Company Number 09481161

MEREO BIOPHARMA GROUP PLC

Annual Report and Accounts
Year ended December 31, 2021

MEREO BIOPHARMA GROUP PLC

CONTENTS

Directors	Dr. Denise Scots-Knight (Chief Executive Officer) Dr. Peter Fellner (Chairman) Dr. Jeremy Bender Dr. Anders Ekblom Peter Bains (resigned September 20, 2021) Dr. Pierre Jacquet (appointed September 20, 2021) Kunal Kashyap (resigned October 26, 2021) Dr. Deepa Pakianathan Dr. Brian Schwartz Michael Wyzga Anne Hyland (appointed March 1, 2022)
Company Secretary	Charles Sermon
Registered Office	4th Floor, One Cavendish Place London W1G 0QF
Company Number	09481161
Auditors	BDO LLP Level 12, Thames Tower Reading, Berkshire RG1 1LX
Solicitors	Mayer Brown International LLP 201 Bishopsgate London EC2M 3AF
Registrars	Link Group 10th Floor, Central Square 29 Wellington Street Leeds, LS1 4DL

Introduction

Mereo BioPharma Group plc (the "Company", "Mereo" or "Parent Company") is a public limited company incorporated under the laws of England and Wales and is listed on the Nasdaq Global Select Market ("NASDAQ"). The Company is a "quoted company" for the purposes of the Companies Act 2006 (the "Companies Act").

The Directors present their strategic report together with the directors' remuneration report, directors' report, audited consolidated financial statements of Mereo BioPharma Group plc and its subsidiaries (collectively, the "Group"), audited company financial statements and auditors' report for the year ended December 31, 2021. The Company has also filed with the U.S. Securities and Exchange Commission (the "SEC") its Annual Report on Form 20-F for the year ended December 31, 2021, which contains additional disclosures regarding some of the matters discussed in this report.

Business overview and strategy

We are a biopharmaceutical company focused on the development of innovative therapeutics that aim to improve outcomes for oncology and rare diseases and plan to commercialize selected rare disease programs. Our existing portfolio consists of six clinical stage product candidates two of which, etigilimab and alvelestat, are in ongoing clinical studies. Our lead oncology product candidate, etigilimab (an "anti-TIGIT antibody"), has completed a Phase 1a dose escalation clinical trial in patients with advanced solid tumors and has been evaluated in a Phase 1b study in combination with nivolumab in select tumor types. We initiated a Phase1b/2 basket study for etigilimab in combination with nivolumab in three rare tumors, sarcoma, uveal melanoma and germ cell cancer, three gynecological carcinomas, cervical, ovarian and endometrial carcinomas and tumors with high mutation burden, along with a Phase 1b/2 study in clear cell ovarian cancer with a partner. Our rare disease product candidates are alvelestat, which is being investigated in two ongoing Phase 2 proof of-concept studies for the treatment of severe AATD and in an investigator-sponsored study in Bronchiolitis Obliterans Syndrome (BOS) following allogenic stem cell transplant, and setrusumab for the treatment of OI. Following the announcement of the results for setrusumab in a Phase 2b study in adults with OI which demonstrated a dose dependent statistically significant increase in bone mineral density and bone strength, we announced a strategic partnership with Ultragenyx in December 2020 for the development of setrusumab in children and adults with OI. Ultragenyx plans to start a pivotal, Phase 2/3 pediatric and young adult study (5-25 year olds) in the first half of 2022 and intend to initiate a separate Phase 2 study of patients under age five with OI to commence in the second half of 2022.

We plan to develop our product candidates through the next key clinical milestone and then partner where it makes sense strategically to do so but also in select cases for our rare disease product candidates, to develop them through regulatory approval and potentially commercialization.

Our second oncology product, navicixizumab for the treatment of late line ovarian cancer, has completed a Phase 1b study and was partnered in January 2020 for further development with OncXerna on a global basis.

We plan to out-license or sell our other two product candidates acumapimod for the treatment of AECOPD and leflutrozole for the treatment of male infertility associated with HH, recognizing the need for greater resources to take these product candidates to market.

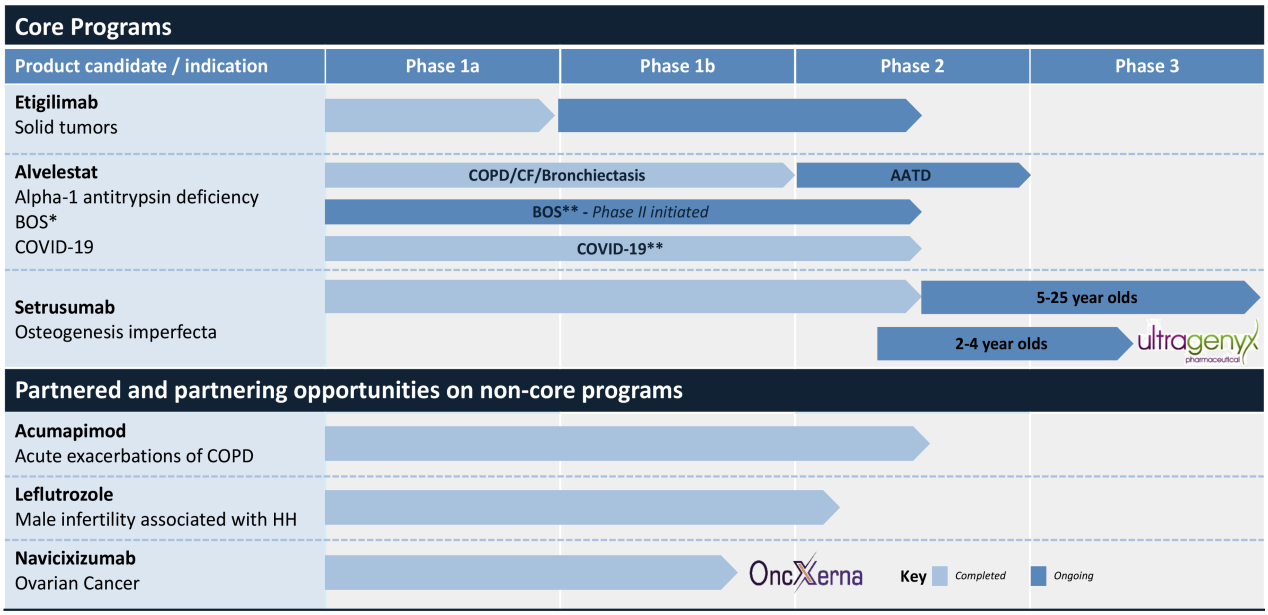
Our strategy is selectively to acquire and develop product candidates for rare diseases that have already received significant investment from large pharmaceutical and biotechnology companies and that have substantial pre-clinical, clinical and manufacturing data packages. Since our formation in March 2015, we have successfully executed on this strategy by acquiring six clinical-stage product candidates of which four were in oncology and rare diseases. Four of our six clinical-stage product candidates were acquired from large pharmaceutical companies and two were acquired in the Merger. We aim to efficiently develop our product candidates through the clinic and have successfully commenced or completed large, randomized Phase 2 clinical trials for five of our product candidates.

