the shareholders for the proper management of the Group and meets regularly to set the overall direction and strategy of the Group and to review scientific, operational and financial performance. The Board has also convened on an ad-hoc basis between scheduled Board meetings to review the strategy and activities of the business. The key responsibilities of the Board are as follows:

- setting the Company's values and standards;
- approval of long-term objectives and strategy;
- approval of budgets and plans;
- oversight of operations ensuring adequate systems of internal controls and risk management are in place, maintenance of accounting and other records and compliance with statutory and regulatory obligations;
- review of performance in light of strategy and budgets, ensuring any necessary corrective actions are taken;
- approval of the annual report and financial statements and major projects such as new product acquisitions;
- changes to the structure, size and composition of the Board;
- determining the remuneration policy for the directors and approval of the remuneration of the NEDs; and
- approval of communications with shareholders and the market through a separate disclosure committee.

The Company Secretary, Charles Sermon, is responsible for ensuring that Board procedures are followed and applicable rules and regulations are complied with.

There is a clear separation of the roles of the Chief Executive Officer (or CEO) and the non-executive Chairman. The Chairman is responsible for overseeing the running of the Board, ensuring that no individual or group dominates the Board's decision making and ensuring the NEDs are properly briefed on matters. The Chief Executive Officer has the responsibility for implementing the strategy of the Board and managing the day-to-day business activities of the Group.

All of the directors are subject to re-election by shareholders at the third annual general meeting (AGM) after the AGM at which they were appointed or reappointed.

Conflicts of interest

Under the Articles of Association the directors may authorize any actual or potential conflict of interest a director may have and may impose any conditions on the director that are felt to be appropriate. Directors are not able to vote in respect of any contract, arrangement or transaction in which they have a material interest and they are not counted in the quorum. A process has been developed to identify any of the directors' potential or actual conflicts of interest. This includes declaring any new conflicts before the start of each Board meeting.

Development, information and support

Updates are given to the Board on developments in governance and regulations as appropriate, including presentations from the Company's Nomad and financial, legal and remuneration advisors. The Company Secretary supports me in ensuring that the Board receives the information and support it needs in order to carry out its roles.

Performance evaluation

The Board has a process for evaluation of its own performance and that of its committees and individual directors, including the Chairman.

Attendance at Board meetings

There were 11 Board meetings during 2017, of which five were scheduled in-person meetings. Directors' attendance was as follows:

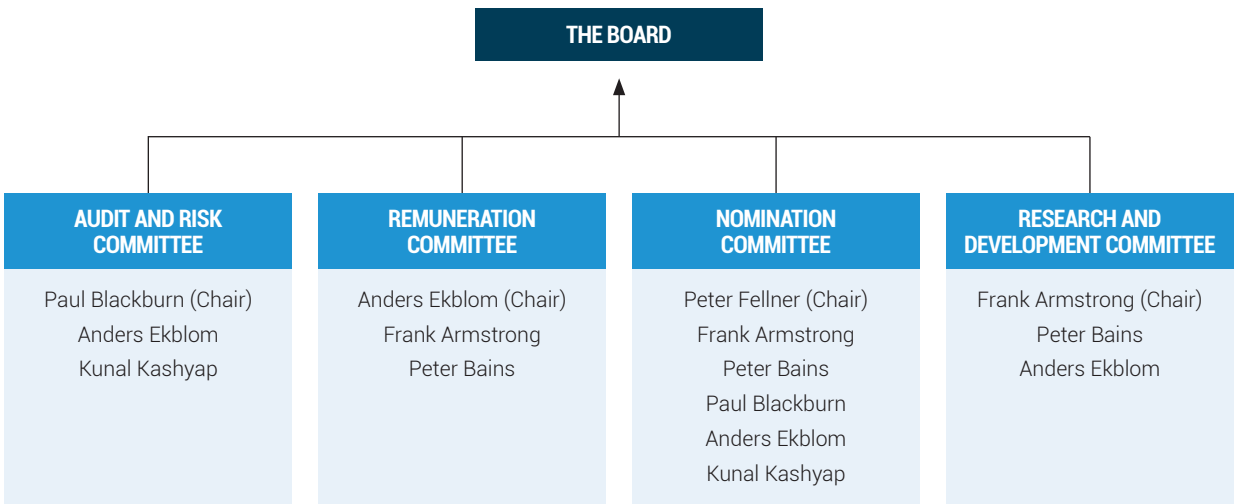
	Attendance
Non-executive directors	
Peter Fellner	11
Frank Armstrong	9
Peter Bains	10
Paul Blackburn	11
Anders Ekblom	10
Kunal Kashyap	8
Executive directors	
Denise Scots-Knight	11
Richard Jones	11

Corporate governance report *continued*

Board committees

In order to effectively manage governance of the Group, the Board has delegated certain responsibilities to sub-committees, as detailed below:

The detailed charters for each of the committees can be found on the Group's website at www.mereobiopharma.com. All of the Board committees are authorized to obtain, at the Company's expense, professional advice on any matter within their terms of reference and to have access to sufficient resources in order to carry out their duties.



Audit and Risk Committee

The Audit and Risk Committee, which consists of Paul Blackburn, Dr. Anders Ekblom and Kunal Kashyap, assists the Board in reviewing our accounting policies, financial reporting processes, audits of our financial statements, internal control and risk frameworks, principal risks and mitigation plans. Mr. Blackburn serves as Chairman of the committee. The Audit and Risk Committee consists exclusively of members of our Board who are financially literate. While Mr. Kashyap is not currently considered to be independent by the Board, he has recent and relevant financial experience.

The Audit and Risk Committee will normally meet at least four times a year at the appropriate times in the reporting and audit cycle. The Audit and Risk Committee's responsibilities include:

- recommending the appointment of the independent Auditor to the general meeting of shareholders;
- the appointment, compensation, retention and oversight of any accounting firm engaged to prepare or issue an audit report or perform other audit services;
- pre-approving the audit services and non-audit services to be provided by our independent auditor before the auditor is engaged to render such services;
- evaluating the independent auditor's qualifications, performance and independence, and presenting its conclusions to the full Board on at least an annual basis;
- reviewing and discussing with the executive officers, the Board and the independent auditor our financial statements and our financial reporting process;
- reviewing our internal controls and risk management and reviewing the need for an internal audit function at least annually; and
- approving or ratifying any related person transaction (as defined in our related person transaction policy) in accordance with our related person transaction policy.

The Audit and Risk Report is presented on page 29.

Remuneration committee

The remuneration committee, which consists of Dr. Anders Ekblom, Dr. Frank Armstrong and Peter Bains, assists the Board in determining senior management compensation. Dr. Ekblom serves as Chairman of the committee. The remuneration committee's responsibilities include:

- reviewing the corporate goals and objectives for each year and setting the framework for variable compensation for senior management with reference to the corporate goals;
- identifying, reviewing and proposing policies relevant to senior management compensation;
- evaluating each member of senior management's performance in light of such policies and reporting to the Board;
- analyzing the possible outcomes of the variable compensation components and how they may affect the compensation of senior management;
- recommending any equity long-term incentive component of each member of senior management's compensation in line with any compensation policy and reviewing our senior management compensation and benefits policies generally; and
- reviewing and assessing risks arising from our compensation policies and practices.

During 2017 the remuneration committee set the corporate targets used in assessing the executive and staff bonus in respect of 2017, set the compensation package for the new Chief Financial Officer and set the revised salary for 2018 for the Chief Executive Officer and the Chief Financial Officer.

The Directors' Remuneration Report is presented on pages 30 to 33.

Nomination committee

The nomination committee, which currently consists of all NEDs, assists our Board in identifying individuals qualified to become members of our Board and senior management consistent with criteria established by our Board and in developing our corporate governance principles. Dr. Peter Fellner serves as Chairman of the nomination committee. It is the intention of the Board to reduce the number of members of the nomination committee to three during 2018. The nomination committee's responsibilities include:

- drawing up selection criteria and appointment procedures for Board members;
- reviewing and evaluating the size and composition of our Board and making a proposal for a composition profile of the Board at least annually;
- recommending nominees for election to our Board and its corresponding committees;
- assessing the functioning of individual members of the Board and senior management and reporting the results of such assessment to the Board; and
- developing and recommending to the Board rules governing the Board, reviewing and reassessing the adequacy of such rules governing the Board, and recommending any proposed changes to the Board.

Research and development committee

The research and development committee, which consists of Dr. Frank Armstrong, Dr. Anders Ekblom and Peter Bains, assists our senior management with oversight and guidance related to research and development matters and provides guidance and makes recommendations to our Board regarding research and development matters. Dr. Armstrong serves as Chairman of the research and development committee. The research and development committee's responsibilities include oversight of:

- our strategic development plans for products, taking into account any regulatory feedback; and
- the acquisition of new products.

During 2017 and early 2018 the research and development committee reviewed and provided input into regulatory strategy for BPS-804 and the interpretation of clinical trial results for BCT-197 and BGS-649 and reviewed and provided input on the acquisition of AZD-9668 and on other new product opportunities.

Corporate governance report *continued*

Corporate social responsibility

The Board recognizes the importance of social, environmental and ethical matters and it endeavors to take into account the differing interests of the Group's stakeholders, including its investors, employees, suppliers and business partners, when operating its business.

Corporate Criminal Offence (or CCO) U.K. legislation

The Board is aware of the new CCO legislation adopted in the U.K. and is committed to implementing the guidance set out by HMRC. An initial review has been carried out and the Company's internal control procedures already in place in respect of money laundering have been expanded to ensure compliance with the guidelines.

Code of Business Conduct and Ethics

During 2018 the Board intends to adopt a Code of Business Conduct and Ethics that covers a broad range of matters including the handling of conflicts of interest, compliance issues and other corporate policies such as equal opportunity and non-discrimination standards.

General Data Protection Regulation (GDPR)

In anticipation of the adoption of GDPR we have been updating our data protection guidelines, training and processes to ensure we are ready for this to take effect during 2018. During 2017 we also appointed a Data Protection Officer (DPO).

Risk management and internal control

The Board is responsible for the systems of internal control and for reviewing their effectiveness. Details of the Board's review of the Company's risk management and internal control procedures are set out in the Audit and Risk Report on page 29. Details of our principal risks are set out on pages 14 to 16.

Employment

The Board recognizes its legal responsibility to ensure the wellbeing, safety and welfare of its employees and to maintain a safe and healthy working environment for them and for its visitors.

Financial and business reporting

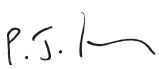
The Board seeks to present a balanced and understandable assessment of the Group's position and prospects in all financial reports and other Company announcements and other information required to be presented by all relevant statutes. The Board receives a number of reports to enable it to monitor and clearly understand the Group's financial and operational position. Procedures are in place to comply with the Market Abuse Regime (MAR), and in particular MAR (596/2014) in respect of inside information and all communications with the market are released in accordance with AIM Rules.

Relations with shareholders

The Board recognizes the importance of communication with its shareholders to ensure that its strategy and performance are understood and that it remains accountable to shareholders and we therefore maintain a regular dialogue with our institutional investors. Our website, www.mereobiopharma.com, has a dedicated investor section, which is fully compliant with AIM Rule 26 and provides useful information for our shareholders including the latest announcements, press releases, published financial information, details of our products and our current development pipeline and other information about the Company. The Board as a whole is responsible for ensuring that a satisfactory dialogue with shareholders takes place, while the Chief Executive Officer and I ensure that the views of the shareholders are communicated to the Board as a whole. The Board ensures that our strategic plans have been carefully reviewed in terms of their ability to deliver long-term shareholder value.

Shareholders are welcome to attend our AGM, where they have the opportunity to meet the Board. All shareholders will have at least 21 days' notice of the AGM, at which directors will be available to discuss aspects of the Group's performance and answer questions.

This year's annual general meeting of the Company will be held on June 21. The notice of annual general meeting, which includes all of the proposed resolutions, will be posted to shareholders in due course and will be available on the Group's website.



Dr. Peter Fellner
Non-executive Chairman
March 22, 2018

Audit and Risk Report

The Board has delegated certain responsibilities for oversight of the financial reporting process and for managing its external Auditor to the Audit and Risk Committee (or ARC). Details of the ARC, its remit and activities are set out in the Corporate Governance Report on pages 24 to 28.

The ARC met seven times in 2017. A summary of the committee's key activities during 2017 is as follows:

Review of Auditor and appointment of new tax advisors

The ARC monitors the relationship with the external Auditor, Ernst & Young LLP, which was appointed in 2015 and reappointed at the 2017 AGM, to ensure that auditor independence and objectivity are maintained. We also reviewed and approved the 2017 audit fees. As part of its review we monitor the provision of non-audit services by the external Auditor. The breakdown of fees between audit and non-audit services for 2017 is provided in Note 6 to the financial statements. We also assess the Auditor's performance.

Having reviewed the Auditor's independence and performance, we recommended to the Board that Ernst & Young LLP be reappointed as the Company's Auditor at the next annual general meeting. We also engaged Ernst & Young LLP to carry out the 2016 and 2017 audit to PCAOB standards in respect of our plans to conduct a registered initial public offering in the U.S.

During the year we also reviewed our advisors for corporate tax and agreed the appointment of Deloitte LLP as our corporate tax advisors for our tax compliance and any ad hoc taxation advice.

Financial statements

During the year we met with the executive team and with the Auditor to agree the scope of the 2017 audit plan. We also reviewed and approved the FY 2016 financial statements, the FY 2017 interim statements and the FY 2016 and FY 2017 financial statements audited under U.S. PCAOB standards. As part of our review we considered and approved existing and new accounting policies and updated judgments and estimates in respect of FY 2017.

Internal controls

The internal controls are designed to manage rather than eliminate risk and provide reasonable but not absolute assurance against material misstatement or loss. These procedures include the preparation of management accounts, forecast variance analysis and other ad-hoc reports. A Financial Procedures Manual sets out accounting procedures, policies and minimum reporting standards.

During 2017, we reviewed our internal controls and whether there was adequate oversight without an internal audit function. Given the current size of the Group and the control systems that are in place we concluded that there is currently sufficient management oversight to highlight any areas of weakness in the financial reporting systems.

Risk management

During the year we reviewed and approved the risk framework, agreed the principal risks in the business and reviewed a number of principal risk mitigation plans presented by individual risk owners. Principal risks identified are set out in the Strategic Report on pages 14 to 16.

Paul Blackburn
Chairman of the Audit and Risk Committee
March 22, 2018

Remuneration report

This report sets out the remuneration policy operated by the Group in respect of the executive and NEDs together with details of all remuneration, share options and shareholdings of its directors in respect of the year ended December 31, 2017.

The remuneration committee

The Board has delegated certain responsibilities for executive director remuneration to the remuneration committee. Details of the remuneration committee, its remit and activities are set out in the Corporate Governance Report on pages 24 to 28. The remuneration committee met twice in 2017.

Remuneration policy

The Group's remuneration strategy is to provide pay packages that will:

- reward delivery of value to shareholders and achievement of the Group's key strategic objectives;
- motivate and retain business-critical employees; and
- enable the Group to continue to attract high quality recruits.

The remuneration framework for executive directors is a combination of base salary, benefits, an annual bonus and awards under share plans as described below. A similar pay structure is operated for other key members of senior management. During 2018 the Board intends to adopt a new framework for incentive arrangements that will allow for share options to be granted to NEDs under a new scheme and for regular annual awards to executive officers and other employees under the Share Option Plan. As details of these schemes have not been finalized as at the date of this report the incentive arrangements disclosed below relate to the current remuneration policies.

Element	Description	Vesting/performance conditions
Base salary	Base salaries are reviewed annually with effect from January 1 each year. The review process is managed by the remuneration committee with reference to market salary data and the individual's performance and contribution to the Group during the year. With effect from January 1, 2018 the base salary of Denise Scots-Knight, CEO, was increased by 4% to £379,600 and the base salary of Richard Jones, Chief Financial Officer (CFO), was increased by 4% to £260,000.	n/a
Bonuses	Annual bonuses for executive directors and executive officers are based on achievement of Group strategic, clinical development and financial targets. The annual bonus potential for the executive directors and executive officers is a maximum of 100% of salary. For the year ended December 31, 2017 bonuses were awarded at 95% of the maximum potential.	70% of the annual bonus is paid in cash. 30% of the annual bonus is deferred into rights to acquire shares equal in value at the time cash bonuses are paid to the amount deferred free of charge (or awards). The awards are made under the Deferred Bonus Share Plan (DBSP). The DBSP awards vest three years after the date of issue and have no performance conditions.
Long Term Incentive Plan (LTIP)	In order to further incentivize the executive directors and senior management, and align their interests with shareholders, the Group has put in place an LTIP scheme, under which rights to acquire shares at nil cost may be awarded. The shares to satisfy LTIP awards are delivered through an employee benefit trust (EBT), as detailed in Note 2 to the financial statements. The only LTIP award in 2017 was to Richard Jones in respect of his appointment as CFO.	The LTIP awards vest over a five-year period with 75% of the total award based upon the achievement of share price targets and 25% of the total award based upon the achievement of strategic targets.
The Mereo BioPharma Group plc Share Option Plan (Share Option Plan)	Prior to admission to trading on AIM in June 2016, the Group operated a share option plan (the "2015 Plan"). At the time of admission the Company established new plans including the Share Option Plan. Share options may be granted to all employees on commencement of employment with the Group and may be granted on a periodic basis thereafter.	Under the 2015 Plan share options for executives vest over a four-year period; share options for NEDs vest over a three-year period; and there are no performance conditions other than continued service with the Company. Under the Share Option Plan share options vest over a three-year period and NEDs are not eligible to participate. There are no performance conditions under this scheme.