Rare diseases represent an attractive development and, in some cases, commercialization opportunity for us since they typically have high unmet medical need and can utilize regulatory pathways that facilitate acceleration to approval and to the potential market. Development of products for oncology and rare diseases both involve close collaboration with key opinion leaders and investigators. Development of rare disease products generally involves close coordination with the patient organizations and patients are treated at a limited number of specialized sites which helps identification of the patient population and enables a small targeted sales infrastructure to commercialize the products in key markets.

Our team has extensive experience in the pharmaceutical and biotechnology sector in the identification, acquisition, development, manufacturing and commercialization of product candidates in multiple therapeutic areas including oncology and rare diseases. Our senior management has long- standing relationships with senior executives of large pharmaceutical and biotechnology companies which we believe enhances our ability to form strategic partnerships on our product candidates and to identify and acquire additional product candidates.

Our Pipeline

The following tables summarize our pipeline for our product candidates. We have global commercial rights to etigilimab, alvelestat, acumapimod and leflutrozole and commercial rights to setrusumab in Europe and the U.K. We have granted Ultragenyx an exclusive license to develop and commercialize setrusumab in the U.S. and rest of the world, and we licensed global rights for navicixizumab to OncXerna.



*BOS: Bronchiolitis Obliterans Syndrome; ** Investigator initiated studies in collaboration with University of Alabama in Birmingham & National Cancer Institute

Core Oncology and Rare Disease Product Candidates

Etigilimab (MPH-313): Etigilimab is an antibody against TIGIT (T-cell immunoreceptor with Ig and ITIM domains). TIGIT is a next generation checkpoint receptor shown to block T-cell activation and the body's natural anti-cancer immune response. Etigilimab is an IgG1 monoclonal antibody which binds to the human TIGIT receptor on immune cells with a goal of improving the activation and effectiveness of T-cell and NK cell anti-tumor activity. We completed a Phase 1a dose escalation clinical trial with etigilimab in patients with advanced solid tumors and enrolled patients in a Phase 1b study in combination with nivolumab in selected tumor types.

23 patients were treated in the Phase 1a dose escalation study with doses up to 20mg/kg Q2W. Tumor types included colorectal cancer, endometrial cancer, head and neck cancer, pancreatic cancer, ovarian cancer, and other tumor types. No dose limiting toxicities were observed. In the Phase 1b combination study, a total of ten patients, nine of whom had progressed on prior anti-PD1/PD-L1 therapies, were enrolled at doses of 3, 10 and 20 mg/kg. Tumor types included gastric cancer and six other tumor types. Eight patients were evaluable for tumor growth assessment, and all of these patients had progressed on PD1/PD-L1 therapies with best responses, including two patients with a partial response and stable disease. Patients remained on study for up to 224 days. No dose limiting toxicities (DLTs) were observed.

Treatment emergent adverse events (TEAEs) related to study drug were reported by 16 patients (69.6%) in the Phase 1a portion of the study and 7 patients (70.0%) in the Phase 1b portion of the study. The most commonly reported related TEAEs in the Phase 1a portion of the study were pruritus (4 patients, 17.4%) and fatigue, nausea, rash and maculopapular rash (each reported by 3 patients, 8.7%). In the Phase 1b portion of the study, the most commonly reported related TEAEs were fatigue (3 patients, 30.0%) and pruritus, rash and pruritic rash (each reported by 2 patients, 20.0%).

There were no treatment-related serious adverse events in the Phase 1a portion and there was only one treatment-related serious adverse event (autoimmune hepatitis) in the Phase 1b portion of the study. The Phase 1b study has now been completed.

Etigilimab is currently in an open label Phase 1b/2 basket study in combination with nivolumab in a range of tumor types. This is focused on three rare tumors, sarcoma, uveal melanoma and germ cell cancer, three gynecological carcinomas, cervical, ovarian and endometrial carcinomas and tumors with high mutation burden. We reported interim data on this study in November 2021. At the time of the data cut-off, 22 patients were included in the safety analysis set, 20 patients were evaluable with a minimum of at least one scan, and 15 patients were included in the efficacy analysis population.

As at the cut-off date, there was one complete response in cervical cancer, one partial response in ovarian cancer and four instances of stable disease in ovarian cancer, cervical cancer and uveal melanoma. The combination of etigilimab and nivolumab has been safe and well tolerated with no new safety signals. The most common treatment-related adverse events were skin reactions, observed in seven patients. None of these reactions required treatment with systemic steroids. There was one case of immune diabetes mellitus.

We expect to provide an update on the Phase 1b/2 basket study of etigilimab in combination with nivolumab in mid-2022.

In April 2021, the Company entered into partnership with Cancer Focus Fund for a Phase 1b/2 study of etigilimab in Clear Cell Ovarian Cancer to be conducted at The University of Texas MD Anderson Cancer Center. The Phase 1b/2 study is being financed by Cancer Focus Fund in exchange for upfront consideration of $1.5 million of the Company's shares and additional payments based on the achievement of certain milestones. Clear cell ovarian cancer is a rare cancer that accounts for approximately 5 to 10% of all ovarian carcinomas in North America.

Alvelestat (MPH-966): Alvelestat is a novel, oral small molecule we are developing for the treatment of severe AATD Lung Disease and BOS. AATD is a potentially life-threatening, rare, genetic condition caused by a lack of effective alpha-1 antitrypsin ("AAT"). The lungs are normally protected from enzymatic degradation by neutrophil elastase by the AAT protein, but in severe AATD the AAT is either misfolded and fails to be released into the circulation, inactive or completely missing. The degradation of tissue by unopposed neutrophil elastase leads to severe debilitating diseases, including early-onset pulmonary emphysema, a disease that irreversibly destroys the tissues that support lung function. There are an estimated 50,000 patients in North America and 60,000 patients in Europe with severe AATD, although due to underdiagnosis, there are estimated to be approximately 6,000 – 10,000 patients diagnosed in North America. BOS is a progressive, ultimately fatal fibrotic lung disease due to graft versus host disease following stem cell transplant, or lung transplant rejection. An estimated fifty percent of lung transplant recipients will develop BOS by five years post-transplant, with an average survival of less than five years. There are an estimated 10,000 people living with lung transplant and BOS in the US and Europe. Alvelestat is designed to inhibit NE, a neutrophil protease, which is a key enzyme involved in the destruction of lung tissue. We believe the inhibition of NE has the potential to protect patients with AATD from further lung damage. BOS is characterized by anti-organ auto-immune responses, either graft versus host (in SCT) or host versus graft (in lung transplant), exacerbated

by elevated neutrophils in the lung and excess NE activity, leading to lung damage through elastin breakdown in the tissue and progressive fibrosis, and ultimately respiratory failure. By inhibiting NE, alvelestat will reduce the accelerating effects of NE-driven inflammation on BOS.