Remuneration policy continued

Element	Description	Vesting/performance conditions
Pension	The Group operates a defined contribution pension plan and has a policy of encouraging all employees to plan responsibly for their retirement. The policy also complies with the provisions of auto-enrolment. The Company makes payments of 10% of basic salary for executive directors and executive officers (15% for the Chief Executive Officer) into any pension scheme or similar arrangement as the participating executive may reasonably request (or a payment in lieu). Such payments are not counted for the purposes of determining bonuses.	n/a
Other benefits	Other benefits provided to all employees are life assurance, income protection, private medical insurance and subsidized gym membership.	n/a

Executive directors' service agreements and termination provisions

Details of the executive directors' service agreements are set out below.

Director	Date of initial contract	Notice period by Company	Notice period by director
Denise Scots-Knight, Chief Executive Officer	July 29, 2015	12 months	12 months
Richard Jones, Chief Financial Officer	January 28, 2017	6 months	6 months

There are no specific provisions under which executive directors are entitled to receive compensation upon early termination, other than in accordance with the notice period.

At the Company's sole discretion it may make a payment in lieu of notice equivalent to the basic salary which the individual would have been entitled to receive following notice of termination.

Non-executive directors

Non-executive directors' terms of appointment

Non-executive director	Date of initial contract	Notice period by Company	Notice period by director
Frank Armstrong	July 29, 2015	3 months	3 months
Peter Bains	July 29, 2015	3 months	3 months
Paul Blackburn	October 6, 2015	3 months	3 months
Anders Ekblom	July 29, 2015	3 months	3 months
Kunal Kashyap	July 29, 2015	3 months	3 months

The appointments for each non-executive director are for an initial term of three years commencing on the date above until the conclusion of the Company's annual general meeting occurring approximately three years from that date and may be terminated by either party giving notice as shown above. There are no arrangements under which any non-executive director is entitled to receive compensation upon the early termination of his appointment. The remuneration payable to NEDs is decided by the Chairman and the executive directors.

Remuneration report *continued*

Directors' remuneration for the year ended December 31, 2017*

Under the terms of their service agreements as varied by annual awards or letters of appointment, the remuneration and benefits of the directors serving during the year ended December 31, 2017 are set out below. (See also Note 7 on pages 52 and 53.)

	Basic salary and fees £	Benefits in kind £	Pension contributions £	Bonus[1] £	Total £	2016 Total £
Non-executive directors						
Frank Armstrong	56,000	—	—	—	56,000	56,000
Peter Bains	44,000	—	—	—	44,000	44,000
Paul Blackburn	48,000	—	—	—	48,000	48,000
Anders Ekblom	48,000	—	—	—	48,000	48,000
Peter Fellner	100,000	—	—	—	100,000	100,000
Kunal Kashyap	40,000	—	—	—	40,000	40,000
Executive directors						
Denise Scots-Knight[1]	365,000	6,669	57,527	242,725	671,921	563,463
Richard Jones[1]	231,090	6,115	23,109	166,250	426,564	—
Richard Bungay[2]	—	—	—	—	—	367,559

(1) The bonus earned is split 70% cash and 30% deferred under the DBSP. Only the cash element is disclosed in the table above. The DBSP awards are disclosed below, and the share price on the date of the award was 323 pence (January 31, 2018) and 302 pence (April 4, 2017).
(2) Richard Bungay resigned as a director on October 31, 2016 and left the Company on January 13, 2017.

Directors' share interests for the year ended December 31, 2017*

As at December 31, 2017 the directors serving during the year had the following interests in share plans:

	Date of grant[1]	At January 1, 2017[1]	Awarded[1]	Canceled	Lapsed	**At December 31, 2017**	Exercise price	Latest date of exercise
Denise Scots-Knight								
2015 Plan	25/9/15	1,544,745	—	—	—	**1,544,745**	£1.29	24/9/25
LTIP	9/6/16	461,538	—	—	—	**461,538**	£nil	9/6/22
DBSP	4/4/17	25,319	—	—	—	**25,319**	£nil	4/4/21
DBSP	31/1/18[1]	—	32,205	—	—	**32,205**	£nil	n/a
		2,031,602	32,205	—	—	**2,063,807**	—	—
Richard Jones								
Share Option Plan	4/4/17	—	650,000	—	—	**650,000**	£3.03	4/4/27
LTIP	4/4/17	—	185,950	—	—	**185,950**	£nil	3/1/23
DBSP	31/1/18[1]	—	22,058	—	—	**22,058**	£nil	n/a
		—	858,008	—	—	**858,008**	—	—
Frank Armstrong	29/9/15	216,264	—	—	—	**216,264**	£1.29	9/28/25
Peter Bains	29/9/15	710,583	—	—	—	**710,583**	£1.29	9/28/25
Paul Blackburn	11/5/16	236,974	—	—	—	**236,974**	£1.84	5/28/26
Anders Ekblom	29/9/15	216,264	—	—	—	**216,264**	£1.29	9/28/25
Peter Fellner	29/9/15	1,692,673	—	—	—	**1,692,673**	£1.29	9/28/25
Kunal Kashyap	29/9/15	216,264	—	—	—	**216,264**	£1.29	9/28/25

(1) The awards under the DBSP in respect of the annual bonus for the year ended December 31, 2017 were made on January 31, 2018 but have not yet been granted. Since the expense relating to the DBSP options has been reflected in the consolidated statement of comprehensive loss for the year ended December 31, 2017, the awards have been included in the share interests as at December 31, 2017.

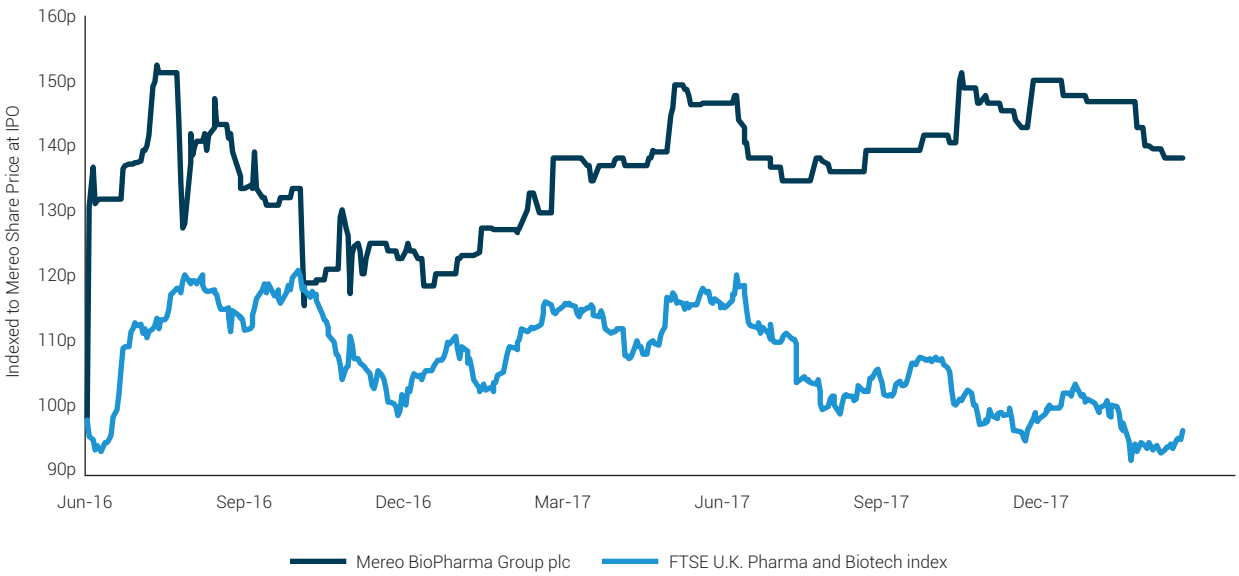
* Subject to audit, see Note 7 on pages 52 and 53.

Directors' interests in the share capital of the Company as at the date of this report*

Director	Number of ordinary shares	Percentage of issued share capital
Denise Scots-Knight	844,199	1.19%
Peter Fellner	10,000	0.01%
Frank Armstrong	256,444	0.36%
Peter Bains	107,906	0.15%
Paul Blackburn	22,624	0.03%
NxtScience AB (on behalf of Anders Ekblom)	93,002	0.13%
Kunal Kashyap	1,497,735	2.11%

The shares were admitted to trading on the AIM market of the London Stock Exchange under the ticker symbol "MPH" on June 9, 2016.

The Board considers that the FTSE U.K. Pharma and Biotech share index is an appropriate benchmark for the performance of its shares and a comparison is set out below rebased to Mereo's price from admission on June 9, 2016. This chart highlights that Mereo's share price outperformed the index by 40% in the period.



Anders Ekblom
Chairman of the Remuneration Committee
March 22, 2018

* Subject to audit, see Note 7 on pages 52 and 53.

Directors' report

The directors present their report and the audited financial statements for Mereo BioPharma Group plc and its subsidiaries (the "Group") for its financial year ended December 31, 2017. Comparative data is presented for the year ended December 31, 2016.

Mereo BioPharma Group plc is registered in England and Wales with the company number 09481161. Our registered office is One Cavendish Place, London W1G 0QF.

Principal activities

We are a multi-asset biopharmaceutical company focused on the acquisition, development and commercialization of innovative therapeutics that aim to improve outcomes for patients with rare and specialty diseases. Our portfolio consists of four clinical-stage product candidates, each of which we acquired from large pharmaceutical companies. We operate from a single site in the U.K. and do not have any branches or offices outside the U.K.

Review of the business and future developments

The Strategic Report describes our corporate and development activity during the year and outlines future planned developments. Details of the financial performance, including comments on the cash position and R&D expenditure, are given in the Financial Review. Principal risks and key performance indicators are outlined in the Strategic Report.

Going concern

The directors have reviewed the current and projected financial position of the Group, taking into account existing cash, short-term deposits and short-term investments (or cash resources). Whilst the Group and the Company continue to make losses, the directors believe it is appropriate to prepare the financial information on a going concern basis. This is because our development activities continue to progress according to plan and our cash resources will allow us to meet our liabilities as they fall due for at least 12 months from the date of authorization for issue of these consolidated financial statements.

Results and dividends

The Group recorded a comprehensive loss for the year attributable to equity holders of the Company of £38.8 million (2016: £28.4 million). Further details are given in the Financial Review and in the financial statements. The directors do not recommend payment of a dividend.

Research and development

In the year ended December 31, 2017, we spent £34.6 million (2016: £24.6 million) on R&D. This was a result of increased spending on clinical development as we continued the Phase 2 programs for BCT-197 and BGS-649 and commenced the adult Phase 2b program for BPS-804. Details of our development programs can be found in the Strategic Report.

Directors

The directors of the Company who held office during the year up to the date of this report, unless otherwise noted, were as follows:

Peter Fellner	Chairman
Frank Armstrong	Non-executive director
Peter Bains	Non-executive director
Paul Blackburn	Non-executive director
Anders Ekblom	Non-executive director
Kunal Kashyap	Non-executive director
Denise Scots-Knight	CEO
Richard Jones	CFO, appointed January 28, 2017

Biographical details of the directors are given on pages 20 and 21.

As at the date of this report, the directors held shares representing 4% of the equity of the Company. Details of individual directors' shareholdings and their options over shares in the Company are set out in the Remuneration Report on pages 30 to 33.

Disclosure of information to the Auditor

Each of the persons who is a director at the date of approval of this report confirms that:

- so far as the director is aware, there is no relevant audit information of which the Group's Auditor is unaware; and
- the director has taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the Group's Auditor is aware of that information.

Directors' and officers' liability insurance

The Company has, as permitted by the Companies Act 2006, maintained suitable insurance cover on behalf of the directors, indemnifying them against certain liabilities which may be incurred by them in relation to the Group.

Employees

As at December 31, 2017 the Group had 31 employees. We operate a non-discriminatory employment policy and full and fair consideration is given to applications for employment made by disabled applicants, having regard to their aptitudes and abilities, and the continued employment of staff who become disabled. We are committed to equal opportunities in all our employment practices and for involving and informing our employees of our goals and objectives which also form part of our annual performance incentives. We encourage, and provide support for, ongoing training and development.

We place considerable focus on being open with our staff and, in addition to other communication, we conduct regular all-company meetings to share and discuss important corporate and strategic progress.

Health, safety and environment

The directors are committed to ensuring the highest standards of health and safety, both for their employees and for the communities within which the Group operates. The directors are also committed to minimizing the impact of the Group's operations on the environment.

Political contributions

Neither the Company nor any of its subsidiaries made any political donations or incurred any political expenditure during the years ended December 31, 2017 and December 31, 2016.

Financial risk management

Details of our principal risks are set out on pages 14 to 16 of our Strategic Report. Our risk management is set out in our Audit and Risk Report on page 29.

Share capital

As at the date of this report, the Company had total issued and fully paid up share capital of £213,285 representing 71,094,974 ordinary shares of £0.003 each. Each share carries the right to one vote at general meetings of the Company. There are no specific restrictions on the transfer of shares beyond those standard provisions set out in the Articles of Association. No shareholder holds shares carrying special rights with regard to control of the Company.

Substantial interests

At February 28, 2017 the Company had been informed of the following substantial interests of over 3% in the issued share capital of the Company:

	Number issued	Percentage of share capital
Woodford Investment Management Limited	29,843,946	42.0
Invesco Asset Management	19,149,176	26.9
Novartis Pharma AG	13,767,841	19.4
Hargreave Hale	2,870,000	4.0
Directors	2,831,910	4.0

Post balance sheet events

There were no subsequent events from the year end to the date of this report.

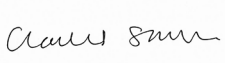
Website publication

The directors are responsible for ensuring that the Annual Report, including the financial statements, are made available on our website.

Annual General Meeting

The 2018 Annual General Meeting of the Company will be held on June 21, 2018 at 11.30 a.m. at the offices of Latham & Watkins LLP, 99 Bishopsgate, London EC2M 3XF. The notice of the meetings, together with an explanation of the business to be dealt with including proposed resolutions, will be prepared as a separate document and distributed to shareholders and posted to our website in due course.

By order of the Board



Charles Sermon
Company Secretary
March 22, 2018

Statement of directors' responsibilities

The directors are responsible for preparing the annual report, the Strategic Report, the Directors' Report and the financial statements in accordance with applicable laws and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under the AIM Rules of the London Stock Exchange we are required to prepare our Group financial statements in accordance with International Accounting Standards. For 2017 we have chosen to prepare our Group and Company accounts according to International Financial Reporting Standards (or IFRS) as issued by the International Accounting Standards Board (IASB). For 2016 we prepared our Group and Company accounts according to IFRS as adopted by the E.U. (E.U. IFRS).

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company and of their profit or loss for that period.

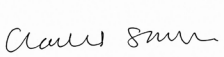
In preparing each of the Group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS as issued by the IASB or as adopted by the E.U.; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's and Group's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and the Group and enable them to ensure that its financial statements and Remuneration Report comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the U.K. governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

By order of the Board



Charles Sermon
Company Secretary
March 22, 2018

Independent Auditor's report to the members of Mereo BioPharma Group plc

Opinion

In our opinion:

- Mereo BioPharma Group plc's Group financial statements and parent company financial statements (the "financial statements") give a true and fair view of the state of the Group's and of the parent company's affairs as at December 31, 2017 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the E.U.;
- the parent company financial statements have been properly prepared in accordance with U.K. Generally Accepted Accounting Practice; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of Mereo BioPharma Group plc which comprise:

Group	Parent company
Consolidated balance sheet as at December 31, 2017	Balance sheet as at December 31, 2017
Consolidated statement of comprehensive loss for the year then ended	Statement of changes in equity for the year then ended
Consolidated statement of changes in equity for the year then ended	Related Notes 1 to 16 to the financial statements including a summary of significant accounting policies
Consolidated statement of cash flows for the year then ended	
Related Notes 1 to 27 to the financial statements, including a summary of significant accounting policies	

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the E.U. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and U.K. Accounting Standards, including FRS 101 Reduced Disclosure Framework (U.K. Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (U.K.) (ISAs (U.K.)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Group and parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the U.K., including the FRC's Ethical Standard as applied to listed entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Use of our report

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

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (U.K.) require us to report to you:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Group's or the parent company's ability to continue to adopt the going concern basis of accounting for a period of at least 12 months from the date when the financial statements are authorized for issue.

Overview of our audit approach

Key audit matters	» Risk of undetected impairment of intangible assets » AZD-9668 license acquisition and future financial commitments
Audit scope	» We performed an audit of the complete financial information of the Group, covering 100% of Group operating costs and 100% total assets
Materiality	» Overall Group materiality of £1 million which represents 2% of operating costs

Independent Auditor's report *continued* to the members of Mereo BioPharma Group plc

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Risk of undetected impairment of intangible assets Refer to the accounting policies (page 46) and Note 12 of the consolidated financial statements (page 58). The Group has significant intangible assets arising from the acquisition of products in development. Recoverability of these assets is based on forecasting and discounting future cash flows, which are inherently highly judgmental. For products in development, the main judgment is achieving successful trial results and obtaining required clinical and regulatory approvals. The risk is that there may be errors in these judgments. The risk has decreased in the current year due to the progression of the development programs.	Our principal audit procedures included: » evaluating the Group's assumptions used in assessing the recoverability of intangible assets, in particular, revenue and cash flow projections, the probability of obtaining regulatory approval and the weighted average cost of capital; » performing sensitivity analyses over individual intangible asset models, to assess the level of sensitivity to key assumptions, and focused our work in those areas; » assessing the reasonableness of the Group's assumptions regarding probability of obtaining regulatory approval through consideration of the current phase of development and comparison to industry practice; » interviewing key R&D personnel to corroborate the assumptions used; » evaluating the WACC, with the assistance of EY valuations specialists; » challenging management's key assumptions regarding the size of the therapeutic area market and the product's projected share of this market through comparison to external scientific literature and market research; » challenging internally generated evidence by reviewing analyst forecasts, and retrospective assessment of the accuracy of the Group's projections; and » assessing the adequacy of related disclosures in the Group's financial statements.	We have concluded that the assumptions made by management are reasonable with no impairment issues having been identified.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
AZD-9668 license acquisition and future financial commitments The acquisition of the license for AZD-9668 in the year was significant to our audit due to the importance of the transaction to the Group and due to significant judgments and assumptions involved in the recognition and measurement of potential future payments to the vendor in the form of cash and shares. The value of the intangible asset recognized as at December 31, 2017 is £7.2 million and the deferred consideration is recorded as £2.1 million within "Provisions" (Note 19) and £1.3 million within "Other Capital Reserves" (Note 17). The risk is new in the year.	We read the legal agreements connected with the transaction to understand how the transaction was constructed and the obligations involved. We focused our audit on the accounting treatment of the initial and deferred consideration, which included: » agreeing upfront cash consideration to bank statements and shares issued to the share register; » understanding how the Company had determined the probability of success for each milestone, which we then corroborated to externally available data; » reperforming the probability-adjusted calculations of the deferred cash consideration element; » testing the recording of the deferred share consideration; and » evaluating the completeness and adequacy of the disclosures in the financial statements.	We concur with the accounting treatment and that the various elements of the deferred consideration are appropriately measured and disclosed.

An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for each entity within the Group. Taken together, this enables us to form an opinion on the consolidated financial statements. We take into account size, risk profile, the organization of the Group, changes in the business environment and other factors such as local statutory reporting requirements when assessing the level of work to be performed at each entity.

We performed audit procedures accounting for 100% (2016: 100%) of the Group's operating costs and 100% (2016: 100%) of the Group's total assets. All audit procedures were undertaken by the central U.K. audit team.

Changes from the prior year

The addition of Mereo BioPharma 4 Limited to the Group during the year represents the only change in scope from the prior year. Mereo BioPharma 4 was included as a full scope component.

Involvement with component teams

All audit work performed for the purposes of the audit was undertaken by the Group audit team.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Group to be £1 million (2016: £0.7 million), which is 2% (2016: 2%) of operating costs. We believe that operating costs provide us with an appropriate basis upon which to set materiality, since the Group is in the development stage of its life cycle and is investing in R&D, with no operating income to date.

We determined materiality for the parent company to be £4.1 million (2016: £3.5 million), which is 3% (2016: 3%) of equity. Materiality for the parent company is higher than the Group, due to the underlying basis on which it is calculated. The parent company's purpose is to raise funds to finance the Group's operations, and therefore we believe equity is the most suitable basis on which to calculate materiality.

Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgment was that performance materiality was 50% (2016: 50%) of our planning materiality, namely £0.5 million (2016: £0.3 million). We have set performance materiality at this percentage due to the rate of change in the business and existence of audit differences in the previous year.

Independent Auditor's report *continued* to the members of Mereo BioPharma Group plc

An overview of the scope of our audit continued

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.05 million (2016: £0.03 million), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

The other information comprises the information included in the annual report set out on pages 1 to 36, other than the financial statements and our Auditor's Report thereon. The Directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and Directors' Report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

In light of the knowledge and understanding of the Group and the parent company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or the Directors' Report.

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

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

Responsibilities of directors

As explained more fully in the Statement of Directors' Responsibilities set out on page 36, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group and parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an Auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (U.K.) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our Auditor's Report.

Ernst & Young LLP

David Hales (Senior Statutory Auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
Reading
March 22, 2018

Notes:

(1) The maintenance and integrity of the Mereo BioPharma Group plc website is the responsibility of the directors; the work carried out by the Auditor does not involve consideration of these matters and, accordingly, the Auditor accepts no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

(2) Legislation in the U.K. governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Consolidated statement of comprehensive loss for the year ended December 31, 2017

	Notes	Year ended December 31, 2017 £	Year ended December 31, 2016 £
R&D expenses		**(34,606,649)**	(24,562,502)
Administrative expenses		**(10,697,194)**	(11,616,816)
Operating loss	8.4	**(45,303,843)**	(36,179,318)
Finance income	8.1	**826,855**	374,906
Finance charge		**(1,089,925)**	(179,765)
Net foreign exchange (loss)/gain		**(1,384,225)**	2,262,626
Loss before tax		**(46,951,138)**	(33,721,551)
Taxation	9	**8,152,084**	5,331,271
Loss attributable to equity holders of the parent		**(38,799,054)**	(28,390,280)
Other comprehensive income for the year, net of tax		**–**	–
Total comprehensive loss for the year, net of tax and attributable to the equity holders of the parent		**(38,799,054)**	(28,390,280)
Basic and diluted loss per share	10	**(£0.56)**	(£0.63)
Non-GAAP measure			
Adjusted loss per share	10	**(0.47)**	(0.51)

Consolidated balance sheet as at December 31, 2017

	Notes	December 31, 2017 £	December 31, 2016 £
Assets			
Non-current assets			
Property, plant and equipment	11	**153,361**	173,869
Intangible assets	12	**33,005,229**	25,812,941
		33,158,590	25,986,810
Current assets			
Prepayments		**1,970,781**	1,102,146
R&D tax credits	9	**8,152,084**	5,331,271
Other receivables	14	**509,350**	767,009
Short-term investments	16	**2,500,000**	–
Cash and short-term deposits	15	**50,044,672**	53,577,571
		63,176,887	60,777,997
Total assets		**96,335,477**	86,764,807
Equity and liabilities			
Equity			
Issued capital	17	**213,285**	193,022
Share premium	17	**118,226,956**	99,975,399
Other capital reserves	17	**16,359,169**	12,667,562
Other reserves	17	**7,000,000**	7,000,000
Accumulated loss		**(79,315,920)**	(40,579,241)
Total equity		**62,483,490**	79,256,742
Non-current liabilities			
Provisions	19	**4,075,386**	1,172,420
Interest-bearing loans and borrowings	18	**18,812,511**	3,126,526
Warrant liability	20	**1,346,484**	–
		24,234,381	4,298,946
Current liabilities			
Trade and other payables	21	**3,024,026**	1,121,107
Accruals		**4,379,774**	2,088,012
Provisions	19	**274,000**	–
Interest-bearing loans and borrowings	18	**1,939,806**	–
		9,617,606	3,209,119
Total liabilities		**33,851,987**	7,508,065
Total equity and liabilities		**96,335,477**	86,764,807

Approved by the Board on March 22, 2018 and signed on its behalf by

Dr. Denise Scots-Knight
Director

Richard Jones
Director

Company number: 9481161 (England and Wales)

Consolidated statement of cash flows for the year ended December 31, 2017

	Notes	December 31, 2017 £	December 31, 2016 £
Operating activities			
Loss before tax		**(46,951,138)**	(33,721,551)
Adjustments to reconcile loss before tax to net cash flows:			
Depreciation of property, plant and equipment	11	**36,076**	32,940
Share-based payment expense	24	**3,651,898**	6,494,018
Net foreign exchange loss/(gain)		**1,384,225**	(2,262,626)
Provision for social security contributions on employee share options		**1,115,966**	1,031,109
Interest earned	8.1	**(826,855)**	(374,906)
Loss on short-term deposits	8.2	**338,279**	–
Accrued interest on convertible loan	8.2	**103,115**	179,765
Transaction costs on bank loan	8.2	**200,000**	–
Interest on bank loan	8.2	**327,123**	–
Accreted interest on bank loan	8.2	**66,935**	–
Warrant fair value adjustment	8.2	**54,473**	–
Working capital adjustments:			
Increase in receivables		**(839,751)**	(1,219,202)
Increase/(decrease) in payables		**3,860,412**	(768,402)
Tax received		**5,331,271**	946,681
Net cash flows from operating activities		**(32,147,971)**	(29,662,174)
Investing activities			
Purchase of property, plant and equipment	11	**(15,568)**	(3,467)
Purchase of license	12	**(2,280,000)**	–
Disposal of property, plant and equipment	11	**–**	1,175
Short-term investments	16	**(2,500,000)**	–
Interest earned		**1,051,620**	374,906
Net cash flows used in investing activities		**(3,743,948)**	372,614
Financing activities			
Proceeds from issue of ordinary shares	17	**15,000,000**	67,888,820
Transaction costs on issue of shares	17	**(729,632)**	(2,995,864)
Proceeds from issue of convertible loan	18a	**–**	3,463,563
Proceeds from issue of bank loan	18b	**20,000,000**	–
Transaction costs on bank loan		**(200,000)**	–
Interest paid on bank loan		**(327,123)**	–
Net cash flows from financing activities		**33,743,245**	68,356,519
Net (decrease)/increase in cash and cash equivalents		**(2,148,674)**	39,066,959
Cash and cash equivalents at January 1		**53,577,571**	12,247,986
Effect of exchange rate changes on cash and cash equivalents		**(1,384,225)**	2,262,626
Cash and cash equivalents at December 31	15	**50,044,672**	53,577,571

Significant non-cash transaction

During the year, 588,532 shares were issued to Novartis Pharma AG (for nil consideration), The fair value of these was £1.84 per share.

During the year, 490,798 shares were issued to AstraZeneca AB (for nil consideration), The fair value of these was £3.097 per share.

Consolidated statement of changes in equity for the year ended December 31, 2017

	Issued capital £	Share premium £	Other capital reserves £	Other reserves £	Accumulated losses £	Total equity £
At December 31, 2015	59,221	26,212,880	21,660,105	—	(12,188,961)	35,743,245
Loss for the year to December 31, 2016	—	—	—	—	(28,390,280)	(28,390,280)
Issue of share capital (Note 17)	107,709	67,781,112	—	—	—	67,888,821
Share-based payments – share options (Note 24)	—	—	6,185,067	—	—	6,185,067
Share-based payments – LTIPs (Note 24)	—	—	133,601	—	—	133,601
Share-based payments – deferred bonus shares (Note 24)	—	—	175,350	—	—	175,350
Redemption of shares to be issued (Note 17)	26,092	15,977,271	(16,003,363)	—	—	—
Equity element of convertible loan (Note 18a)	—	—	516,802	—	—	516,802
Share capital reduction (Note 17)	—	(7,000,000)	—	7,000,000	—	—
Transaction costs on issuance of share capital (Note 17)	—	(2,995,864)	—	—	—	(2,995,864)
At December 31, 2016	193,022	99,975,399	12,667,562	7,000,000	(40,579,241)	79,256,742
Loss for the year to December 31, 2017	—	—	—	—	(38,799,054)	(38,799,054)
Share-based payments – share options (Note 24)	—	—	3,027,963	—	—	3,027,963
Share-based payments – LTIPs (Note 24)	—	—	298,287	—	—	298,287
Share-based payments – deferred bonus shares (Note 24)	—	—	325,648	—	—	325,648
Share-based payments – deferred equity consideration (Note 24)	—	—	1,331,288	—	—	1,331,288
Issue of share capital on April 4, 2017 (Note 17)	15,125	14,984,875	—	—	—	15,000,000
Issue of share capital on conversion of loan note (Note 17)	1,899	1,396,654	—	—	—	1,398,553
Issue of share capital for Novartis bonus shares (Note 17)	1,766	1,081,133	(1,082,899)	—	—	—
Equity element of convertible loan (Note 18a)	—	—	(208,680)	—	—	(208,680)
Conversion of convertible loan (Note 18a)	—	—	—	—	62,375	62,375
Issue of share capital on October 31, 2017 (Note 17)	1,473	1,518,527	—	—	—	1,520,000
Transaction costs on issuance of share capital (Note 17)	—	(729,632)	—	—	—	(729,632)
At December 31, 2017	**213,285**	**118,226,956**	**16,359,169**	**7,000,000**	**(79,315,920)**	**62,483,490**

1. Corporate information

Mereo BioPharma Group plc (the "Company") is a multi-asset biopharmaceutical company focused on the acquisition, development and commercialization of innovative therapeutics that aim to improve outcomes for patients with rare and specialty diseases.

The Company is a public limited company incorporated and domiciled in the U.K., and registered in England, with our shares publicly traded on the Alternative Investment Market of the London Stock Exchange. Our registered office is located at Fourth Floor, 1 Cavendish Place, London W1G 0QF.

The consolidated financial statements of Mereo BioPharma Group plc and its subsidiaries (collectively, the "Group") for the year ended December 31, 2017 were authorized for issue in accordance with a resolution of the directors on March 22, 2018.

2. Significant accounting policies

2.1 Basis of preparation

The Group's annual financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and adopted by the E.U. and in accordance with the Companies Act 2006.

The financial information is presented in Sterling.

2.2 Revision of previously issued financial statements

We have reclassified the capital reduction undertaken in 2016 resulting in the reduction of the accumulated losses by £7.0 million and the crediting a new Other reserves by the same amount as set out in the Consolidated balance sheet and in the Consolidated statement of changes in equity.

We have revised our consolidated statement of cash flows for the year ended December 31, 2016. Net foreign exchange gains amounting to £2.3 million related to cash balances held in U.S. dollars were not included in the adjustments to reconcile loss before tax to net cash flows. The revision resulted in an increase in net cash flows used in operating activities by £2.3 million and the addition of the effect of foreign exchange rates in cash and cash equivalents reconciliation by the same amount.

2.3 Going concern

Though the Group continues to make losses, the directors believe it is appropriate to prepare the financial information on the going concern basis. This is because the Group's research into new products continues to progress according to plan and the funding secured to date will allow it to meet its liabilities as they fall due for at least 12 months from the date of authorization for the issue of these consolidated financial statements.

2.4 Basis of consolidation

The consolidated financial information comprises the financial statements of Mereo BioPharma Group plc and its subsidiaries as at December 31, 2017. Subsidiaries are all entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases. Intercompany transactions, balances and unrealized gains on transactions between Group companies are eliminated in preparing the consolidated financial statements. Accounting policies of subsidiaries are consistent with the policies adopted by the Group.

The Company has an employee share trust to facilitate share transactions pursuant to employee share schemes. Although the trust is a separate legal entity from the Group, it is consolidated into the Group's results in accordance with the IFRS 10 rules on special purpose vehicles. The Company is deemed to control the trust principally because the trust cannot operate without the funding the Group provides.

All Group subsidiaries prepare yearly financial information to December 31 consistent with the Company.

2.5 Changes of accounting policies

a) Segment reporting

Effective in the third quarter of 2017 and following the completion of the exclusive license agreement with AstraZeneca for AZD-9668, the Company has revised its policy and now reports as a single operating segment (see Note 4).

b) Other reserves

Other reserves arose on the reduction of the share premium. These reserves are available for distribution to shareholders in the future at a time when the Company has sufficient accumulated realized profits to make a distribution.

2. Significant accounting policies continued

2.6 Summary of significant accounting policies

a) Taxes

Current income tax

Current income tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities, and include R&D tax credits receivable under the HM Revenue and Customs (HMRC) small or medium enterprise (SME) scheme, which provides additional taxation relief for qualifying expenditure on R&D activities, and allows for the surrender of tax losses in exchange for a cash payment from HMRC.

Current income tax relating to items recognized directly in equity is recognized in equity and not in the statement of comprehensive loss.

Income tax credit

The Group benefits from the U.K. R&D tax credit regime whereby a portion of the Group's losses can be surrendered for a cash rebate of up to 33.35% of eligible expenditures. Such credits are accounted for within the tax provision, in the year in which the expenditures were incurred.

Deferred tax

Deferred tax is provided using the liability method on temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the reporting date.

Deferred income tax assets are recognized for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carry-forward of unused tax credits and unused tax losses can be utilized. The carrying amount of deferred income tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Unrecognized deferred income tax assets are reassessed at the end of each reporting period and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured on an undiscounted basis at the tax rates that are expected to apply to the year when the asset is realized, based on tax rates (and tax laws) enacted or substantively enacted at the end of the reporting period.

b) Foreign currencies

The functional currency of the Company and its subsidiaries is Sterling. Transactions in foreign currencies are initially recorded by the Group's entities at the rate ruling on the date the transaction first qualifies for recognition.

Differences arising on settlement or translation of monetary items are recognized in profit or loss.

Gains or losses on the retranslation of foreign currency balances at the year end are recognized in the consolidated statement of comprehensive loss under net foreign exchange gains/(losses).

c) Property, plant and equipment

Property, plant and equipment is stated at cost, net of accumulated depreciation and accumulated impairment losses, if any. Such cost includes the cost of replacing part of the plant and equipment if the recognition criteria are met. All other repair and maintenance costs are recognized in profit or loss as incurred.

Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, as follows:

- Leasehold improvements — ten years
- Office equipment — five years
- IT equipment — three years

An item of property, plant and equipment and any significant part initially recognized is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the statement of comprehensive loss when the asset is derecognized.

The residual values, useful lives and methods of depreciation of property, plant and equipment are reviewed at each financial year end and adjusted prospectively, if appropriate.

2. Significant accounting policies continued

2.6 Summary of significant accounting policies continued

d) Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the statement of comprehensive loss on a straight-line basis over the period of the lease.

The Group leases its premises (see Note 25). The Company recognizes any lease incentives on a straight-line basis over the entire period of the lease, assuming that any break clauses available will not be exercised. By not exercising any break clauses, the Group receives a 50% rent discount from the landlord for a fixed period of time as described in Note 25.