Prior to our license of alvelestat, AstraZeneca conducted 12 clinical trials involving 1,776 subjects, including trials in bronchiectasis and CF. Although these trials were conducted in diseases other than AATD, we believe the data demonstrated potential clinical benefit and biomarker evidence of treatment effect for AATD patients. These trials created a safety database of 1,149 subjects treated with alvelestat.

We recently closed enrollment in a Phase 2 proof-of-concept clinical trial in patients with severe AATD in the United States and the EU and expect to report top-line data from this trial in early Q2 2022. An investigator-initiated complementary study, including testing of alvelestat on top of AAT replacement therapy in AATD is also underway in the US.

Emerging data on the potential of NE inhibition to reduce the inflammatory and thrombotic effects of Neutrophil Extracellular Traps (NETs) in COVID-19, led to the initiation of a study in this disease. The top-line results were reported in December 2021. The results demonstrated a safety profile consistent with previous studies, and in the alvelestat arm, a reduction (an improvement) of 2 points or more in the World Health Organization (WHO) Severity Score in 62.5% (5/9) of the patients versus 28.5% (2/7) in the placebo arm at day 5. At day 7 87.5% (7/8) patients in the alvelestat arm had improved by 2 points or more vs 57% (4/7) in the placebo arm. Inflammatory and pro-coagulopathy biomarkers were also supportive.

An open-label Phase 1b/2 investigator-sponsored study in BOS following allogeneic stem cell transplant is ongoing. Interim results of Phase 1b were reported in December 2021 showing stabilization or improvement in lung function measured by Forced Expiratory Volume in 1 second, (FEV1) in 6 of 7 patients, and supportive biomarker responses, with reduction in neutrophil elastase and the mature elastin breakdown product (desmosine) and reductions in markers of collagen synthesis associated with fibrosis. We expect to provide an update on this study and on the expansion into Phase 2 during 2022.

Setrusumab (BPS-804): Setrusumab is a novel antibody designed to inhibit sclerostin, a protein that inhibits the activity of bone-forming cells. Inhibiting sclerostin has been shown to promote increases in bone mineral density through stimulation of bone-formation (through osteoblasts) and inhibition of bone-resorption (through osteoclasts). We are developing setrusumab 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 FDA or EMA. It is estimated that OI affects a minimum of 25,000 people in the United States and approximately an aggregate of 32,000 people in Germany, Spain, France, Italy and the United Kingdom. We believe setrusumab'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.

Prior to our acquisition of setrusumab, Novartis conducted four clinical trials in 106 patients and healthy volunteers. In 2016, we obtained orphan drug designation in OI for setrusumab in the United States and the EU and, in November 2017, it was accepted into the Priority Medicines scheme ("PRIME") of the EMA. In September 2020 we received rare pediatric disease designation for setrusumab in OI from the FDA. In November 2019 we reported top-line data on a Phase 2b clinical trial of setrusumab for adults with OI. The Phase 2b was a dose ranging study with three blinded arms at high, medium and low doses to establish the dose response curve and an open label arm at the top dose. Setrusumab demonstrated statistically significant improvements in bone formation biomarkers and bone mineral density (measured by Dual Energy X-ray Absorptiometry) and a trend to a reduction in fractures at the high dose, compared to the other doses, even though the study was not powered for fracture reduction. The results support the progression of setrusumab into a pediatric pivotal study in OI. The data was also presented, as a podium presentation, at the American Society of Bone and Mineral Research ("ASBMR") in October 2021.

We completed a Type B end of Phase 2b meeting with the FDA in February 2020, a priority medicines scheme (PRIME) meeting with the EMA in May 2020 and sought scientific advice from the EMA in December 2020. These meetings resulted in alignment between the regulators on a Phase 2/3 pediatric study in children with OI.

In December 2020 we announced a partnership with Ultragenyx for the development of setrusumab for OI. Under the terms of the partnership, Ultragenyx will lead future global development of setrusumab in both pediatric and adult patients. We granted Ultragenyx an exclusive license to develop and commercialize setrusumab in the US and rest of the world, excluding Europe and the U.K. where we retain commercial rights. Each party will be responsible for post-marketing commitments in their respective territories.

Ultragenyx made an upfront payment of $50 million to Mereo and will fund global development of the program until approval and has agreed to pay a total of up to $254 million upon achievement of certain clinical, regulatory and commercial milestones. Ultragenyx will pay tiered double digit percentage royalties to us on net sales outside of Europe and the U.K. and we will pay a fixed double digit percentage royalty to Ultragenyx on net sales in Europe and the U.K. Under the terms of our 2015 agreement with Novartis, we will pay Novartis a percentage of proceeds, subject to certain deductions, with Mereo receiving a substantial majority of the payments from Ultragenyx.

Ultragenyx plans to start a pediatric and young adult Phase 2/3 study in the first half of 2022. The objective of the Phase 2/3 study will first focus on determining the optimal dose based on increases in collagen production using serum P1NP levels and an acceptable safety profile. Following determination of the dose, Ultragenyx currently intend to adapt the study into a pivotal Phase 3 stage, evaluating fracture reduction over an estimated 15 to 24 months as the primary endpoint, subject to regulatory review. Ultragenyx currently expect a separate Phase 2 study of patients under age five with OI to start in the second half of 2022. Ultragenyx will, also, continue to evaluate adult patients who were previously treated in the ASTEROID study.

Our Non-Core Partnering Portfolio

Following completion of successful Phase 1 or Phase 2 studies the products below are either partnered or programs which we intend to out-license or sell.

- **Acumapimod (BCT-197):** Acumapimod is a p38 MAP kinase inhibitor therapy for treatment of severe acute exacerbations of COPD (AECOPD). In a Phase 2 trial, acumapimod given over 5 days in patients hospitalized with AECOPD demonstrated a statistically significant reduction in re-hospitalization for treatment failure and recurrent exacerbations. Acumapimod was reported to be safe and well tolerated. Following meetings with FDA and EMA a global Phase 3 registrational program has been designed and we intend to explore out-licensing or sale opportunities with third parties for the further development of acumapimod.

- **Leflutrozole (BGS-649):** Leflutrozole is an oral inhibitor of aromatase for the treatment of male infertility associated with HH. Excess aromatase in fat tissue reduces testosterone, LH and FSH, leading to HH. In Phase 2 trials, leflutrozole normalized testosterone, increased LH and FSH and was reported to be well-tolerated. Effects on sperm counts supported that future development of leflutrozole should focus on male infertility associated with HH. We intend to explore out-licensing or sale opportunities with third parties for the further development of leflutrozole.