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at the inception date. The arrangement is assessed for whether fulfilment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset or assets, even if that right is not explicitly specified in an arrangement.

e) Intangible assets

Intangible assets, relating to intellectual property rights acquired through licensing or assigning patents and know-how, are initially recognized at cost which has been determined as the fair value of the consideration paid and payable. Consideration comprises cash paid together with the net present value of any provision for deferred cash consideration (see Note 2p) and the fair value of consideration settled in shares. The fair value of consideration is regularly reviewed based on the probability of achieving the contractual milestones. Where share transfer occurs, the cost is measured at fair value of the shares issued or to be issued in accordance with IFRS 2. Intangible assets are held at cost less accumulated amortization and provision for impairment, if any. Where a finite useful life of the acquired intangible asset cannot be determined or the intangible asset is not yet available for use, the asset is tested annually for impairment by allocating the assets to the cash-generating units to which they relate. Amortization would commence when product candidates underpinned by the intellectual property rights become available for commercial use. No amortization has been charged to date, as the product candidates underpinned by the intellectual property rights are not yet available for commercial use.

f) Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- in the principal market for the asset or liability; or
- in the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Group.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 — quoted (unadjusted) market prices in active markets for identical assets or liabilities
- Level 2 — valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable
- Level 3 — valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

For assets and liabilities that are recognized in the financial statements on a recurring basis, the Group determines whether transfers have occurred between levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

2. Significant accounting policies continued

2.6 Summary of significant accounting policies continued

g) Impairment of non-financial assets

Further disclosures relating to impairment of non-financial assets are also provided in the following Notes:

- Disclosures for significant assumptions — Note 3
- Property, plant and equipment — Note 11
- Intangible assets not yet available for use — Notes 12 and 13

The Group assesses, at each reporting date, whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's (CGU) fair value less costs of disposal and its value in use. The recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. When the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs of disposal, recent market transactions are taken into account. If no such transactions can be identified, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded companies or other available fair value indicators.

Impairment losses are recognized in the statement of comprehensive loss in expense categories consistent with the function of the impaired asset.

An assessment is made at each reporting date to determine whether there is an indication that previously recognized impairment losses no longer exist or have decreased. If such indication exists, the Group estimates the asset's or CGU's recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognized. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the statement of comprehensive loss unless the asset is carried at a revalued amount, in which case the reversal is treated as a revaluation increase.

Intangible assets not yet available for use are tested for impairment annually as at December 31 at the CGU level, as appropriate, and when circumstances indicate that the carrying value may be impaired. An impairment test was performed at December 31, 2017.

h) Cash and short-term deposits

Cash and short-term deposits in the balance sheet comprise cash at banks and on hand and short-term deposits with a maturity of three months or less, which are subject to an insignificant risk of changes in value.

i) Short-term investments

Cash on deposit for terms greater than three months are recognized at fair value in the balance sheet.

j) Provisions

General

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. When the Group expects some or all of a provision to be reimbursed, for example, under an insurance contract, the reimbursement is recognized as a separate asset, but only when the reimbursement is virtually certain. The expense relating to a provision is presented in the statement of comprehensive loss net of any reimbursement.

If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, when appropriate, the risks specific to the liability. When discounting is used, the increase in the provision due to the passage of time is recognized as a finance cost.

2. Significant accounting policies continued

2.6 Summary of significant accounting policies continued

k) Share-based payments

Employees (including senior executives) of the Group receive remuneration in the form of share-based payments, whereby employees render services as consideration for equity instruments (equity settled transactions).

Incentives in the form of shares are provided to employees under the Share Option Plan. Executive Officers are also provided with shares under a deferred bonus share plan ("DBSP Plan") and a long-term incentive plan ("LTIP Plan"). In accordance with IFRS 2 Share-based Payment ("IFRS 2"), charges for these incentives are expensed through the consolidated statement of comprehensive loss on a straight-line basis over their vesting period, based on the Group's estimate of shares that will eventually vest. The total amount to be expensed is determined by reference to the fair value of the options or awards at the date they were granted. For LTIP shares, the fair value excludes the impact of any non-market vesting conditions. The fair value of LTIP shares, which have market conditions attached, includes an adjustment based on the probability of the shares vesting at the end of the vesting period.

Under the 2015 plan, options were historically awarded to employees, NEDs and certain consultants. Share options awarded to non-employees under the 2015 plan are accounted for as options awarded to employees as the value of non-employee services could be readily determined.

In accordance with IFRS 2, the cancellation of share options is accounted for as an acceleration of the vesting period and therefore any amount unrecognized that would otherwise have been charged in future accounting periods is recognized immediately. When options are forfeited, the accounting expense for any unvested awards is reversed.

Purchases, where consideration is satisfied by issuing equity shares is accounted for as equity settled share-based payment transactions in accordance with IFRS 2. Fair value is determined by the share price at the date of purchase.

l) Costs of issuing capital

The Group deducts directly attributable costs of issuing capital from the proceeds in accordance with IAS 39 Financial Instruments: Recognition and Measurement. Incremental costs incurred and directly attributable to the offering of equity securities are deducted from the related proceeds of the offering. The net amount is recorded as share premium in the period when such shares are issued. Where such expenses are incurred prior to the offering they are recorded in prepayments until the offering completes. Other costs incurred in such offerings are expensed as incurred and included in general and administrative expenses.

m) Convertible loan instrument

Convertible loan notes are regarded as compound instruments consisting of a liability component and an equity component. At the date of issue the fair value of the liability component is estimated using a discount rate for an equivalent liability without the conversion feature. The difference between the proceeds of issue of the convertible loan note and the fair value assigned to the liability component, representing the embedded option to convert the liability into equity of the Group, is included in equity.

An exchange between an existing borrower and lender of debt instruments with substantially different terms are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability as per IAS 39 and IFRS 9. Similarly, a substantial modification of the terms of an existing financial liability, or a part of it, (whether or not due to the financial difficulty of the debtor) should be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

In line with IAS 39 the terms of exchanged or modified debt are regarded as substantially different if the net present value of the cash flows under the new terms (including any fees paid net of any fees received) discounted at the original effective interest rate is at least 10% different from the discounted present value of the remaining cash flows of the original debt instrument. Where such modifications are less than 10% different, the effective interest rate is adjusted to take account of the new terms.

2. Significant accounting policies continued

2.6 Summary of significant accounting policies continued

n) Employee Benefit Trust

The Group operates an Employee Benefit Trust (EBT): Mereo BioPharma Group plc Employee Benefit Trust.

The EBT has been established to fulfil awards made under the Deferred Bonus Share Plan and the Long Term Incentive Plan. The EBT is a Jersey-based trust which is funded by a loan from the Company, which it will utilize to buy shares at nominal value from the Company in sufficient quantity to fulfil the envisaged awards. The EBT will acquire shares in the Company and these will be deducted from the shareholders' funds on the consolidated balance sheet at the cost of acquisition less proceeds on disposal.

In compliance with IAS 32 Financial Instruments: Presentation Group, shares held by the EBT are included in the consolidated balance sheet as a reduction in equity. Gains and losses on Group shares are recognized directly in equity.

The Group consolidated accounts treat the EBT as a wholly owned subsidiary company. Residual cash within the EBT is classified as a debtor (restricted cash) since it is not readily accessible by the Group.

o) R&D costs

Expenditure on product development is capitalized as an intangible asset and amortized over the expected useful economic life of the product candidate concerned. Capitalization commences from the point at which technical feasibility and commercial viability of the product candidate can be demonstrated and the Group is satisfied that it is probable that future economic benefits will result from the product candidate once completed. Capitalization ceases when the product candidate receives regulatory approval for launch. No such costs have been capitalized to date.

Expenditure on R&D activities that do not meet the above criteria, including ongoing costs associated with acquired intellectual property rights and intellectual property rights generated internally by the Group, is charged to the statement of comprehensive loss as incurred. Intellectual property and in-process R&D from asset acquisitions are recognized as intangible assets at cost.

p) Provision for deferred cash consideration

Provision for deferred cash consideration consists of future payments which are contractually committed but not yet certain. In respect of products which are not yet approved, such deferred cash consideration excludes potential milestones, royalties or other payments that are deemed to be so uncertain as to be unquantifiable. Deferred cash consideration is recognized as a liability with the amounts calculated as the risk adjusted net present value of anticipated deferred payments.

The provision is reviewed at each balance sheet date and adjusted based on the likelihood of contractual milestones being achieved and therefore the deferred payment being settled. Increases in the provision relating to changes in the probability are recognized as an intangible asset. Increases in the provision relating to the unwinding of the time value of money are recognized as a finance expense.

q) Bank loan and associated warrants

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortized cost using the effective interest rate (EIR) method. The EIR amortization is included as a finance charge in the statement of comprehensive loss. This category applies to interest-bearing borrowings, trade and other payables.

Associated warrants are measured at fair value with changes recorded through the statement of comprehensive loss (see Note 20).

3. Significant accounting judgments, estimates and assumptions

The preparation of the consolidated accounts requires the management of the Group to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. The Group bases its estimates and judgments on historical experience and on various other assumptions that it considers to be reasonable. Actual results may differ from these estimates under different assumptions or conditions.

Share-based compensation

Incentives in the form of shares are provided to employees under a share option plan, long-term incentive plan and deferred bonus share plan. The fair value of the employee services received in exchange for the grant of the options is recognized as an expense. The expense is based upon a number of assumptions disclosed in Note 24. The selection of different assumptions could affect the results of the Group.

3. Significant accounting judgments, estimates and assumptions continued

Impairment of intangible assets and property, plant and equipment

An assessment was made in respect of indicators of impairment in the carrying value of the Group's intangible assets (see Note 13) and leasehold improvements, office equipment and IT equipment as at December 31, 2017. If such an indication exists, the recoverable amount of the asset, being the higher of the asset's fair value less costs to sell and value in use, is compared to the asset's carrying value. Any excess of the asset's carrying value over its recoverable amount is expensed to the income statement. The assessment of intangible assets involves a number of judgments regarding the likelihood of successful product approval, the costs of reaching approval and the subsequent commercial profitability of the product once approved.

Deferred license consideration

Deferred consideration in the form of cash is recognized as a provision at each balance sheet date, to the extent its amount is quantifiable at the inception of the arrangement. The amount provided is based on a number of judgments regarding the timing and progress of the related research.

Deferred consideration in the form of shares is recognized as a share-based payment when it is probable that shares will be transferred.

Bank loan and associated warrants

As part of the bank loan the Group has issued warrants to subscribe for shares. The fair value of the warrants issued is assessed at each balance sheet date based upon a number of assumptions, as disclosed in Note 20.

4. Segment information

The consolidation of product candidates into a single segment follows management's view of the business as a single portfolio of product candidates. R&D expenses only are monitored at a product candidate level, however the Chief Operating Decision Maker (CODM) makes decisions over resource allocation at an overall portfolio level. The Group's financing is managed and monitored on a consolidated basis. All non-current assets held by the Group are located in the U.K.

The Company's CODM is the executive management team (comprised of the Chief Executive Officer, Chief Financial Officer, Chief Medical Officer, General Counsel and the Head of Corporate Development) which manages the operating results of the business.

5. Group information

Information about subsidiaries

The consolidated financial statements of the Group include:

Name	Principal activities	Country of incorporation	**% equity interest December 31, 2017**	% equity interest December 31, 2016
Mereo BioPharma 1 Limited	Pharmaceutical R&D	U.K.	**100**	100
Mereo BioPharma 2 Limited	Pharmaceutical R&D	U.K.	**100**	100
Mereo BioPharma 3 Limited	Pharmaceutical R&D	U.K.	**100**	100
Mereo BioPharma 4 Limited	Pharmaceutical R&D	U.K.	**100**	–
Mereo BioPharma Group plc Employee Benefit Trust	Employee share scheme	Jersey	**–**	–

The registered office of Mereo BioPharma 1 Limited, Mereo BioPharma 2 Limited, Mereo BioPharma 3 Limited and Mereo BioPharma 4 Limited is located at Fourth Floor, 1 Cavendish Place, London W1G 0QF.

Mereo BioPharma 1 Limited, Mereo BioPharma 2 Limited, Mereo BioPharma 3 Limited and Mereo BioPharma 4 Limited each have issued share capital of one ordinary share of £1 fully paid or credited as fully paid, totaling £4.

Under IFRS, the Employee Benefit Trust is treated as a wholly owned subsidiary company.

Notes to the financial statements *continued*

6. Auditor's remuneration

During the year the Group obtained the following services from the Auditor and its associates:

	Year ended December 31, 2017 £	Year ended December 31, 2016 £
Audit of Group accounts	**178,457**	50,000
Audit of subsidiary accounts	**21,000**	20,000
Audit-related assurance services	**—**	10,000
Corporate finance transaction services	**—**	169,196
Accounting advisory services	**2,500**	—
Total	**201,957**	249,196

7. Employees and directors

The average monthly number of persons (including executive directors) employed by the Group and Company during the year was:

	Year ended December 31, 2017 Number	Year ended December 31, 2016 Number
By activity		
Office and management	**18**	16
R&D	**10**	7
Total	**28**	23

The Group contributes to defined contribution pension schemes for its executive directors and employees. Contributions of £19,375 (2016: £13,001) were payable to the funds at the year end.

The details of directors of Mereo BioPharma Group plc who received emoluments from the Group and Company are shown in the table below:

	Year ended December 31, 2017 £	Year ended December 31, 2016 £
Salaries and fees	**962,658**	923,000
Benefits in kind	**12,784**	11,210
Pension contributions	**34,507**	57,000
Bonus	**408,975**	347,212
Total	**1,418,924**	1,338,422

Full details of the directors' remuneration and directors' options are contained in the Directors' Remuneration Report. The audited directors' remuneration is included under the heading "Directors' remuneration for the year ended December 31, 2017" on page 32, "Directors' share interests for the year ended December 31, 2017" on page 32, and "Directors' interests in the share capital of the Company" on page 33. No other information included in the Directors' Remuneration Report is subject to audit.

7. Employees and directors continued

Compensation of key management personnel of the Group

Key management includes directors (executive and non-executive) and executive officers, the General Counsel, the Chief Medical Officer and the Head of Corporate Development. The compensation paid or payable to key management is set out below:

	Year ended December 31, 2017 £	Year ended December 31, 2016 £
Short-term benefits	**2,756,979**	2,111,712
Post-employment benefits	**87,269**	106,500
IFRS 2 share-based payment charge	**2,726,337**	4,631,853
Total compensation paid to key management personnel	**5,570,585**	6,850,065

8. Other income/expenses and adjustments

8.1. Finance income

	Year ended December 31, 2017 £	Year ended December 31, 2016 £
Bank interest earned	**826,855**	374,906

8.2. Finance charge

	Year ended December 31, 2017 £	Year ended December 31, 2016 £
Interest payable on convertible loan	**(103,115)**	(179,765)
Interest payable on bank loan	**(327,123)**	–
Accreted interest on bank loan	**(66,935)**	–
Transaction costs on bank loan	**(200,000)**	–
Loss on short-term deposits	**(338,279)**	–
Change in warrant fair value	**(54,473)**	–
Total	**(1,089,925)**	(179,765)

Notes to the financial statements *continued*

8. Other income/expenses and adjustments continued

8.3. Employee benefits expense

	December 31, 2017 £	December 31, 2016 £
Included in R&D expenses:		
Salaries	**1,640,373**	1,150,222
Social security costs	**420,417**	344,467
Pension contributions	**77,425**	50,864
Share-based payment expense	**822,173**	1,550,884
Included in administrative expenses:		
Salaries	**2,253,393**	2,132,920
Social security costs	**1,159,548**	1,040,409
Pension contributions	**96,598**	109,187
Share-based payment expense	**2,829,725**	4,943,133
Total employee benefits expense	**9,299,652**	11,322,086

8.4. Operating loss

	Year ended December 31, 2017 £	Year ended December 31, 2016 £
Employee benefits expense (Note 8.3)	**9,299,652**	11,322,086
Externally contracted R&D	**31,321,355**	21,417,083
Legal and professional fees including patent costs	**683,668**	782,492
Operating lease expense	**293,328**	293,328
Depreciation	**36,076**	33,397
Other expenses	**3,669,764**	2,330,932
Total operating loss	**45,303,843**	36,179,318

9. Income tax

The Group is entitled to claim tax credits in the U.K. under the U.K. R&D small or medium-sized enterprise (SME) scheme, which provides additional taxation relief for qualifying expenditure on R&D activities and includes an option to surrender a portion of tax losses arising from qualifying activities in return for a cash payment from HM Revenue & Customs (HMRC). The claims in respect of the year ended December 31, 2016 were received by the Group in May 2017. The year ended December 31, 2017 amounts have not yet been agreed with the relevant tax authorities.

	Year ended December 31, 2017 £	Year ended December 31, 2016 £
U.K. corporation tax R&D credit	**8,152,084**	5,331,271
Income tax credit	**8,152,084**	5,331,271

9. Income tax continued

The charge for the year can be reconciled to the loss per the income statement as follows:

	Year ended December 31, 2017 £	Year ended December 31, 2016 £
Loss on ordinary activities before income tax	**(46,951,138)**	(33,721,551)
Loss on ordinary activities before tax at the U.K.'s statutory income tax rate of 19.25% (2016: 20.00%)	**9,038,094**	6,744,310
Expenses not deductible for tax purposes (permanent differences)	**(14,316)**	(15,116)
Temporary timing differences	**(711,677)**	(1,300,044)
R&D relief uplift	**3,447,474**	2,134,107
Losses (unrecognized)	**(3,784,801)**	(2,231,986)
Deferred income from MBG loan guarantee costs	**177,310**	–
Tax credit for the year	**8,152,084**	5,331,271

At December 31, 2017 the Group had tax losses to be carried forward of approximately £36,010,916 (2016: £16,343,508).

Deferred tax

Deferred tax relates to the following:

	December 31, 2017 £	December 31, 2016 £
Losses	**6,121,400**	2,778,396
Accelerated capital allowances	**–**	(9,883)
Other	**–**	2,210
Temporary differences trading	**2,266,798**	–
Net deferred tax asset	**8,388,198**	2,770,723

The deferred tax asset has not been recognized as there is uncertainty regarding when suitable future profits against which to offset the accumulated tax losses will arise. There is no expiration date for the accumulated tax losses.

A reduction in the rate of U.K. corporation tax to 19% from April 1, 2017 and to 17% from April 1, 2020 has been substantively enacted. The standard rate of corporation tax applied to reported loss is 19.25% (2016: 20.00%) and any U.K. deferred tax assets and liabilities would be recognized at a rate of 17%.

Notes to the financial statements *continued*

10. Loss per share

Basic loss per share is calculated by dividing the loss attributable for the year to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year. As net losses from continuing operations were recorded in the year, the dilutive potential shares are anti-dilutive for the earnings per share calculation.

	Year ended December 31, 2017			Year ended December 31, 2016		
	Loss £	**Weighted shares number**	**Loss per share £**	Loss £	Weighted shares number	Loss per share £
IFRS – basic and diluted	**(38,799,054)**	**69,012,348**	**(0.56)**	(28,390,280)	44,789,893	(0.63)
Adjusted – basic and diluted	**(32,101,862)**	**69,012,348**	**(0.47)**	(22,956,976)	44,789,893	(0.51)

The Company operates share option schemes (see Note 24) which could potentially dilute basic earnings per share in the future. In addition there exist within equity 864,988 (2016: 1,453,520) shares to be issued which also have the potential to dilute basic earnings per share in the future (see Note 17).

As part of a license and option agreement with AstraZeneca (see Note 25), additional future payments of a maximum of 1,349,692 new ordinary shares would be payable on reaching certain clinical milestones.

Warrants totaling 696,490 were issued in 2017 that could potentially dilute basic earnings per share if converted.

There have been no other transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of authorization of these financial statements.

The non-GAAP (adjusted) loss is calculated after adding back non-recurring items and share-based payment charges as set out in the table below. The adjusted loss per share is calculated using the weighted average number of ordinary shares in issue during the year.

	Year ended December 31, 2017	Year ended December 31, 2016
Loss for the year	**(38,799,054)**	(28,390,280)
Share-based payments	**3,651,898**	6,494,018
Provision for social security on share options	**1,115,966**	1,031,109
Non-capitalized equity fundraising costs	**75,326**	45,000
One-off legal and professional fees	**131,538**	125,803
Acquisition of intangible assets	**338,239**	—
Net loss/(gain) on foreign exchange	**1,384,225**	(2,262,626)
Adjusted loss	**(32,101,862)**	(22,956,976)

11. Property, plant and equipment

	Leasehold improvements £	Office equipment £	IT equipment £	Total £
Cost or valuation				
At January 1, 2017	155,494	20,024	42,652	218,170
Additions	—	10,107	5,461	15,568
Disposals	—	—	—	—
At December 31, 2017	**155,494**	**30,131**	**48,113**	**233,738**
Depreciation and impairment				
At January 1, 2017	(21,174)	(5,340)	(17,787)	(44,301)
Disposals	—	—	—	—
Depreciation for the year	(15,549)	(5,386)	(15,141)	(36,076)
At December 31, 2017	**(36,723)**	**(10,726)**	**(32,928)**	**(80,377)**
Net book value				
At January 1, 2017	134,320	14,684	24,865	173,869
At December 31, 2017	**118,771**	**19,405**	**15,185**	**153,361**

	Leasehold improvements £	Office equipment £	IT equipment £	Total £
Cost or valuation				
At January 1, 2016	155,494	20,024	40,360	215,878
Additions	—	—	3,467	3,467
Disposals	—	—	(1,175)	(1,175)
At December 31, 2016	155,494	20,024	42,652	218,170
Depreciation and impairment				
At January 1, 2016	(5,625)	(1,335)	(4,401)	(11,361)
Disposals	—	—	457	457
Depreciation for the year	(15,549)	(4,005)	(13,843)	(33,397)
At December 31, 2016	(21,174)	(5,340)	(17,787)	(44,301)
Net book value				
At January 1, 2016	149,869	18,689	35,959	204,517
At December 31, 2016	134,320	14,684	24,865	173,869

12. Intangible assets

	Acquired development programs £
Cost at January 1, 2017	25,812,941
Additions	**7,192,288**
At December 31, 2017	**33,005,229**
Amortization and impairment	
At January 1, 2017	—
Impairment (Note 13)	—
At December 31, 2017	**—**
Net book value	
At January 1, 2017	25,812,941
At December 31, 2017	**33,005,229**

	Acquired development programs £
Cost at January 1, 2016 and December 31, 2016	25,812,941
Amortization and impairment	
At January 1, 2016	—
Impairment (Note 13)	—
At December 31, 2016	—
Net book value	
At January 1, 2016	25,812,941
At December 31, 2016	25,812,941

The Group's strategy is to acquire clinical-stage development programs for the treatment of specialty and rare diseases from large pharmaceutical companies.

On October 28, 2017, the Group acquired the exclusive license for AZD-9668 and included the option to acquire certain assets from AstraZeneca AB (AstraZeneca). AZD-9668 is being developed for the treatment of severe alpha-1 antitrypsin deficiency, at a cost of £7,192,288 as follows:

	Year ended December 31, 2017
Cash payment in October 2017	**2,280,000**
Equity issued (see Note 17)	**1,520,000**
Deferred equity consideration (see Note 24)	**1,331,288**
Present value of provision for deferred cash consideration (see Note 19)	**2,061,000**
	7,192,288

13. Impairment testing of acquired development programs not yet available for use

Acquired development programs not yet available for use are assessed annually for impairment.

The carrying amount of acquired development programs is as follows:

	As at December 31, 2017 £				
	BPS-804 (setrusumab)	**AZD-9668 (alvelestat)**	**BGS-649 (leflutrozole)**	**BCT-197 (acumapimod)**	**Total**
Acquired development programs	**11,615,824**	**7,192,288**	**9,886,356**	**4,310,761**	**33,005,229**

	As at December 31, 2016 £			
	BPS-804 (setrusumab)	BGS-649 (leflurtozole)	BCT-197 (acumapimod)	Total
Acquired development programs	11,615,824	9,886,356	4,310,761	25,812,941

The Group considers the future development costs, the probability of successfully progressing each program to product approval and likely commercial returns after product approval, among other factors, when reviewing for indicators of impairment. The results of this testing did not indicate any impairment of the acquired products' rights in the year to December 31, 2017. The directors believe that the likelihood of a materially different outcome using different assumptions is remote.

The acquired development programs are assets which are not used in launched products. These assets have not yet begun to be amortized but have been tested for impairment by assessing their value in use. Value in use calculations for each program are utilized to calculate the recoverable amount. The calculations use pre-tax cash flow projections covering the period through product development to commercial sales up to the later of loss of patent protection or market exclusivity, which extend beyond five years from the balance sheet date. Approved products are assumed to be out-licensed such that the Group receives signature fees, milestone receipts and royalties on sales; therefore, the Group does not incur any costs of commercialization after out-licensing.

Key assumptions for the value in use calculations are described as follows:

- development costs to obtain regulatory approval – costs are estimated net of any contributions expected from collaborative arrangements with future partners. The directors have developed cost estimates based on their previous experience and in conjunction with the expertise of their clinical development partners;
- launch dates of products – these reflect management's expected date of launch for products based on the timeline of development programs required to obtain regulatory approval. The assumptions are based on the directors' and clinical development partners' prior experience;
- probability of successful development – management estimates probabilities of success for each phase of development based on industry averages and knowledge of specific programs;
- out-licensing signature fees, milestones and royalty rates on sales – management estimates these amounts based on prior experience and access to values from similar transactions in the industry, which are collated and accessible from specialist third-party sources;
- sales projections – these are based on management's internal projections using external market data and market research commissioned by the Company;
- profit margins and other operational expenses – these are based on the Company's internal projections of current product manufacturing costings, with input from manufacturing partners where applicable, and estimates of operating costs based on management's prior industry experience;
- cash flow projections – the periods over which cash flows are forecast (based on the current patent protection periods relevant to the asset) are as follows:
  - BCT-197 – 18 years;
  - BGS-649 – 17 years;
  - BPS-804 – 14 years; and
  - AZD-9668 – 16 years; and
- discount rates – the discount rate is estimated on a pre-tax basis reflecting the estimated cost of capital of the Group and is applied consistently across each of the operating segments. The cost of capital was calculated at 15.3% (2016: 11.2%).

At this stage of product development, the key sensitivity for all three development programs is the probability of successful completion of clinical trials in order to obtain regulatory approval for sale. Therefore, full impairment of a development program is expected should such related trials be unsuccessful.

Notes to the financial statements *continued*

14. Other receivables

	December 31, 2017 £	December 31, 2016 £
Rent deposit	**293,328**	293,328
Accrued interest	**—**	228,775
VAT recoverable	**212,422**	241,306
Cash held by Employee Benefit Trust	**3,600**	3,600
	509,350	767,009

15. Cash and short-term deposits

	December 31, 2017 £	December 31, 2016 £
Cash at banks and on hand	**11,005,675**	421,292
Short-term deposits	**39,038,997**	53,156,279
	50,044,672	53,577,571

Cash at banks earns interest at floating rates based on daily bank deposit rates. Short-term deposits are available immediately and earn fixed interest at the respective short-term deposit rates and are held in a diversified portfolio of counter parties.

16. Short-term investments

	December 31, 2017 £	December 31, 2016 £
Short-term investments	**2,500,000**	—

Short-term investments consist of cash deposits held with greater than three month's term to maturity. None of these investments are held with terms greater than a year.

17. Issued capital and reserves

Ordinary share capital	Year ended December 31, 2017 £	Year ended December 31, 2016 £
Balance at beginning of year	**193,022**	59,221
Issuances in the year	**20,263**	133,801
Nominal share capital as at December 31	**213,285**	193,022

17. Issued capital and reserves continued

Ordinary shares of £0.003 each issued and fully paid

At January 1, 2017	**64,340,798**
Issued on April 3, 2017 for private financing round	**5,042,017**
Issued on April 26, 2017 for conversion of loan note	**1,221,361**
Issued on October 28, 2017 for acquisition of license	**490,798**
At December 31, 2017	**71,094,974**
Nominal value at December 31, 2017 (£)	**0.003**
Issued capital at December 31, 2017 (£)	**213,285**
Ordinary shares issued and fully paid	
At January 1, 2016	19,740,296
Issued on June 9, 2016 for private financing round	39,464,540
Issued on June 9, 2016 for private placement	5,135,962
At December 31, 2016	64,340,798
Nominal value at December 31, 2016 (£)	0.003
Issued capital at December 31, 2016 (£)	193,022

Since January 1, 2016, the following alterations to the Company's share capital have been made:

- under the subscription agreement dated July 28, 2015, as amended by an agreement dated June 1, 2016, the issue and allotment of 39,464,540 ordinary shares of £0.003 in nominal value in the capital of the Company on June 9, 2016 at a price of £1.84 per share. 39,699 of these ordinary shares were issued to WG Partners LLP, for no cash consideration, as payment for financial advisory services;
- on March 21, 2016 the directors of the Company signed a solvency statement with the agreement of all shareholders and undertook a capital reduction, reducing the share premium account by £7,000,000 and reducing the accumulated losses by the same amount;
- under a private placement dated June 9, 2016, the issue and allotment of 5,135,962 ordinary shares of £0.003 in nominal value in the capital of the Company on June 9, 2016 at a price of £2.21 per share;
- on June 9, 2016, the Company's ordinary shares were admitted to trading on AIM, part of the London Stock Exchange;
- under the private placement dated April 3, 2017, the Company issued and allotted 5,042,017 ordinary shares of £0.003 in nominal value in the capital of the Company on April 3, 2017 at a price of £2.975 per share to institutional investors. Gross cash received was £15,000,000;
- on April 26, 2017 Novartis converted £1,398,552 of loan notes dated June 3, 2016 into 632,829 ordinary shares of £0.003 in nominal value in the capital of the Company at the fixed conversion price of £2.21 per share. Under the terms of the notes, Novartis also received 588,532 bonus shares; and
- on October 31, 2017, Mereo BioPharma Group plc issued 490,798 ordinary shares of £0.003 in nominal value in the capital of the Company to AstraZeneca AB as part payment for the acquisition by Mereo BioPharma 4 Limited of an exclusive license and option to acquire certain assets.

Notes to the financial statements *continued*

17. Issued capital and reserves continued

Share premium	December 31, 2017 £
At January 1, 2017	**99,975,399**
Issued on April 3, 2017 for private financing round	**14,984,875**
Issued on April 26, 2017 for conversion of loan note	**2,477,787**
Issued on October 28, 2017 for acquisition of license	**1,518,527**
Transaction costs for issued share capital	**(729,632)**
At December 31, 2017	**118,226,956**

Share premium	December 31, 2016 £
At January 1, 2016	26,212,880
Share capital reduction on March 21, 2016	(7,000,000)
Issuance of share capital for private financing round on June 9, 2016	72,423,314
Issuance of share capital for private placement on June 9, 2016	11,335,069
Transaction costs for issued share capital	(2,995,864)
At December 31, 2016	99,975,399

Other capital reserves

	Shares to be issued £	Share-based payments £	Equity component of convertible loan £	Total £
At January 1, 2017	2,674,477	9,476,283	516,802	12,667,562
Share-based payments expense during the year	—	4,983,186	—	4,983,186
Shares issued	(1,082,899)	—	—	(1,082,899)
Equity component of convertible loan instrument	—	—	(208,680)	(208,680)
At December 31, 2017	**1,591,578**	**14,459,469**	**308,122**	**16,359,169**

	Shares to be issued £	Share-based payments £	Equity component of convertible loan £	Total £
At January 1, 2016	18,677,840	2,982,265	—	21,660,105
Share-based payments expense during the year	—	6,494,018	—	6,494,018
Shares issued	(16,003,363)	—	—	(16,003,363)
Equity component of convertible loan instrument	—	—	516,802	516,802
At December 31, 2016	2,674,477	9,476,283	516,802	12,667,562

17. Issued capital and reserves continued

Share-based payments

The Group has a share option scheme under which options to subscribe for the Group's shares have been granted to certain executives, NEDs and employees (see Note 24 for further details).

The share-based payment reserve is used to recognize a) the value of equity settled share-based payments provided to employees, including key management personnel, as part of their remuneration and b) deferred equity consideration. Refer to Note 24 for further details of these plans. Of the £6,494,018 share-based payment expense in 2016, £298,836 is an accelerated charge relating to 500,000 share options which were canceled on June 9, 2016.

Shares issued/to be issued

Shares to be issued at January 1, 2016 of £18,677,840 represented a maximum potential 10,151,000 bonus shares due to Novartis under the terms of an investment in the prior year. Of the 44,600,502 ordinary shares issued on June 9, 2016, 8,697,480 shares were issued to Novartis as fully paid up bonus shares (for £nil consideration), the number of which was calculated to maintain its shareholding at 19.5%. The fair value of these shares was £1.84 per share. At December 31, 2016, £2,674,477 representing a maximum of 1,453,520 shares at £1.84 were remaining to be issued to Novartis pro rata to their percentage shareholding as and when the Company issues further ordinary shares.

Of the 1,221,361 ordinary shares issued on April 26, 2017, 588,532 shares were issued to Novartis as fully paid up bonus shares (for £nil consideration), the number of which was calculated to maintain its shareholding at 19.5%. The fair value of these shares was £1.84 per share. At December 31, 2017, £1,591,578 representing a maximum of 864,988 shares at £1.84 were remaining to be issued to Novartis pro rata to their percentage shareholding as and when the Company issues further ordinary shares.

Equity component of convertible loan instrument

The convertible loan notes issued to Novartis are a compound instrument consisting of a liability and an equity component (see Note 18a). The value of the equity component (cost of the conversion option) as at December 31, 2017 is £308,122 (2016: £516,802).

Accumulated deficit

	Year ended December 31, 2017 £	Year ended December 31, 2016 £
Other reserves	**7,000,000**	7,000,000
Accumulated losses	**(79,315,920)**	(40,579,241)
Accumulated deficit	**(72,315,920)**	(33,579,241)

On March 21, 2016 the directors of the Company signed a solvency statement with the agreement of all shareholders and undertook a capital reduction, reducing the share premium account by £7,000,000 and crediting a new other reserve by the same amount.

18. Interest bearing loans and borrowings

	Year ended December 31, 2017 £	Year ended December 31, 2016 £
Novartis Notes – see Note 18a	**1,977,393**	3,126,526
Bank loan – see Note 18b	**18,774,924**	–
At December 31	**20,752,317**	3,126,526
Current	**1,939,806**	–
Non-current	**18,812,511**	3,126,526

18. Interest bearing loans and borrowings continued

18a. Convertible loan note

On June 3, 2016, the Company issued 3,463,563 £1 unsecured convertible loan notes ("Novartis Notes") to Novartis Pharma AG, a shareholder of the Company (see Note 26) in consideration for an investment in cash by Novartis at the time of the private placement on June 9, 2016. The Novartis Notes attract an interest rate of 4% per annum and accruing daily and constitute direct, unsecured obligations of the Company ranking ahead of any other unsecured obligations of the Company.

On April 26, 2017 Novartis converted £1,398,553 of loan notes into 632,829 ordinary shares at the fixed conversion price of £2.21 per share. This has been recorded as a £1,187,974 reduction in interest-bearing loans and borrowings, a reduction in other capital reserves of £208,680 and a reduction in accumulated losses of £62,375. Under the terms of the notes, Novartis also received 588,532 bonus shares. Novartis holds £2,065,011 principal value of notes at December 31, 2017 representing 934,394 ordinary shares if converted, together with 864,988 potential bonus shares; together these represent 2.5% of the current share capital of the Company as at December 31, 2017.

In August 2017, in connection with the new loan agreements (see Note 18b), Novartis agreed to amend the terms of its Novartis Notes. Under the revised terms of the Novartis Notes, the loan is subordinated to the Silicon Valley Bank and Kreos Capital loan such that Novartis shall be entitled, at any time up to the repayment of the foregoing loan, being March 2, 2021, to serve a conversion notice on the Company to convert all or some only of the outstanding Novartis Notes into fully paid ordinary shares at a conversion price of £2.21 per share. To the extent the Novartis Notes are not converted at that date, the outstanding principal amount of the Novartis Notes, together with any accrued and unconverted interest, is redeemable. Upon conversion of any Novartis Notes, in addition to the relevant number of conversion shares, Novartis is entitled to receive an additional number of ordinary shares in the Company equal to the number of conversion shares into which such Novartis Notes are to convert, multiplied by 0.93, up to a maximum aggregate number of 864,988 such bonus shares.