- **Navicixizumab (OMP-305B83):** Navi is a bispecific antibody that inhibits delta-like ligand 4 (DLL4) and vascular endothelial growth factor (VEGF). We acquired this therapeutic product in the merger with Mereo BioPharma 5 (formerly OncoMed). In a Phase 1a clinical trial, Navi demonstrated single agent activity. Following this we conducted a Phase 1b clinical trial in ovarian cancer, in combination with paclitaxel, in platinum-resistant ovarian cancer. A successful FDA Type B meeting was held in July 2019 and the potential for accelerated approval was discussed. Navicixizumab has also been granted Fast Track Approval by the FDA. In January 2020, Navi was licensed by the Company to OncXerna pursuant to the terms of a global licensing agreement. Under the terms of the contingent value rights agreement between us and Computershare from April 2019 (the "Mereo CVR Agreement"), the holders of contingent value rights are entitled to receive the benefit of certain cash milestone payments made to Mereo under the license agreement. Pursuant to the terms of the Mereo CVR Agreement, if a milestone occurs prior to the fifth anniversary of the closing of the Merger, April 23, 2024, then holders of CVRs will be entitled to receive an amount in cash equal to 70% of the aggregate principal amount received by Mereo after deduction of costs, charges and expenditures set out in detail in the Mereo CVR Agreement. Such milestone payments are also subject to a cash consideration cap, pursuant to which the aggregate principal amount of all cash payments made to holders of CVRs under the Mereo CVR Agreement shall in no case exceed $79.7 million.

Our Strategy

We intend to become a leading biopharmaceutical company developing innovative therapeutics that aim to improve outcomes for patients with rare diseases and select oncology indications. The key elements of our strategy to achieve this goal include:

- **Rapidly develop our product candidates and potentially commercialize our rare disease product candidates.** Etigilimab, our lead oncology program, has completed a Phase 1a dose escalating monotherapy study and has been evaluated in a Phase 1b combination study with nivolumab in a range of tumor types. We have advanced etigilimab into an open label Phase 1b/2 basket study evaluating our anti- TIGIT in combination with nivolumab in a range of tumor types including three rare tumors, sarcoma, uveal melanoma and germ cell cancer, three gynecological carcinomas, cervical, endometrial and ovarian carcinomas and tumors with high mutation burden. We reported interim data from this Phase 1b/2 basket study in November 2021 and expect to provide an additional update in mid-2022. We have an on-going Phase 2 proof-of-concept clinical trial of alvelestat for the treatment of severe AATD which we closed to enrollment in late 2021 and now expect to report top-line data from this trial in early Q2 2022. If the results are favorable and pending regulatory feedback, we will determine the optimum path forward for development of alvelestat towards approval and commercialization. We also announced the completion and top-line data of a Phase 1b/2 placebo-controlled clinical trial to evaluate the safety and efficacy of alvelestat in hospitalized adult patients with moderate to severe COVID-19 respiratory disease. The investigator-sponsored Phase 1b/2 study in BOS following SCT has completed the Phase 1b stage (10 patients) and is expected to commence Phase 2 in the second half of 2022 to evaluate clinical efficacy on lung function (FEV1) in a 6-month study in up to an additional 24 patients, with expansion for responders to 12 months. We have completed and announced top-line data on a Phase 2b clinical trial of setrusumab for the treatment of OI in adults in the United States, Europe and Canada. We reported topline data on the three blinded dose ranging arms in November 2019 with the results supporting progression of setrusumab into a pediatric pivotal study in OI. Following the completion of the dosing part of the study, patients were followed for a further twelve months to examine the off-effects of setrusumab. In September 2020, the FDA granted Rare Pediatric Disease designation to setrusumab for the treatment of OI. Following our completion of the Phase 2b ASTEROID study, we met with both the FDA (end-of-Phase 2 (EOP2) meeting in February 2020) and the EMA (PRIME meeting in May 2020) to discuss the principles of a design of a single Phase 2/3 registrational pediatric study in OI. In December 2020, we signed a license and collaboration agreement for setrusumab in OI with Ultragenyx Pharmaceutical Inc. Ultragenyx plans to start a Phase 2/3 study in young adults and pediatric patients (5-25 years old) in the first half of 2022 and to provide an update on the Phase 2 dose ranging part of this study in the second half of 2022. Following selection of the dose for the Phase 3 study, Ultragenyx intend to initiate an additional registrational trial in young pediatric patients (2-4 years old) in the second half of 2022. We intend to commercialize our rare disease product candidates where it makes strategic sense to do so. For example, in our global licensing collaboration with Ultragenyx we have retained commercial rights to setrusumab for children and adults with OI in the EU and U.K.

- **Efficiently advance our other product candidates and explore out-licensing or sale opportunities with third parties for further clinical development and/or commercialization.** Based on the results from our Phase 2 clinical trial of acumapimod, we plan to enter into one or more strategic relationships with third parties for acumapimod to undertake the next phase of clinical development and, if approved, commercialization. In March 2018, we reported top-line Phase 2b data for leflutrozole for the treatment of HH and in December 2018, we reported positive results from the safety extension study for leflutrozole. We intend to explore out-licensing or sale opportunities with third parties for the further development and commercialization of leflutrozole. Our second oncology product, navicixizumab, for the treatment of late line ovarian cancer, has completed a Phase 1 study and has been partnered on a global basis with OncXerna.

- **Continue to be a partner of choice for pharmaceutical and biotechnology companies.** We believe that we are a preferred partner for 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, as well as by the Merger, 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 pharmaceutical and biotechnology companies and that we believe to be mutually beneficial.

- **Leverage our expertise in business development.** Our senior management team has extensive relationships with large pharmaceutical and biotechnology companies. These relationships are important to us as we seek to form strategic partnerships on our product candidates and as appropriate, to grow our pipeline of product candidates in rare diseases.

Financial review

The following table sets forth Mereo's results of operations for the years ended December 31, 2021 and 2020.

	Year Ended December 31, 2021 £'000s	2020 £'000s
Revenue	36,464	–
Cost of revenue	(17,908)	–
Research and development expenses	(23,559)	(16,347)
Administrative expenses	(15,933)	(21,222)
Operating loss	**(20,936)**	**(37,569)**
Finance income	1	44
Finance costs	(4,022)	(6,383)
Changes in fair value of financial instruments	40,039	(109,849)
Gain/(loss) on disposal of intangible assets	113	(10,872)
Net foreign exchange loss	(954)	(1,821)
Profit/(loss) before tax	**14,241**	**(166,450)**
Taxation	(1,516)	2,822
Loss attributable to equity holders of the parent	**12,725**	**(163,628)**
Exchange differences on translation of foreign operations	(191)	349
Total comprehensive loss attributable to equity holders of the parent	**12,534**	**(163,279)**

Revenue

Revenue was £36.5 million for the year ended December 31, 2021 compared to nil for year ended December 31, 2020.

In January 2021, the Company's licensing and collaboration agreement with Ultragenyx for the development and commercialization of setrusumab for OI became effective. Under the terms of the agreement, Ultragenyx will lead future global development of setrusumab in both pediatric and adult patients. We granted Ultragenyx an exclusive license to develop and commercialize setrusumab in the US and rest of the world, excluding Europe and the U.K. where we retain commercial rights. Each party will be responsible for post-marketing commitments in their respective territories.

Ultragenyx made an upfront payment of £36.5 million ($50 million) to Mereo in January 2021 and will fund global development of the program until approval and has agreed to pay a total of up to $254 million upon achievement of certain clinical, regulatory and commercial milestones. Ultragenyx will pay tiered double digit percentage royalties to us on net sales outside of Europe and the U.K. and we will pay a fixed double digit percentage royalty to Ultragenyx on net sales in Europe and the U.K.