The value of the debt component of the notes at the date of issue was calculated as £2,946,761. The cash flows attached to the note up to the maturity date were calculated and discounted at an appropriate venture debt rate of 10%. The carrying amount at December 31, 2017 is £1,977,393 (2016: £3,126,526).

The value of the equity component of the Notes at December 31, 2017 was calculated as £308,123 (2016: £516,802).

18b. Bank loan

On August 7, 2017, the Group entered into a loan agreement with Silicon Valley Bank and Kreos Capital V (UK) Limited, which provides for total borrowings of £20.0 million and the issue of warrants over shares in the Company (see Note 20). £10.0 million was drawn down on each of August 21, 2017 (Tranche 1) and December 29, 2017 (Tranche 2) for general working capital purposes. The Group is obligated to make interest-only payments on the loan amount until September 30, 2018, and thereafter the Group is obligated to pay interest and principal in 30 equal monthly installments until March 31, 2021, the maturity date. The loan bears interest at an annual fixed rate equal to 9.0%. In addition a final payment of 7.5% of the principal loan amount is due upon the earlier of the maturity date, prepayment in whole of the loan amount, mandatory repayment, acceleration of the loan, and the loan becoming immediately due and payable due to an event of default. The loan is secured by substantially all of the Group's assets, including intellectual property rights owned or controlled by the Group. The terms of the debt facility include an interest-only period to September 30, 2018, a 30-month capital and interest repayment period thereafter, a 9% headline interest rate and customary security over all assets of the Group.

The fair value of warrants issued as part of Tranche 1 on August 21, 2017 was £657,676. The fair value of the loan liability of Tranche 1 on August 21, 2017 was £9,342,324. Application of the effective interest method is required to accrete the initial loan liability value up to the face value of the loan at the end of the loan term. This non-cash interest charge will be made in each statutory reporting period. The annual value of this interest charge is £182,133, which is an effective interest rate of 1.95%.

The fair value of warrants issued as part of Tranche 2 on December 29, 2017 was £634,335. The fair value of the loan liability of Tranche 2 on December 29, 2017 was £9,365,665. Application of the effective interest method is required to accrete the initial loan liability value up to the face value of the loan at the end of the loan term. This non-cash interest charge will be made in each statutory reporting period. The annual value of this interest charge is £194,892, which is an effective interest rate of 2.08%.

The total carrying value of the loan at December 31, 2017 was £18,774,924. £1,939,806 is a current liability and £16,835,118 is a non-current liability. A total of £66,935 of non-cash interest has been charged to the statement of comprehensive loss in the period.

19. Provisions

	Year ended December 31, 2017 £	Year ended December 31, 2016 £
Social security contributions on share options	**2,288,386**	1,172,420
Provision for deferred cash consideration	**2,061,000**	–
At December 31	**4,349,386**	1,172,420
Current	**274,000**	–
Non-current	**4,075,386**	1,172,420

Social security contributions on share options	Year ended December 31, 2017 £	Year ended December 31, 2016 £
At beginning of year	**1,172,420**	141,311
Accretion of discount	**–**	7,293
Arising during the year	**1,115,966**	1,084,181
Released	**–**	(60,365)
At December 31	**2,288,386**	1,172,420
Current	**–**	–
Non-current	**2,288,386**	1,172,420

The provision for social security contributions on share options is calculated based on the number of options outstanding at the reporting date that are expected to be exercised. The provision is based on the estimated gain arising on exercise of the share options, using the best estimate of the market price at the balance sheet date. Since the directors assume the options will be held for their full contractual life of ten years (see Note 24) the liability has been classified as non-current. The provision has been discounted.

Provision for deferred cash consideration	Year ended December 31, 2017 £	Year ended December 31, 2016 £
At beginning of year	**–**	–
Arising during the year	**2,061,000**	–
At December 31	**2,061,000**	–
Current	**274,000**	–
Non-current	**1,787,000**	–

The deferred cash consideration is the estimate of the quantifiable but not certain future cash payment obligations due to AstraZeneca for the acquisition of certain assets (see Note 12). This liability is calculated as the risk adjusted net present value of future cash payments to be made by the Group. The payments are dependent on reaching certain milestones based on the commencement and outcome of clinical trials. The likelihood of achieving such milestones is reviewed at the balance sheet date and increased or decreased as appropriate.

Notes to the financial statements *continued*

20. Warrant liability

	Year ended December 31, 2017 £	Year ended December 31, 2016 £
At beginning of year	—	—
Arising during the year	**1,346,484**	—
At December 31	**1,346,484**	—

As part of the bank loan facility (see Note 18b), 363,156 warrants to subscribe for shares were issued to the lenders on August 21, 2017. These warrants will be capable of exercise until August 7, 2027 at an exercise price of £3.029. A further 333,334 warrants were issued to the lenders on December 29, 2017. These warrants will be capable of exercise until August 7, 2027 at an exercise price of £3.30. The total of 696,490 warrants is equivalent to 0.98% of ordinary share capital at December 31, 2017.

The terms of the warrant instrument allow for a cashless exercise. In line with IAS 32, the future number of shares to be issued to the warrant holder under a cashless exercise can only be determined at that future date. At each balance sheet date the fair value of the warrants will be assessed using the Black Scholes model taking into account appropriate amendments to inputs in respect of volatility and remaining expected life of the warrants.

The following table lists the weighted average inputs to the models used for the fair value of warrants granted during the year ended December 31, 2017:

	Year ended December 31, 2017 £
Expected volatility (%)	**50–51**
Risk-free interest rate (%)	**1.10–1.25**
Expected life of share options (years)	**9.6–10**
Market price of ordinary shares (£)	**3.00–3.25**
Model used	**Black Scholes**

The fair value of the warrants at grant was £1,292,011. At December 31, 2017 it was £1,346,484.

Since there is no historical data in relation to the expected life of the warrants, the contractual life of the options was used in calculating the expense for the year.

Volatility was estimated by reference to the share price volatility of a group of comparable companies over a retrospective year equal to the expected life of the warrants.

21. Trade and other payables

	Year ended December 31, 2017 £	Year ended December 31, 2016 £
Trade payables	**2,860,303**	994,901
Social security and other taxes	**144,348**	113,205
Other payables	**19,375**	13,001
	3,024,026	1,121,107

Terms and conditions of the above financial liabilities:

- trade payables are non-interest bearing and are normally settled on 30-day terms; and
- other payables are non-interest bearing and have an average term of one month.

22. Changes in liabilities arising from financing activities

	Total interest-bearing loans and borrowings £	Total other liabilities £	Total £
January 1, 2017	3,126,526	—	3,126,526
Cash			
Net increase in bank loan	18,507,989	—	18,507,989
Increase in warrant liability	—	1,292,011	1,292,011
Interest payments	(327,123)	—	(327,123)
Non-cash			
Conversion of Novartis Notes	(1,252,248)	—	(1,252,248)
Bank loan transaction costs	200,000	—	200,000
Change in fair value warrant	—	54,473	54,473
Provision for deferred cash consideration	—	2,061,000	2,061,000
Interest accrual	327,123	—	327,123
Accreted interest	170,050	—	170,050
December 31, 2017	**20,752,317**	**3,407,484**	**24,159,801**

23. Financial and capital risk management and fair value measurement

23.1. Capital risk management

For the purpose of the Group's capital management, capital includes issued capital, share premium, the equity component of a convertible loan note and all other equity reserves attributable to the equity holders of the parent.

The Group's objectives when managing capital are to safeguard the ability to continue as a going concern and ensure that sufficient capital is in place to fund the Group's R&D activities. The Group's principal method of adjusting the capital available is through issuing new shares or arranging suitable debt financing, including any related warrants. The Group's share capital and share premium are disclosed in Note 17. The Group's loans are disclosed in Note 18. The Group monitors the availability of capital with regard to its committed and planned forecast future expenditure on an ongoing basis.

23.2. Financial risk management objectives and policies

Monitoring of financial risk is part of the Board's ongoing risk management, the effectiveness of which is reviewed annually. Our agreed policies are implemented by the Chief Financial Officer, who submits periodic reports to the Board. The Group seeks to maintain a balance between equity capital and convertible and secured debt to provide sufficient cash resources to execute the business plan. In addition, the Group maintains a balance between cash held on deposit and short-term investments in Sterling and other currencies to reduce its exposure to foreign exchange fluctuations in respect of our planned expenditure. During the year, in order to maintain a strong cash runway the Group completed an equity placing and arranged and drew down a new bank debt facility, which includes an initial interest-only period until September 2018.

Except for the bank loans and the existing convertible loan notes issued in 2016, the Group's principal financial instruments comprise trade payables which arise directly from its operations and are not designed as a means of raising finance for the Group's operations. The Group has various financial assets, such as receivables and cash and short-term deposits. The Group does not consider that its financial instruments gave rise to any material financial risks during the year to December 31, 2017.

Interest rate risk

The Group's policy in relation to interest rate risk is to monitor short and medium-term interest rates and to place cash on deposit for periods that optimize the amount of interest earned while maintaining access to sufficient funds to meet day-to-day cash requirements.

The interest payable on both the convertible loan note and on the bank loan is fixed. Consequently, there is no material exposure to interest rate risk in respect of interest payable.

Foreign currency risk

The Group currently has no revenue. The majority of operating costs are denominated in Sterling, Euros and U.S. dollars (USD). Foreign exchange risk arises from commercial transactions and recognized assets and liabilities in foreign currencies. In relation to foreign currency risk, the Group's policy is to hold the majority of its funds in Sterling and to hold sufficient USD to fund planned commitments for the next 12 months on a rolling basis with short-term spot purchases to manage commitments in other currencies.

23. Financial and capital risk management and fair value measurement continued

23.2. Financial risk management objectives and policies continued

Credit risks

The Group's policy is to place funds with financial institutions which have a minimum long-term credit rating with S&P of A. The Group also allocates a quota to individual institutions in respect of cash deposits and also seeks to diversify its investments where this is consistent with achieving competitive rates of return. It is the Group's policy to place not more than £10 million with any one investment counterparty and no more than £5 million with any one cash deposit counterparty.

Cash flow and liquidity risk

Credit risk from balances with banks and financial institutions is managed by the Group's finance department in accordance with the Group's policy. Investments of surplus funds are made only with approved counterparties and within credit limits assigned to each counter party. Counterparty credit limits are reviewed by the Group's Board of directors on an annual basis, and may be updated throughout the year subject to approval of the Group's Audit and Risk Committee. The limits are set to minimize the concentration of risks and therefore mitigate financial loss through a counterparty's potential failure to make payments.

The Group's maximum exposure to credit risk for the components of the balance sheet at December 31, 2017 is the carrying amounts.

The Group monitors its funding requirements through preparation of short-term, mid-term and long-term forecasts. All short-term deposits are immediately convertible to liquid funds without penalty and are recorded in the balance sheet at their open market value. Please refer to Note 2.3 "Going Concern" regarding the directors' assessment of liquidity for further information.

23.3. Fair value hierarchy

			Fair value measurement using		
	Date of valuation	Total	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Liabilities measured at fair value					
Provision for deferred cash consideration (Note 19)	December 31, 2017	£2,061,000	—	—	£2,061,000
Warrant liability (Note 20)	December 31, 2017	£1,346,484	—	—	£1,346,484
Liabilities for which fair values are disclosed					
Convertible loan (Note 18a)	December 31, 2017	£1,977,393	—	—	£1,977,393
Bank loan (Note 18b)	December 31, 2017	£18,774,924	—	—	£18,774,924

There were no transfers between Level 1 and Level 2 during 2017.

Fair value measurement hierarchy for liabilities as at December 31, 2016:

			Fair value measurement using		
	Date of valuation	Total	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Liabilities for which fair values are disclosed					
Convertible loan (Note 18a)	December 31, 2016	£3,126,526	—	—	£3,126,526

There were no transfers between Level 1 and Level 2 during 2016.

23. Financial and capital risk management and fair value measurement continued

23.3. Fair value hierarchy continued

Set out below is a comparison, by class, of the carrying amounts and fair values of the Group's financial instruments:

	December 31, 2017		December 31, 2016	
	Carrying amount £	Fair value £	Carrying amount £	Fair value £
Liabilities				
Provision for deferred cash consideration	**2,061,000**	**2,061,000**	—	—
Warrant liability	**1,346,484**	**1,346,484**	—	—

The management of the Group assessed that the fair values of cash and short-term deposits, other receivables, trade payables, and other current liabilities approximate their carrying amounts largely due to the short-term maturities of these instruments.

The following methods and assumptions were used to estimate the fair values:

- the fair value of the provision for deferred cash consideration is estimated by discounting future cash flows using rates currently available for debt on similar terms and credit risk. In addition to being sensitive to a reasonably possible change in the forecast cash flows or the discount rate, the fair value of the deferred cash consideration is also sensitive to a reasonably possible change in the probability of reaching certain milestones. The valuation requires management to use unobservable inputs in the model, of which the significant unobservable inputs are disclosed in the tables below. Management regularly assesses a range of reasonably possible alternatives for those significant unobservable inputs and determines their impact on the total fair value; and
- the warrant liability is estimated using the Black Scholes model taking into account appropriate amendments to inputs in respect of volatility, remaining expected life of the warrants, cost of capital, probability of success and rates of interest.

The significant unobservable inputs used in the fair value measurements categorized within Level 3 of the fair value hierarchy, together with a quantitative sensitivity analysis as at December 31, 2017 and 2016 are as shown below:

	Valuation technique	Significant unobservable inputs	Range (weighted average)	Sensitivity of the input to fair value
Provision for deferred cash consideration	DCF	WACC	2017: 15.3%	1% increase/(decrease) would result in a decrease/(increase) in fair value by £30,000.
		Probability of success	2017: 28%-85%	10% increase/(decrease) would result in an increase/(decrease) in fair value by £600,000.
Warrant liability	Black Scholes	Risk-free interest rate	2017: 1.25%	1% increase/(decrease) would result in an increase/(decrease) of £46,000
		Volatility	2017: 50%	10% increase/(decrease) would result in an increase/(decrease) of £200,000
		Remaining life	2017: 3,519 days	Increase/(decrease) of 365 days would result in an increase/(decrease) of £54,000

The table below summarizes the maturity profile of the Group's financial liabilities based on contractual undiscounted payments at December 31, 2017:

	Payments due by period				
	Up to 1 year £	1–3 years £	3–5 years £	Over 5 years £	Total £
Novartis Notes	**82,600**	**165,427**	**2,078,815**	**—**	**2,326,842**
Bank loan	**3,574,208**	**17,793,665**	**2,982,805**	**—**	**24,350,678**
Operating lease (see Note 25)	**743,858**	**535,203**	**—**	**—**	**1,279,061**
	4,400,666	**18,494,295**	**5,061,620**	**—**	**27,956,581**

23. Financial and capital risk management and fair value measurement continued

23.3. Fair value hierarchy continued

The table below summarizes our contractual obligations at December 31, 2016:

	Payments due by period				
	Up to 1 year £	1-3 years £	3-5 years £	Over 5 years £	Total £
Novartis Notes	138,543	3,660,559	—	—	3,799,102
Bank loan	—	—	—	—	—
Operating lease (see Note 25)	325,920	651,840	202,736	—	1,180,496
	464,463	4,312,399	202,736	—	4,979,598

The Group may incur potential payments upon achievement of clinical, regulatory and commercial milestones, as applicable, or royalty payments that may be required to be made under license agreements the Group entered into with various entities pursuant to which the Group has in-licensed certain intellectual property, including license agreements with Novartis and AstraZeneca. Due to the uncertainty of the achievement and timing of the events requiring payment under these agreements, the amounts to be paid are not fixed or determinable at this time.

24. Share-based payments

The charge for share-based payments under IFRS 2 arises across the following schemes:

	Year ended December 31, 2017	Year ended December 31, 2016
2015 Plan	**2,441,671**	6,185,067
Mereo BioPharma Group plc Share Option Plan	**586,291**	—
Long Term Incentive Plan	**298,287**	133,601
Deferred Bonus Share Plan	**325,649**	175,350
	3,651,898	6,494,018

The 2015 Plan

Under the Mereo BioPharma Group Limited Share Option Plan (the "2015 Plan"), the Group, at its discretion, granted share options to employees, including executive management, and NEDs. Share options vest over four years for executive management and employees and over three years for NEDs. There are no performance conditions attached to the options issued under the Option Plan. The fair value of share options granted was estimated at the date of grant using a Black Scholes pricing model, taking into account the terms and conditions upon which the share options were granted. The fair value calculation does not include any allowance for dividends as the Company has no available profits for distribution.

The exercise price of the share options will be equal to the market price of the underlying shares on the date of grant, less a discount agreed with the Group's institutional investors. The contractual term of the share options is ten years.

Of the £6,185,067 expense recognized in 2016 under the 2015 plan for employee services received during 2016, £298,836 is an accelerated charge relating to 500,000 options which were canceled on June 9, 2016.

No share options were issued during the year under the 2015 Share Plan.

24. Share-based payments continued

The 2015 Plan continued

Movements during the year

The following table illustrates the number and weighted average exercise prices (WAEP) of, and movements in, options for the 2015 Plan during the year:

	2017		2016	
	Number	WAEP £	Number	WAEP £
Outstanding at beginning of the year	**9,198,655**	**1.32**	8,964,394	1.29
Granted during the year	**–**	**–**	1,316,117	1.49
Canceled during the year	**–**	**–**	(500,000)	1.29
Forfeited during the year	**(74,045)**	**1.29**	(581,856)	1.29
Outstanding at December 31	**9,124,610**	**1.32**	9,198,655	1.32
Exercisable at December 31	**5,655,676**	**1.31**	3,115,337	1.29

The weighted average remaining contractual life for the share options outstanding as at December 31, 2017 was 7.6 years (2016: 8.3 years).

There were no options granted in 2017. The weighted average fair value of options granted during 2016 was £1.29.

Options outstanding at the end of the year had an exercise price of between £1.29 and £2.21.

The following tables list the weighted average inputs to the models used for the fair value of share options granted during the year ended December 31:

	Year ended December 31, 2017	Year ended December 31, 2016
Expected volatility (%)	**–**	56
Risk-free interest rate (%)	**–**	1.48–2.07
Expected life of share options (years)	**–**	10
Market price of ordinary shares (£)	**–**	1.84–2.21
Model used	**–**	Black Scholes

Since there is no historical data in relation to the expected life of the share options, the contractual life of the options was used in calculating the expense for the year.

Volatility was estimated by reference to the share price volatility of a group of comparable companies over a retrospective year equal to the expected life of the share options.

The Mereo BioPharma Group plc Share Option Plan

The Mereo BioPharma Group plc Share Option Plan ("Share Option Plan") provides for the grant of options to acquire our ordinary shares to employees, executive directors and executive officers. Options may be granted to all eligible employees on commencement of employment and may be granted on a periodic basis after that. Under the Share Option Plan, our Board of directors may determine if the vesting of an option will be subject to the satisfaction of a performance condition. With regard to an option which is subject to satisfaction of a performance condition, the option will normally vest on the later of: (i) the date on which our Board of directors determines that the performance condition has been satisfied; and (ii) the third anniversary of the date of grant. With regard to an option which is not subject to the satisfaction of a performance condition, the option will normally vest on the third anniversary of the date of grant, or such other date determined by our Board of directors and notified to the participant. Once an option has vested, it may be exercised during the period ending on the tenth anniversary of the date of grant, after which time it will lapse. The exercise price of an option may not be less than the greater of: (i) the market value of a share on the date of grant; or (ii) if the shares are to be subscribed, the nominal value of a share. Options are not currently subject to performance conditions other than continued service with us and typically vest on the third anniversary of the date of grant, after which they remain exercisable generally until the tenth anniversary of the grant date. Our Board of directors may determine that an option be settled in cash or by net exercise of the option.

24. Share-based payments continued

The Mereo BioPharma Group plc Share Option Plan continued

Movements during the year

The following table illustrates the number and weighted average exercise prices (WAEP) of, and movements in, options for the Option Plan during the year:

	2017		2016	
	Number	**WAEP £**	Number	WAEP £
Outstanding at beginning of the year	**—**	**—**	—	—
Granted during the year	**1,593,188**	**3.05**	—	—
Canceled during the year	**—**	**—**	—	—
Forfeited during the year	**(15,000)**	**3.03**	—	—
Outstanding at December 31	**1,578,188**	**3.05**	—	—
Exercisable at December 31	**—**	**—**	—	—

The weighted average remaining contractual life for the share options outstanding as at December 31, 2017 was 9.4 years.

The weighted average fair value of options granted during the year was £1.85.

Options outstanding at the end of the year had an exercise price of between £3.03 and £3.23.

The following tables list the weighted average inputs to the models used for the fair value of share options granted during the years ended December 31:

	Year ended December 31, 2017	Year ended December 31, 2016
Expected volatility (%)	**49–51**	—
Risk-free interest rate (%)	**1.06–1.33**	—
Expected life of share options (years)	**10**	—
Market price of ordinary shares (£)	**3.03–3.23**	—
Model used	**Black Scholes**	—

Since there is no historical data in relation to the expected life of the share options, the contractual life of the options was used in calculating the expense for the year.

Volatility was estimated by reference to the share price volatility of a group of comparable companies over a retrospective period equal to the expected life of the share options.

Long Term Incentive Plan

Under the Company's Long Term Incentive Plan (the "LTIP"), initiated in 2016, the Group, at its discretion, may grant nil-cost options to acquire shares to employees. Under the LTIP rules, vesting of 75% of the options issued to employees is subject to a share price performance condition (the "Share Price Element") and vesting of 25% of the options is subject to achievement of strategic operational targets (the "Strategic Element"). Share options vest over a maximum of five years, dependent upon achievement of these targets.

The fair value of the LTIP Share Price Element is estimated at the date of grant using a Monte Carlo pricing model, taking into account the terms and conditions upon which the share options were granted.

The fair value of the LTIP Strategic Element is estimated at the date of grant using a Black Scholes pricing model, taking into account the terms and conditions upon which the share options were granted, and the expense recorded is based upon the expected level of achievement of strategic targets.

The fair value calculations do not include any allowance for dividends as the Company has no available profits for distribution.

The contractual term of the LTIP options is five years.

The expense recognized for employee services received during the year to December 31, 2017 was £298,287 (2016: £133,601).

24. Share-based payments continued

Long Term Incentive Plan continued

Movements during the year

The following table illustrates the number of, and movements in, LTIP options during the year:

	2017 Number	2016 Number
Granted during the year	**185,950**	1,199,658
Canceled during the year	**–**	–
Forfeited during the year	**–**	(234,162)
Outstanding at December 31	**1,151,446**	965,496
Exercisable at December 31	**–**	–

The weighted average remaining contractual life for the LTIP options outstanding as at December 31, 2017 was 2.9 years (2016: 3.7 years).

The weighted average fair value of LTIP options granted during the year to December 31, 2017 was £1.99 (2016: £1.21).

The following tables list the weighted average inputs to the models used for the fair value of LTIP options granted during the years ended December 31:

LTIP Share Price Element

	Year ended December 31, 2017	Year ended December 31, 2016
Expected volatility (%)	**51.7**	48.9
Risk-free interest rate (%)	**0.17–0.39**	0.48–0.74
Expected life of share options (years)	**3–5**	3–5
Market price of ordinary shares (£)	**3.03**	2.21
Model used	**Monte Carlo**	Monte Carlo

LTIP Strategic Element

	Year ended December 31, 2017	Year ended December 31, 2016
Expected volatility (%)	**51.7**	48.9
Risk-free interest rate (%)	**0.39**	0.74
Expected life of share options (years)	**5**	5
Market price of ordinary shares (£)	**3.03**	2.21
Model used	**Black Scholes**	Black Scholes

Since there is no historical data in relation to the expected life of the LTIP options, the contractual life of the options has been used in calculating the expense for the year.

Volatility is estimated by reference to the share price volatility of a group of comparable companies over a retrospective period equal to the expected life of the LTIP options.

Deferred Bonus Share Plan

Under the Company's Deferred Bonus Share Plan (DBSP), 30% of the annual bonus for the senior management team is payable in deferred shares, which are governed by the DBSP plan rules. At the date of grant of the awards, the monetary bonus amount will be divided by the closing share price to give the number of shares issued to the employee under the DBSP. The number of shares is fixed and not subject to adjustment between the issue date and vesting date. Under the DBSP, awards vest after three years from the date of the award. There are no further performance conditions attached to the award, nor any service conditions (including no requirement for continued employment once the awards have been made). The plan does allow for adjustment of awards in the event of a material misstatement of Mereo's accounts or fraud or misconduct on the part of an individual. The plan also allows for adjustment of awards in the event there was an error in calculating the vesting of the awards.

24. Share-based payments continued

Deferred Bonus Share Plan continued

Since the awards are issued at nil cost they will be satisfied by the issue of shares from the Employee Benefit Trust.

The following table illustrates the number of, and movements in, DBSP options during the year:

	2017 Number	2016 Number
Outstanding at January 1	**62,180**	—
Awarded during the year	**100,820**	62,180
Granted during the year	**—**	—
Outstanding at December 31	**163,000**	62,180
Exercisable at December 31	**—**	—

The weighted average remaining contractual life for the DBSP options outstanding as at December 31, 2017 was 3.6 years (2016: 4 years).

The weighted average fair value of DBSP options granted during the year was £3.23 (2016: £2.80).

Deferred equity consideration

In October 2017, our wholly owned subsidiary Mereo BioPharma 4 Limited entered into an exclusive license and option agreement, or the License Agreement, to obtain from AstraZeneca an exclusive worldwide, sub-licensable license under AstraZeneca's intellectual property rights relating to AZD-9668, with an option to acquire such intellectual property rights following commencement of a pivotal trial and payment of related milestone payments, or the Option, together with the acquisition of certain related assets.

Under the agreement with AstraZeneca, the Company may issue up to 1,349,693 ordinary shares which are dependent on achieving certain milestones.

In respect of milestones that are probable, the Group has accounted for, but not yet issued, 429,448 ordinary shares which have been measured at fair value, being £3.10, giving a total of £1,331,288.

25. Commitments and contingencies

Operating lease commitments – Group as lessee

Future minimum rentals payable under non-cancellable operating leases as at December 31, 2017 are as follows:

	December 31, 2017 £	December 31, 2016 £
Within one year	**743,858**	325,920
After one year but not more than three years	**535,203**	651,840
After one year but not more than five years	**—**	202,736
More than five years	**—**	—
	1,279,061	1,180,496

The Group has entered into a lease for its premises at Fourth Floor, 1 Cavendish Place, London W1G 0QF. The term of the lease agreement is from August 17, 2015 through to August 16, 2025. The total lease expense for the year ended December 31, 2017 was £293,328 (2016: £293,328).

The premises comprise approximately 4,000 sq ft. The principal rent for the premises is £162,960 per annum through December 16, 2016 and £325,920 per annum thereafter, subject to an increase on August 17, 2020 based on the open market value of the premises (the "Principal Rent"). In addition to the Principal Rent, the Group is responsible for value added tax on the Principal Rent and certain insurance costs and service charges incurred by the landlord.

The Group may break the lease agreement on August 16, 2020 by providing six months' prior written notice to the landlord. If the Group does not exercise its break option, the landlord will decrease by 50% the Principal Rent for the period from August 16, 2020 through to April 15, 2021.

25. Commitments and contingencies continued

Operating lease commitments – Group as lessee continued

The Group has entered into a lease for six High Resolution peripheral quantitative computed tomography (HRpQCT) scanners for use in its ongoing clinical studies.

Each scanner has a lease term of 12 months from the date on which delivery of that scanner occurred. The Company has the right to extend the lease period for a further six months at any point during the lease term. This option may be exercised in respect of any of the individual scanners and does not have to be exercised in respect of all the scanners.

Finance leases – Group as lessee

The Group did not have any leasing arrangements classifying as finance leases at December 31, 2017 (2016: £nil).

Financial commitments

Each of Mereo BioPharma 1 Ltd, Mereo BioPharma 2 Limited and Mereo BioPharma 3 Limited issued to Novartis loan notes (the Novartis Notes) (which were assigned by Novartis to the Company in exchange for ordinary shares pursuant to the Subscription Agreement) and each of Mereo BioPharma 1 Limited, Mereo BioPharma 2 Limited and Mereo BioPharma 3 Limited agreed to make future payments to Novartis comprising amounts equal to ascending specified percentages of tiered annual worldwide net sales (beginning at high single digits and reaching into double digits at higher sales) by such subsidiary of products that include the assets acquired. The levels of ascending percentages of tiered annual worldwide net sales are the same for each of Mereo BioPharma 1, Mereo BioPharma 2 and Mereo BioPharma 3 under the respective Purchase Agreements.

Each of Mereo BioPharma 1 Limited, Mereo BioPharma 2 Limited and Mereo BioPharma 3 Limited further agreed that in the event it transfers, licenses, assigns or leases all or substantially all of its assets, it will pay Novartis a percentage of the proceeds of such transaction. The Company will retain the majority of the proceeds from such a transaction. Such percentage is the same for each of Mereo BioPharma 1 Limited, Mereo BioPharma 2 Limited and Mereo BioPharma 3 Limited under the respective Purchase Agreements. The payment of a percentage of proceeds is not payable with respect to any transaction involving equity interests of Mereo BioPharma Group plc, a merger or consolidation of Mereo BioPharma Group plc, or a sale of any assets of Mereo BioPharma Group plc.

In October 2017, the Group's wholly owned subsidiary Mereo BioPharma 4 Limited entered into an exclusive license and option agreement, or the License Agreement, to obtain from AstraZeneca an exclusive worldwide, sub-licensable license under AstraZeneca's intellectual property rights relating to AZD-9668, with an option to acquire such intellectual property rights following commencement of a pivotal trial and payment of related milestone payments, or the Option, together with the acquisition of certain related assets. Upon entering into the License Agreement, the Group made a payment of $3.0 million and issued 490,798 ordinary shares to AstraZeneca, for an aggregate upfront payment equal to $5.0 million. In connection with certain development and regulatory milestones, the Group has agreed to make payments of up to $115.5 million in the aggregate and issue additional ordinary shares to AstraZeneca for licensed products containing AZD-9668. In addition, the Group has agreed to make payments to AstraZeneca based on specified commercial milestones of the product. The Group has also agreed to pay a specified percentage of sublicensing revenue to AstraZeneca and to make royalty payments to AstraZeneca equal to ascending specified percentages of tiered annual worldwide net sales by the Group of licensed products (subject to certain reductions), ranging from the high single digits to low double digits. Royalties will be payable on a licensed product-by-licensed product and country-by-country basis until the later of ten years after the first commercial sale of such licensed product in such country and expiration of the last patent covering such licensed product in such country that would be sufficient to prevent generic entry. Under the License Agreement, the Group may freely grant sub-licenses to affiliates upon notice to AstraZeneca and must obtain AstraZeneca's consent, not be unreasonably withheld, to grant sub-licenses to a third party. The Group has agreed to use commercially reasonable efforts to develop and commercialize at least one licensed product.

The License Agreement will expire on the expiry of the last-to-expire royalty term with respect to all licensed products. Upon the expiration of the royalty term for a licensed product in a particular country, the licenses to the Group for such product in such country will become fully-paid and irrevocable. Prior to exercise of the Option, if at all, the Group may terminate the License Agreement upon prior written notice. Either party may terminate the agreement upon prior written notice for the other party's material breach that remains uncured for a specified period of time or insolvency. AstraZeneca has agreed to a three-year non-competition restriction in relation to the direct or indirect commercialization or development of NE inhibitors for the treatment of AATD. In addition, AstraZeneca agreed not to assert any AstraZeneca intellectual property rights that were included in the scope of the License Agreement against the Group.

26. Related party disclosures

The following transactions have been entered into with related parties for the year ended December 31, 2016 and 2017.

Novartis Pharma AG (Novartis) holds shares in the Company at December 31, 2016. On June 3, 2016, the Group issued 3,463,563 £1 unsecured convertible loan notes (the Novartis Notes) to Novartis and received £3,463,563 from Novartis in consideration (Note 18a).

The Group purchased goods and services from Novartis in the year as set out below:

	December 31, 2017 £	December 31, 2016 £
Manufacture and supply of clinical trial material	**4,610,106**	968,219

The amount outstanding to be paid to Novartis at December 31, 2017 was £nil (2016: £35,249).

The purchases from related parties are made on terms equivalent to those that prevail in arm's length transactions.

27. Standards issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Group's financial statements are disclosed below. The Group intends to adopt these standards, if applicable, when they become effective.

IFRS 9 Financial Instruments

IFRS 9 applies to reporting periods on or after January 1, 2018. The Group is currently assessing the impact of IFRS 9 and plans to adopt the new standard on the required effective date.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15 revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in IFRS 15 provide a more structured approach to measuring and recognizing revenue.

The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under IFRS. Either a full or modified retrospective application is required for annual periods beginning on or after January 1, 2018 with early adoption permitted. As the Group is not currently, nor will it for the foreseeable future, generating revenues, IFRS 15 will be adopted when the Group has an arrangement within the scope of the standard.

IFRS 16 Leases

IFRS 16 specifies how an IFRS reporter will recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17.

IFRS 16 was issued in January 2016 and applies to annual reporting periods beginning on or after January 1, 2019.

The Group is currently assessing the impact of IFRS 16 and plans to adopt the new standard on the required effective date.

27. Standards issued but not yet effective continued

Other standards

The following standards and interpretations, applicable for annual periods beginning on or after January 1, 2017, are not expected to have any impact on the results of the Group or the presentation of the financial statements:

- IFRS 10 Consolidated Financial Statements – Amendments regarding the sale or contribution of assets between an investor and its associate or joint venture and amendments regarding the application of the consolidation exception.
- IFRS 11 Joint Arrangements – Amendments regarding the accounting for acquisitions of an interest in a joint operation.
- IFRS 12 Disclosure of Interests in Other Entities – Amendments regarding the application of the consolidation exception.
- IFRS 14 Regulatory Deferral Accounts.
- IAS 1 Presentation of Financial Statements – Amendments resulting from the disclosure initiative.
- IAS 7 Statement of Cash Flows – Amendments resulting from the disclosure initiative.
- IAS 12 Income Taxes – Amendments to recognition of deferred tax assets for unrealized losses.
- IAS 16 Property, Plant and Equipment – Amendments regarding the clarification of acceptable methods of depreciation and amortization and amendments bringing bearer plants into the scope of IAS 16.
- IAS 27 Separate Financial Statements (as amended in 2011) – Amendments reinstating the equity method as an accounting option for investments in subsidiaries, joint ventures and associates in an entity's separate financial statements.
- IAS 28 Investments in Associates and Joint Ventures – Amendments regarding the application of the consolidation exception.
- IAS 38 Intangible Assets – Amendments regarding the clarification of acceptable methods of depreciation and amortization.
- IAS 41 Agriculture – Amendments bringing bearer plants into the scope of IAS 16.
- Amendments resulting from September 2014 Annual Improvements to IFRSs:
  - IFRS 2 Classification and Measurement of Share-based Payment Transactions.
  - IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.
  - IFRS 7 Financial Instruments: Disclosures.
  - IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration.
  - IAS 19 Employee Benefits.
  - IAS 34 Interim Financial Reporting.