Cost of revenue

Cost of revenue for the year ended December 31, 2021 was £17.9 million compared to nil for the year ended December 31, 2020. This was comprised of £9.5 million, representing the carrying value of the setrusumab rights granted to Ultragenyx under the licensing and collaboration agreement, and £8.4 million in relation to our 2015 agreement with Novartis, under which the Company pays a percentage of proceeds, subject to certain exceptions. Under the terms of this agreement, we made a payment of £7.2 million to Novartis for the year-ended December 31, 2021.

Research and development ("R&D") Expenses

The following table sets forth our R&D expenses by product development program for the years ended December 31, 2021 and 2020.

	Year Ended December 31,	
	2021	2020
	£'000s	£'000s
Setrusumab (BPS-804)	3,597	7,695
Alvelestat (MPH-966)	5,303	4,709
Etigilimab (MPH-313)	13,499	1,029
Leflutrozole (BGS-649)	157	135
Acumapimod (BCT-197)	94	108
Navicixizumab ("Navi")	15	1,734
Other	63	153
Unallocated costs	831	784
Total R&D expenses	23,559	16,347

Total R&D expenses increased by £7.2 million, or 44%, from £16.3 million in 2020 to £23.6 million in 2021.

R&D expenses relating to etigilimab increased by £12.5 million. The increase was due to the costs associated with commencement of the open label Phase 1b/2 basket study in combination with nivolumab in a range of tumor types. R&D expenses relating to alvelestat increased £0.6 million, or 13%, primarily related to the ongoing Phase 2 proof-of-concept study. Partially offsetting the increases, R&D expenses relating to setrusumab and navicixizumab decreased by £4.1 million and £1.7 million, respectively. The decrease related to setrusumab was primarily driven by the licensing and collaboration agreement with Ultragenyx, under which Ultragenyx will fund global development of the program, and the decrease related to navicixizumab was driven by the global out-licensing agreement with OncXerna for the development and commercialization of navicixizumab.

Administrative expenses

Administrative expenses decreased by £5.3 million, or 25%, from £21.2 million in 2020 to £15.9 million in 2021.

The decrease was primarily driven by a £4.0 million reduction in legal and professional fees in 2021, reflecting lower activity and related transaction costs in 2021 compared to 2020, which included the June 2020 Private Placement and the cancellation of admission of our ordinary shares to trading on the AIM market of London Stock Exchange in December 2020. Premises-related costs decreased by £1.3 million in 2021 primarily due to one-off transaction costs in 2020 associated with renegotiation of our office lease in Redwood City.

Finance income and costs

Total finance costs decreased from £6.4 million in 2020 to £4.0 million in 2021. The decrease is primarily related to a decrease in bank loan interest of £2.9 million following the settlement of the bank loan in December 2020 and a decrease in lease liability finance charges of £0.9 million, partially offset by £1.3 million of additional interest primarily on the June 2020 Private Placement convertible loan notes.

Changes in fair value of financial instruments

The total change in fair value of financial instruments for 2021 was a gain of £40.0 million. The gain resulted from a £39.5 million unrealized gain on Warrants in respect of the June 2020 Private Placement and a £0.5 million unrealized gain on warrants issued to our former lenders in connection with the loan facility.

The total change in fair value of financial instruments for 2020 was a loss of £109.8 million. The loss primarily resulted from the Loan Notes and Warrants in respect of the June 2020 Private Placement, including: (i) a £63.2 million loss realized on the embedded derivative associated with the Loan Notes that was conditional on the passing of the Resolutions at a subsequent general meeting of shareholders held on June 30, 2020, and (ii) a £46.0 million unrealized loss on the Warrants. In addition, the unrealized loss on warrants issued to our former lenders in connection with the loan facility was £0.7 million in 2020.

Net foreign exchange gain/(loss)

The net foreign exchange loss for 2021 was £1.0 million, a decrease of £0.8 million from a £1.8 million loss in 2020. The net foreign exchange loss consists primarily of foreign exchange loss on the translation of non-functional currency cash deposits, primarily held in U.S. dollars.

Taxation

The income tax charge for 2021 was £1.5 million. The income tax charge arises primarily from £40.0 million unrealized gain resulting from changes in the fair value of warrant instruments.

The income tax benefit for 2020 was £2.8 million. The income tax benefit represents eligible cash rebates paid or receivable from the tax authorities in the jurisdictions within which we operate for eligible types of research and development activities and associated expenditure (the "R&D tax credit"). Further, in February 2020, Mereo BioPharma 5 received a tax refund in respect of AMT of £0.2 million from the U.S. Internal Revenue Service ("IRS"). We currently estimate that an additional £0.8 million of tax refund in respect of AMT will be received in 2022 with respect to 2019.

Liquidity and Capital Resources

Overview

Under the current business plan and cash flow forecasts, and in consideration of (i) our ongoing research and development efforts which are focused on our etigilimab, our oncology product candidate, and on our rare disease product candidates, setrusumab and alvelestat, (ii) our general corporate funding requirements, (iii) the upfront payment of $50 million received under the license and collaboration agreement with Ultragenyx for setrusumab, and (iv) our public offering of ADSs in February 2021 which raised approximately $108.2 million (£78.4 million) net cash proceeds, we anticipate that our current on-hand cash resources will extend into 2024. However, we will need additional external funding to complete our development plans and take selected products through to commercialization.

We do not currently have any approved product candidates and as a result, have not generated any revenue from product sales. As a result, to date, we have financed our operations primarily through the issuances of our equity securities and convertible debt and our credit facility, which we entered into in August 2017 and subsequently repaid in full in December 2020. We raised $183 million (£137.9 million) in private placements of ordinary shares and convertible loan notes in 2020 and in a public offering of ADSs in February 2021.

In September 2018, we entered into a revised loan agreement which enabled us to extend the interest only period of the credit facility from September 30, 2018 to April 30, 2019. On April 23, 2019, we agreed a revision to the loan agreement which extended the interest only period of the credit facility through December 31, 2020. On December 15, 2020, we repaid the outstanding principal and accrued interest in full. In connection with the credit facility, we have issued warrants for (i) 1,243,908 ordinary shares at an exercise price of £2.95 per share, and (ii). 1,243,908 ordinary shares at a price of $0.4144 per share.

On October 8, 2018, we entered into a funding agreement with The Alpha-1 Project, Inc. ("TAP"), which provided for funding of up to $0.4 million as a contribution towards the development of our product candidate alvelestat. On November 1, 2018, the first tranche of $0.1 million was received and as a result we issued 41,286 warrants to subscribe for our ordinary shares at an exercise price of £0.003 per share.

February 2021 Public Offering

On February 12, 2021, we announced the completion of an underwritten public offering of 39,675,000 ADSs, at a public offering price of $2.90 per ADS, which includes 5,175,000 additional ADSs issued upon the exercise in full of the underwriters' option to purchase additional ADSs. The aggregate gross proceeds to us from the offering, before deducting underwriting discounts and commissions and offering expenses were $115.1 million. The net proceeds, after transaction costs, were £78.4 million ($108.2 million).