Company balance sheet as at December 31, 2017

	Notes	December 31, 2017 £	December 31, 2016 £
Assets			
Non-current assets			
Property, plant and equipment	6	**153,361**	173,869
Investments	4	**97,104,623**	67,754,682
Amounts owed by Group undertakings	5	**1,331,288**	—
		98,589,272	67,928,551
Current assets			
Prepayments		**1,970,780**	1,102,146
Other receivables	7	**509,350**	767,009
Short-term investments	9	**2,500,000**	—
Cash and short-term deposits	8	**50,044,672**	53,577,571
Amounts owed by Group undertakings	5	**6,355,111**	—
		61,379,913	55,446,726
Current liabilities			
Trade and other payables	14	**3,024,026**	1,121,107
Accruals		**4,379,774**	2,088,012
Interest bearing loans and borrowings	11	**1,939,806**	—
		9,343,606	3,209,119
Net current assets		**52,036,307**	52,237,607
Total assets less current liabilities		**150,625,579**	120,166,158
Non-current liabilities			
Provisions	12	**2,288,386**	1,172,420
Interest bearing loans and borrowings	11	**18,812,511**	3,126,526
Warrant liability	13	**1,346,484**	—
Amounts owed to Group undertakings		**152,401**	—
		22,599,782	4,298,946
Net assets		**128,025,797**	115,867,212
Equity shareholder's funds			
Share capital	10	**213,285**	193,022
Share premium	10	**118,226,956**	99,975,399
Other capital reserves	10	**16,359,169**	12,667,562
Other reserves	10	**7,000,000**	7,000,000
Losses brought forward		**(3,968,771)**	(2,827,315)
Loss for the year		**(9,867,217)**	(1,141,456)
Adjustment to losses upon conversion of convertible loan note		**62,375**	—
		(13,773,613)	(3,968,771)
Total equity shareholder's funds		**128,025,797**	115,867,212

Approved by the Board on March 22, 2018 and signed on its behalf by:

Dr Denise Scots-Knight
Director

Richard Jones
Director

Company number: 9481161 (England and Wales)

Company statement of changes in equity for the year ended December 31, 2017

	Issued capital £	Share premium £	Other capital reserves £	Other reserves £	Accumulated losses £	Total equity £
At December 1, 2015	59,221	26,212,880	21,660,105	—	(2,827,315)	45,104,891
Loss for the year to December 31, 2016	—	—	—	—	(1,141,456)	(1,141,456)
Issue of share capital (Note 10)	107,709	67,781,112	—	—	—	67,888,821
Share-based payments (Note 15)	—	—	6,185,067	—	—	6,185,067
Share-based payments – LTIPs (Note 15)	—	—	133,601	—	—	133,601
Share-based payments – deferred bonus shares (Note 15)	—	—	175,350	—	—	175,350
Redemption of shares to be issued (Note 10)	26,092	15,977,271	(16,003,363)	—	—	—
Equity element of convertible loan (Note 10)	—	—	516,802	—	—	516,802
Share capital reduction (Note 10)	—	(7,000,000)	—	7,000,000		—
Transaction costs on issuance of share capital (Note 10)	—	(2,995,864)	—	—	—	(2,995,864)
At December 31, 2016	193,022	99,975,399	12,667,562	7,000,000	(3,968,771)	115,867,212
Loss for the year to December 31, 2017	—	—	—	—	(9,867,217)	(9,867,217)
Share-based payments – share options (Note 15)	—	—	3,027,963	—	—	3,027,963
Share-based payments – LTIPs (Note 15)	—	—	298,287	—	—	298,287
Share-based payments – deferred bonus shares (Note 15)	—	—	325,648	—	—	325,648
Share-based payments – deferred equity consideration (Note 15)	—	—	1,331,288	—	—	1,331,288
Issue of share capital on April 4, 2017 (Note 10)	15,125	14,984,875	—	—	—	15,000,000
Issue of share capital on conversion of loan note (Note 10)	1,899	1,396,654	—	—	—	1,398,553
Issue of share capital for Novartis bonus shares (Note 10)	1,766	1,081,133	(1,082,899)	—	—	—
Equity element of convertible loan (Note 10)	—	—	(208,680)	—	—	(208,680)
Conversion of convertible loan (Note 10)	—	—	—	—	62,375	62,375
Issue of share capital on October 31, 2017 (Note 10)	1,473	1,518,527	—	—	—	1,520,000
Transaction costs on issuance of share capital (Note 10)	—	(729,632)	—	—	—	(729,632)
At December 31, 2017	**213,285**	**118,226,956**	**16,359,169**	**7,000,000**	**(13,773,613)**	**128,025,797**

Notes to the Company financial statements

1. Significant accounting policies

1.1 Basis of preparation

The Company has transitioned from IFRS, as adopted by the E.U., to Financial Reporting Standard 101 Reduced Disclosure Framework (FRS 101) for all periods presented.

In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the E.U. (Adopted IFRSs), but makes amendments where necessary in order to comply with the Companies Act 2006 and has set out below where advantage of the FRS 101 disclosure exemptions has been taken.

As permitted by FRS 101, the Company has taken advantage of the disclosure exemptions available under that standard in relation to:

- paragraphs 45(b) and 46–52 of IFRS 2 Share Based Payment;
- IFRS 7 Financial Instruments: Disclosures;
- paragraphs 91–99 of IFRS 13 Fair Value Measurement;
- paragraph 38 of IAS 1 Presentation of Financial Statements to present comparative information in respect of:
  - (i) paragraph 79(a)(iv) of IAS 1;
  - (ii) paragraph 73(e) of IAS 16 Property, Plant and Equipment; and
  - (iii) paragraph 118(e) of IAS 38 Intangible Assets;
- paragraphs 10(d), 10(f), 39(c) and 134–136 of IAS 1;
- IAS 7 Statement of Cash Flows;
- paragraphs 30 and 31 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors;
- paragraph 17 of IAS 24 Related Party Disclosures;
- the requirements in IAS 24 Related Party Disclosures to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member; and
- paragraphs 134(d)–134(f) and 135(c)–135(e) of IAS 36 Impairment of Assets.

The Company's prior period financial statements were prepared in accordance with IFRS and as such there are no differences to be made in measurement and recognition.

These financial statements are prepared in Sterling.

1.2 Revision of previously issued financial statements

Accumulated losses have been debited with the £7.0 million capital reduction undertaken in 2016 and a new other reserve credited by the same amount as set out in the consolidated balance sheet and in the consolidated statement of changes in equity.

1.3 Changes of accounting policies

Other reserves

Other reserves arose on reduction of share premium. These reserves are available for distribution to shareholders in the future at a time when the Company has sufficient accumulated realized profits to make a distribution.

1. Significant accounting policies continued

1.4 Summary of significant accounting policies

a) The accounting policies for the Company that relate to the following items can be found in Note 2.6 to the consolidated financial statements:

- income taxes;
- foreign currencies;
- property, plant and equipment;
- leases;
- impairment of non-financial assets;
- cash and short-term deposits;
- short-term investments;
- provisions;
- share-based payments;
- costs of issuing capital;
- convertible loan instrument;
- R&D costs; and
- bank loan and associated warrants.

b) Intercompany guarantee

Financial guarantees given by subsidiaries to the Company are measured at fair value. The total cost of such guarantees is charged to the statement of comprehensive loss at the time the guarantee is given, in accordance with IAS 39.

c) Investment in subsidiaries

The Company capitalizes intercompany balances with its subsidiaries at each month end (creating an investment in subsidiaries), up to the point where it believes the subsidiary is in a position to repay any balances within the next 12 months. Capitalized balances are reviewed for impairment at each period end.

2. Significant accounting judgments, estimates and assumptions

The preparation of the Company accounts requires the management of the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. The Company bases its estimates and judgments on historical experience and on various other assumptions that it considers to be reasonable. Actual results may differ from these estimates under different assumptions or conditions.

Share-based compensation

Incentives in the form of shares are provided to employees under a share option plan, long-term incentive plan and deferred bonus share plan. The fair value of the employee services received in exchange for the grant of the options is recognized as an expense. The selection of different assumptions could affect the results of the Company.

Deferred license consideration

Deferred consideration in the form of shares is recognized as a share-based payment when it is probable that shares will be transferred (see Note 24 to the consolidated financial statements).

Bank loan and associated warrants

As part of the bank loan the Company has issued warrants to subscribe for shares. The fair value of the warrants issued is assessed at each balance sheet date based upon a number of assumptions, as disclosed in Note 20 to the consolidated financial statements.

Intercompany guarantee

As part of the bank loan, the Company's subsidiaries have provided certain guarantees to the lender. In return for these guarantees the subsidiaries have each charged the Company a guarantee fee on an arm's length basis. The fee has been calculated using management's best judgments and estimates of the fair value of the guarantee including a credit default swap valuation methodology for estimating the fair value of the guarantee and an estimate of the likely interest rate which would have been payable had the guarantees not been given.

Notes to the Company financial statements *continued*

3. Loss for the year

The Company has taken advantage of the exemption permitted by Section 408 of the Companies Act 2006 not to present an income statement for the year. The Company's loss for the year was £9,867,217 (2016: £1,141,456), which has been included in the Company's statement of comprehensive loss.

The auditors' remuneration for audit and other services is disclosed in Note 6 to the consolidated financial statements.

The average number of employees in the year was 28 (2016: 23). The directors' remuneration is detailed in Note 7 to the consolidated financial statements.

The Company had a net deferred tax asset of £3,039,892 at December 31, 2017 (2016: £7,673).

The deferred tax asset has not been recognized as there is uncertainty regarding when suitable future profits against which to offset the accumulated tax losses will arise. There is no expiration date for the accumulated tax losses.

4. Company information

Investments in subsidiaries

	£
At January 1, 2016	421,352
Additions in the year	67,333,330
At December 31, 2016	67,754,682
Additions in the year	29,349,941
At December 31, 2017	**97,104,623**

Information about subsidiaries

The following were subsidiary undertakings at the end of the year and have been included in the consolidated financial statements of the Group:

Name	Principal activities	Country of incorporation	% equity interest December 31, 2017	% equity interest December 31, 2016
Mereo BioPharma 1 Limited	Pharmaceutical R&D	U.K.	**100**	100
Mereo BioPharma 2 Limited	Pharmaceutical R&D	U.K.	**100**	100
Mereo BioPharma 3 Limited	Pharmaceutical R&D	U.K.	**100**	100
Mereo BioPharma 4 Limited	Pharmaceutical R&D	U.K.	**100**	–
Mereo BioPharma Group plc Employee Benefit Trust	Employee share scheme	Jersey	**–**	–

The registered office of Mereo BioPharma 1 Limited, Mereo BioPharma 2 Limited, Mereo BioPharma 3 Limited and Mereo BioPharma 4 Limited is located at Fourth Floor, 1 Cavendish Place, London W1G 0QF.

Mereo BioPharma 1 Limited, Mereo BioPharma 2 Limited, Mereo BioPharma 3 Limited and Mereo BioPharma 4 Limited each have issued share capital of one ordinary share of £1 fully paid or credited as fully paid, totaling £4.

Under IFRS, the Employee Benefit Trust is treated as a wholly owned subsidiary company.

A capital contribution of £29,349,941(2016: £67,333,330) by Mereo BioPharma Group plc to its subsidiaries was recorded in the year to December 31, 2017. £859,681 (2016: £1,588,459) has been recorded for the granting of employees' share options for services rendered by the employees to the subsidiaries. £28,490,260 (2016: £65,744,871) has been recorded for the conversion of intercompany balances at original cost, of which £2,280,000 represents a cash payment made by the Company on behalf of Mereo BioPharma 4 Limited for the acquisition of the exclusive license for AZD-9668.

As at December 31, 2017 a total capital contribution of £2,869,488 (2016: £2,009,811) by Mereo BioPharma Group plc to its subsidiaries has been recorded for the granting of employees' share options for services rendered by the employees to the subsidiaries.

As at December 31, 2017 a total capital contribution of £94,235,135 (2016: £65,744,871) by Mereo BioPharma Group plc to its subsidiaries has been recorded for the conversion of intercompany balances at original cost.

5. Amounts owed by Group undertakings

	December 31, 2017 £	December 31, 2016 £
Intercompany deferred equity consideration	**1,331,288**	–
Intercompany loan Notes	**1,543,987**	–
Other intercompany receivables	**4,811,124**	–
	7,686,399	–
Current	**6,355,111**	–
Non-current	**1,331,288**	–

Deferred equity consideration

In October 2017, our wholly owned subsidiary Mereo BioPharma 4 Limited entered into an exclusive license and option agreement, or the License Agreement, to obtain from AstraZeneca an exclusive worldwide, sub-licensable license under AstraZeneca's intellectual property rights relating to AZD-9668, with an option to acquire such intellectual property rights following commencement of a pivotal trial and payment of related milestone payments, or the Option, together with the acquisition of certain related assets.

Under the agreement with AstraZeneca, the Company may issue, on behalf of Mereo BioPharma 4 Limited, up to 1,349,693 ordinary shares which are dependent on achieving certain milestones.

In respect of milestones that are probable, the Company has accounted for, but not yet issued, 429,448 ordinary shares which have been measured at fair value, being £3.10, giving a total of £1,331,288.

Intercompany loan notes

For the exclusive license and option agreement mentioned above, the initial upfront payment totaled USD $5,000,000, in a combination of USD $3,000,000 in cash and the issue of 490,798 new ordinary shares in the capital of Mereo BioPharma Group plc to AstraZeneca AB with a value of $2,000,000, or £3.097 per share. In consideration for the issuance by the Company to AstraZeneca AB of the consideration shares, Mereo BioPharma Group 4 issued a loan note to the Company of $2,000,000 or £1,520,000. The loan note is interest bearing at a fixed rate of 9% per annum. £23,987 of interest has been charged in the period to December 31, 2017. There is no conversion feature in the loan agreements.

Other intercompany receivables

This represents the amount owed by subsidiaries which has not been capitalized in accordance with our accounting policy (see Note 1.4c) and which we expect to be repaid within the next 12 months.

6. Property, plant and equipment

The Group's property, plant and equipment is all owned by the Company. Details on the property, plant and equipment are provided in Note 11 to the consolidated financial statements.

7. Other receivables

The Group's other receivables all reside in the Company. Details are provided in Note 14 to the consolidated financial statements.

8. Cash and short-term deposits

The Group's cash is all held by the Company. Details on the cash and short-term deposits are provided in Note 15 to the consolidated financial statements.

9. Short-term investments

The Group's short-term investments are all held by the Company. Details on the short-term investments of the Company are provided in Note 16 to the consolidated financial statements.

10. Share capital

The Group's share capital all resides in the Company. Details on the share capital of the Company are provided in Note 17 to the consolidated financial statements.

Notes to the Company financial statements *continued*

11. Interest-bearing loans and borrowings

The Group's interest-bearing loans and borrowings all reside in the Company. Details on the interest bearing loans and borrowings of the Company are provided in Note 18 to the consolidated financial statements.

12. Provisions

Social security contributions on share options	**Year ended December 31, 2017 £**	Year ended December 31, 2016 £
At beginning of the year	**1,172,420**	141,311
Accretion of discount	**–**	7,293
Arising during the year	**1,115,966**	1,084,181
Released	**–**	(60,365)
At December 31	**2,288,386**	1,172,420
Current	**–**	—
Non-current	**2,288,386**	1,172,420

The provision for social security contributions on share options is calculated based on the number of options outstanding at the reporting date that are expected to be exercised. The provision is based on the estimated gain arising on exercise of the share options, using the best estimate of the market price at the balance sheet date. Since the directors assume the options will be held for their full contractual life of ten years (see Note 24 to the consolidated financial statements) the liability has been classified as non-current. The provision has been discounted.

13. Warrant liability

The Group's warrant liability resides in the Company. Details on the warrant liability of the Company are provided in Note 20 to the consolidated financial statements.

14. Trade and other payables

The Group's trade and other payables all reside in the Company. Details on the trade and other payables of the Company are provided in Note 21 to the consolidated financial statements.

15. Share-based payments

The charge for share-based payments under IFRS 2 arises across the following schemes:

	December 31, 2017 £	December 31, 2016 £
2015 Plan	**1,934,893**	4,667,854
Mereo BioPharma Group plc Share Option Plan	**311,612**	—
Long Term Incentive Plan	**263,840**	104,040
Deferred Bonus Share Plan	**281,872**	133,666
	2,792,217	4,905,560

Details on the share-based payments of the Company, including deferred equity consideration, are provided in Note 24 to the consolidated financial statements.

16. Related party disclosures

Details on related parties are provided in Note 26 to the consolidated financial statements.

Nominated advisor and joint broker

Cantor Fitzgerald Europe

One Churchill Place
Canary Wharf
London E14 5RB
U.K.

Joint broker

RBC Europe Limited

Riverbank House
2 Swan Lane
London EC4R 3BF
U.K.

Financial advisor

Evercore Partners International

15 Stanhope Gate
London W1K 1LN
U.K.

Legal advisor

Latham & Watkins LLP

99 Bishopgate
London
EC2M 3XF

Auditor

Ernst & Young LLP

Apex Plaza
Reading RG1 1YE
U.K.

Tax advisor

Deloitte LLP

2 New Street Square
London EC4A 3BZ
U.K.

Financial PR advisors

FTI Consulting

200 Aldergate
Aldergate Street
London EC1A 4HD
U.K.

Burns McClellan Inc.

257 Park Avenue South
15th Floor
New York
NY 10010
U.S.

Registrar

Link Asset Services

65 Gresham Street
London EC2V 7NQ
U.K.

Produced by

designportfolio

MEREO BIOPHARMA GROUP PLC

1 Cavendish Place
London
W1G 0QF
United Kingdom