Partnership with Cancer Focus Fund and The University of Texas MD Anderson Cancer Center

On April 30, 2021, we entered into partnership with Cancer Focus Fund for a Phase 1b/2 study of etigilimab in Clear Cell Ovarian Cancer to be conducted at The University of Texas MD Anderson Cancer Center. The study will be financed by Cancer Focus Fund, in exchange for upfront consideration of $1.5 million (£1.09 million) of the Company's ordinary shares and additional payments based on the achievement of certain milestones.

Cash Flows

Comparison of Years Ended December 31, 2021 and 2020

The table below summarizes our cash flows from (used in) operating, investing and financing activities for the years ended December 31, 2021 and 2020.

	2021 £'000s	2020 £'000s
Net cash used in operating activities	(5,239)	(28,341)
Net cash (used in)/from investing activities	(421)	1,495
Net cash from financing activities	77,652	34,737
Net increase in cash and cash equivalents	71,992	7,891

Operating Activities

Net cash used in operating activities for the year ended December 31, 2021 was £5.2 million, a decrease of £23.1 million from £28.3 million in 2020. The decrease was primarily driven by the receipt of upfront payments from Ultragenyx of £36.5 million, offset by associated payments to Novartis of £7.2 million. In 2021, we received R&D tax credits from the U.K. tax authorities of £2.8 million compared to £10.4 million in 2020.

Investing Activities

Net cash used in investing activities for the year ended December 31, 2021 was £0.4 million, a decrease from a cash inflow of £1.5 million in 2020. In 2020, we received net proceeds of £1.8 million following the global licensing arrangement for navicixizumab to OncXerna.

Financing Activities

Net cash from financing activities for the year ended December 31, 2021 was £77.7 million, an increase of £42.9 million from £34.7 million in 2020. The increase is primarily attributable to: £78.4 million net proceeds from the Public Offering in February 2021 compared to £59.6 million net proceeds from the issuance of ordinary shares and convertible loan notes in 2020; partially offset by repayment of £22.7 million of capital and interest on our bank loan and £2.1 million of lease liabilities in 2020.

Financial outlook

We expect that our existing cash and short-term deposits will enable us to fund our currently committed clinical trials and operating expenses and capital expenditure requirements into 2024.

Principle risks and uncertainties

The risks described below are those that we currently believe may materially affect us. We may face additional risks and uncertainties not currently known to us or that we currently deem to be immaterial.

- We have a limited operating history and have never generated any revenue from product sales.
- We will need additional funding to complete the development of our current product candidates; to license, acquire, and develop future product candidates; and to commercialize our product candidates, if approved. If we are unable to raise capital when needed, we could be forced to delay, reduce, or eliminate research and development programs, any future commercialization efforts or acquisitions of potential product candidates.
- We depend heavily on the success of etigilimab, alvelestat and setrusumab. We cannot give any assurance that any of these product candidates or therapeutic candidates will receive regulatory approval, which is necessary before they can be commercialized. If we are unable to commercialize etigilimab, alvelestat and setrusumab, whether on our own or through agreements with third parties, or experience significant delays in doing so, our ability to generate revenue and our financial condition will be adversely affected.

- The COVID-19 pandemic may continue to impact our business or any other similar pandemic may materially impact our business, including, delays to enrollment of patients in clinical trials for our product candidates, delays in engagement with or responses from regulatory authorities, delays to clinical trial supplies, planned clinical developments and our ongoing or future clinical studies.

- We depend on enrollment of patients in our clinical trials for our product candidates. If we are unable to enroll patients in our clinical trials, or enrollment is slower than anticipated, in particular for our product candidates with rare disease indications, our research and development efforts could be adversely affected.

- We may become exposed to costly and damaging liability claims, either when testing our product candidates in the clinic or at the commercial stage, and our product liability insurance may not cover all damages from such claims.

- Enacted and future healthcare legislation may increase the difficulty and cost for us to obtain marketing approval of and commercialize our product candidates and may affect the prices we may set.

- We operate in a highly competitive and rapidly changing industry, which may result in others acquiring, developing, or commercializing competing product candidates before or more successfully than we do.

- We intend to directly commercialize or co-commercialize our product candidates for rare diseases and potentially rare tumor types and to out-license or sell our other product candidates for further development and/or commercialization. If we are unable to develop our own sales, marketing, and distribution capabilities or enter into business arrangements, we may not be successful in commercializing our product candidates.

- The successful commercialization of our product candidates will depend in part on the extent to which governmental authorities and health insurers establish adequate coverage, reimbursement levels, and pricing policies. Failure to obtain or maintain coverage and adequate reimbursement for our product candidates, if approved, could limit our ability to market those product candidates and decrease our ability to generate revenue.

- Our existing and future product candidates may not gain market acceptance, in which case our ability to generate revenues from product sales will be compromised.

- We rely, and expect to continue to rely, on third parties, including independent investigators and CROs, to conduct our clinical trials. If these CROs do not successfully carry out their contractual duties or meet expected deadlines, we may not be able to obtain regulatory approval for or commercialize our product candidates, or such approval or commercialization may be delayed, and our business could be substantially harmed.

- We currently rely on third-party CMOs for the production of clinical supply of our product candidates and intend to rely on CMOs for the production of commercial supply of our product candidates, if approved. Our dependence on CMOs may impair the development of our product candidates and may impair the commercialization of our product candidates, which would adversely impact our business and financial position.

- We rely on patents and other intellectual property rights to protect our product candidates, the obtainment, enforcement, defense and maintenance of which may be challenging and costly. Failure to enforce or protect these rights adequately could harm our ability to compete and impair our business.

- We may become subject to third parties' claims alleging infringement of third-party patents and proprietary rights, or we may be involved in lawsuits to protect or enforce our patents and other proprietary rights, which could be costly and time consuming, delay or prevent the development and commercialization of our product candidates, or put our patents and other proprietary rights at risk.

- Our future growth and ability to compete depends on retaining our key personnel and recruiting additional qualified personnel.

- Failure to establish and maintain effective internal controls could have a material adverse effect on our business and stock price.

- If our partners do not satisfy their obligations under our agreements with them, or if they terminate our licenses, partnerships or collaborations with them, we may not be able to develop or commercialize our licensed or partnered product candidates as planned.

Risk Mitigations

The Board believes that it has taken all reasonable steps to satisfy itself that the risk management process is effective and fit for purpose. Our control of risk is supported by an in-house quality team that has developed and implemented a Good Practice (GxP) compliant quality management system to mitigate risk. The Head of Quality reports to the General Counsel with appropriate escalation measures in place to review and control new and emerging risks within the business. We set out below the key risk mitigations by area:

Clinical development and manufacturing: Our highly experienced in-house team manages the control over our external vendors and partners that assist us as sponsor in managing our clinical trials under GxP. In addition to quality audits of our CROs and clinical trial sites, we also undertake specialized data analytics that are designed to validate the quality of data generated from our clinical trials. The Group also has an experienced in-house team that is working with a number of specialist manufacturers in respect of its drug manufacturing capabilities.

Commercialization: For our rare disease programs, we engage with regulators, health technology assessment ("HTA") bodies, treating physicians and patient representative organizations at all stages of our development. We are also in regular dialogue with the European payers through the Mechanism of Coordinated Access to Orphan Medicinal Products ("MoCA"). Treating physicians, notably those in the lead centers of expertise are part of our development work on an ongoing basis; and we also consult regularly with the patient representative organizations from the therapeutic areas we intend to address. Market research work, including pricing, has been initiated for our two rare disease candidate products. We constantly monitor development programs from other companies in our target indications, to allow us to effectively understand and evaluate the competitive landscape for etigilimab, alvelestat and setrusumab on an ongoing basis.

Regulatory: We have an experienced in-house team who works with several specialized regulatory advisors to give guidance on regulatory strategy for each of our candidate products. As our programs continue through their respective development plans, the relative risk that we fail to obtain regulatory approval continues to decrease. Matters that remain outside our control, e.g., the scientific performance of a compound in a clinical study, or the ultimate decision-making of a regulatory body, are mitigated by dialogue with decision- makers and rigorous study preparation and design.

Compliance with laws and regulations: Following our U.S. listing of our American Depository Shares ("ADSs") in 2019, we introduced new policies and procedures to ensure that our business practices are aligned with those expected of a Nasdaq listed company. This has included updates to the Terms of Reference for the Board Committees which are available for inspection on our website. We cancelled admission of the Company's ordinary shares to trading on the AIM market of the London Stock Exchange in December 2020. Following the cancellation of AIM admission, many of our corporate governance policies and procedures as well as the terms of reference for the Board Committees were updated to reflect the Company's sole listing on the Nasdaq Global Market. As a data controller, we are accountable for any third-party data service providers we engage to process personal data on our behalf. We attempt to address the associated risks by performing security assessments, detailed due diligence and regularly performing privacy and security reviews of our vendors and requiring all such third-party providers with data access to sign agreements, including business associate agreements, and where required under EU or UK law, obligating them to only process data according to our instructions and to take sufficient security measures to protect such data. The Group's General Counsel and Company Secretary, who serves as an Executive Officer, is responsible for ensuring compliance with laws and regulations. For certain matters, the Company will engage external counsel or regulatory advisors. We continued to make progress during the year in refining our internal financial processes and controls to support our attestation under Section 404(a) of the Sarbanes- Oxley Act of 2002 and involved our Audit and Risk Committee ("ARC") throughout the process.

Intellectual Property: We have an experienced Head of IP employed by the Company since 2015 and, in addition, we utilize expert external counsel in the prosecution and maintenance of our IP portfolio.

Funding: As at December 31, 2021 the Group had total cash resources (being cash and short-term deposits) of £94.3 million. In January 2021, the Group received an upfront payment of £36.5 million under the terms of our license and collaboration agreement with Ultragenyx for setrusumab. Taken together with the public offering which completed on February 12, 2021 and which raised net proceeds of approximately £78.4 million, the Group has sufficient cash resources. The Directors have prepared detailed quarterly cashflow forecasts through December 31, 2024. These forecasts indicate that the Group has a total cash runway into 2024 and will have sufficient funds to meet its liabilities as they fall due for at least the next 12 months.

Key Performance Indicators
The Directors consider that our underlying cash burn, cash balances and future cash runway, and our committed and planned expenditure on research and development ("R&D") to be the Group's key financial KPIs at its current stage of development. Progress and performance against these key financial KPIs are discussed in the "Financial review" section of the Strategic Report.

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;
- Business development including partnering, out-licensing and in-licensing activities; and
- The development and prosecution of our patent portfolio.

These activities are discussed in the "Business overview and strategy" section of the Strategic Report.

Information about the Company's employees
The Group's future success depends on the ability to recruit and retain key employees. Our employee base includes key people in strategic areas including in corporate development, patient access and commercial planning, as we move our rare disease programs forward and seek to partner our specialty products. We have been fortunate to attract and retain highly experienced individuals in clinical development, clinical operations, regulatory, finance, legal, manufacturing, intellectual property and quality assurance, supporting them with strong leadership at the executive and Board level.

Our internal expertise is leveraged with external organizations, including contract research organizations ("CROs") and contract manufacturing organizations ("CMOs") as well as bespoke consulting agreements. This combination has allowed the Group to initiate international clinical trial studies within a relatively short period of time since acquiring products from large pharma, whilst also maintaining a lean internal infrastructure.

Across the U.K. and the U.S., we have 52 employees as of the date of this annual report. Mereo seeks to appoint employees with appropriate skills, knowledge and experience for the roles they undertake and thereafter to develop, incentivize and retain staff. The Board of Directors ("the Board") recognizes its legal responsibility to ensure the well-being, safety and welfare of the Group's employees and maintain a safe and healthy working environment for them and for our visitors. If an employee has a concern about unsafe conditions or tasks, they are encouraged to report their concerns immediately to their manager, human resources or the General Counsel. Employees may also contact a dedicated whistleblowing hotline, independent of the Group, if anonymity is sought.

The Group is fully committed to the elimination of unlawful and unfair discrimination and values the differences that a diverse workforce brings to the organization. The Group endeavors to not discriminate because of age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race (which includes color, nationality and ethnic or national origins), religion or belief, sex or sexual orientation. This is captured in our Employee Handbook, which all employees are required to read and acknowledge on at least annual basis. The Group will undertake an annual review of its policies and procedures to establish its position about compliance and best practice and monitor and promote a healthy corporate culture.

A breakdown of employment statistics by gender as at December 31, 2021 is as follows:

Position	Male	Female	Total
Directors of the Company (CEO and Non-Executive)	6	2	8
Executive officers	4	4	8
Employees	20	20	40
Total	**30**	**26**	**56**

Executive officers consist of senior managers who have responsibility for planning, director or controlling the activities of the Group. As at December 31, 2021, this includes the Chief Financial Officer, Chief Portfolio Management and Pipeline Strategy, General Counsel and Company Secretary, Chief Business Officer, Chief Patient Access and Commercial Planning, Chief Scientific Officer, Senior Vice President and Therapeutic Head and Senior Vice President Clinical Development.

Our Directors have significant operational experience in leadership positions in large and small pharmaceutical and biotechnology companies. They provide valuable strategic input into our corporate development programs and our R&D strategy, corporate and financing strategies. On March 1, 2022, Anne Hyland was appointed as a Non-Executive Director.

Diversity and human rights

The Company recognizes the value in promoting a culture of diversity and inclusion and aims to both reflect the global communities in which we operate and have a positive impact upon them. At present the Company does not have a specific policy on human rights, however we have several policies that promote the principles of human rights. We partner with our suppliers and external organizations to ensure long-term mutually beneficial relationships, and respect for human rights is embedded throughout our global network.

Social and environmental matters

We currently outsource our research, development, testing and manufacturing activities. These activities are subject to various environmental, health and safety laws and regulations, which govern, among other things, the controlled use, handling, release and disposal of, including the maintenance of a registry for, hazardous materials and biological materials. If we or our partners fail to comply with such laws and regulations, we could be subject to fines or other sanctions.

As with other companies engaged in similar activities, we face a risk of environmental liability that is inherent in our current and historical activities, including liability relating to releases of or exposure to hazardous or biological materials. Environmental, health and safety laws and regulations are becoming more stringent. We may be required to incur substantial expenses in connection with future environmental compliance or remediation activities, in which case, production and development efforts being carried out by our outsourced partners relating to our products may be interrupted or delayed.

Quantification and reporting methodology

The 2019 UK Government Environmental Reporting Guidelines and the GHG Protocol Corporate Accounting and Reporting Standard (revised edition) were followed to ensure the Streamlined Energy and Carbon Reporting ("SECR") requirements were met. The SECR disclosures include the U.K. group companies only.

The energy data was collated using existing reporting mechanisms. These methodologies provided continuous record of electricity use.

The energy data was converted to carbon emissions using the 2021 UK Government GHG Conversion Factors for Company Reporting. The associated emissions are divided into the combustion of fuels and the operation of facilities (scope 1), purchased electricity, heating and cooling (scope 2) and in-direct emissions that occur as a consequence of company activities (scope 3). During the year the Group only had emissions relating to scope 2.

Estimations

The electricity use was compiled from invoices and meter readings.

	2021	2020
Energy used by the company (in KWH)	68,626	95,507
Emissions associated with the reported energy use (tCO_2e)	15	22

Intensity Ratio

The chosen primary intensity ratio is total gross emissions in metric tonnes CO2e (mandatory emissions) per employee.

	2021	2020
Tonnes of CO_2e per employee	0.49	0.73

Energy efficiency action during current financial year

The management of resources and the need to embed sustainability is an important issue for the Group and the following actions related to reducing energy use were implemented within the current reporting period.

Energy consumption in 2021 continued to be low resulting from the "work from home" guidance by the U.K. government in the first half of 2021.

In addition, during the office refurbishment in 2021, we prioritized energy saving choices such as insulating floors, motion-activated lighting, and operational changes to the heating system. As a company, we are also committed to sourcing our electricity from fully renewable sources. We continue to invest in energy efficiency and are currently in the process of migrating to more energy efficient IT storage solutions.

Section 172(1) Companies Act 2006

The Directors in line with their duties under section 172 of the Companies Act 2006, act in a way they consider, in good faith to promote the success of the Group for the benefit of its members as a whole. As set out within the content of this annual report, the Directors have considered the following matters throughout the year and in formulating the future strategy of the business:

- The likely long-term consequences of any decision;
- The interests of the Group's employees;
- The need to foster the Group's business relationships with suppliers, customers and others;
- The impact of the Group's operations on the community and the environment;
- The desirability of the Group maintaining a reputation for high standards of business conduct; and
- The need to act fairly between shareholders of the Group.

The Board of Directors meets regularly to discuss developments of the Group's existing portfolio of product candidates, strategic business development, ongoing operations and other relevant matters. The Board takes care to have considered the likely consequences on all stakeholders of the decisions and actions which they take, and these are discussed regularly in the Board meetings. The Group's long-term strategy and the principal risks and uncertainties in the view of the Board are set out in pages 12 to 15.

As set out in greater detail above, the Board considers the Group's future success to depend on our ability to recruit and retain key employees. The Board maintains constructive dialogue with employees through the Chief Executive Officer ("CEO"). The Company also holds regular "town hall" all-employee meetings and video conference calls where the Executive Team provides updates on strategic progress and a forum for answering questions. We implemented a revised long-term incentive plan in April 2019, which allows us to incentivize and retain employees across the Group and aligns employees' objectives with those of the Group. We granted share options under these schemes to all employees and Non-Executive Directors in 2021 and 2020.

The Group endeavors to maintain good relationships with our suppliers by contracting, where possible, on their standard business terms and paying them in accordance with the relevant terms agreed. We meet with

our significant suppliers regularly, using the meetings to ensure that our research programs are planned and delivered effectively and in a timely and cost-efficient manner. This ensures that the Group's and our significant suppliers' interests are aligned. The Group also maintains excellent working relationships with our partners in collaboration agreements, with regular meetings and updates.

The Board understands the importance of environmental, social and governance matters and it endeavors to consider the impact on the community when operating its business. Our greenhouse gas emissions report which is in compliance with streamlined energy and carbon reporting requirements is included on page 16. In 2021, as a result of continuing COVID-19 restrictions, there has been continued use of video conferencing for internal and external meetings and board meetings, reducing the need for travel. The emissions saving resulting from these activities has not been quantified, but this practice has resulted in some behavior changes that are expected to continue for the foreseeable future. In 2021, while we refurbished our office space, we also took the opportunity to ensure we utilize energy efficient and sustainable solutions wherever possible.

The Board recognizes the importance of maintaining high standards of business conduct. The Group operates a Code of Business Conduct and Ethics, publicly available on our website, which contains general guidelines for conducting the business of the Group consistent with the highest standard of business ethics. In addition, the Group has an Employee Handbook that employees are required to read and acknowledge on at least an annual basis and which also includes details of the whistleblowing policy that allows all employees to raise concerns to senior management in strict confidence about any unethical business practices, fraud, misconduct or wrongdoing. The Group also works with business management consultants at a Company and Executive Team level to assess our culture and to embed any agreed modifications.

In maintaining good corporate governance structures, the Board considers the need to act fairly to all shareholders of the Group. The Group maintains a regular dialogue with our institutional investors. The Group's website has a dedicated investor section which provides useful information for our shareholders, including the latest announcements, press releases, published financial information, details of our product candidates and our current development pipeline and other information about the Company.

This strategic report, which has been prepared in accordance with Companies Act 2006, has been approved by the Board and signed on behalf of the Board:

Dr. Peter Fellner	**Dr. Denise Scots-Knight**
Chairman	Chief Executive Officer
March 31, 2022	March 31, 2022

Annual Statement by Chair of Remuneration Committee
Introduction
Dear Shareholder,

As Chair of the Remuneration Committee (the "Committee"), I am pleased to present, on behalf of the Board of Directors of Mereo BioPharma Group plc (the "Company") the Directors' Remuneration Report for the year ended December 31, 2021 (the "Report"). We are required to prepare this Report due to the Company's listing in the U.S. on the Nasdaq Global Market and our UK incorporation.

This Report includes this Annual Statement and the Annual Report on Remuneration for the financial year ended December 31, 2021. The Directors' Remuneration Report will be subject to an advisory shareholder vote at the 2022 Annual General Meeting ("AGM"). The current Directors' Remuneration Policy ("Policy") was approved by shareholders at the AGM on May 27, 2021. The Policy took formal effect from the date of approval and is intended to apply until the 2024 AGM, unless a new version is presented to shareholders in the interim. The full shareholder approved Policy can be found in the Annual Report and Accounts for the year ended December 31, 2020.

The Remuneration Committee has concluded that the current overarching remuneration framework continues to be effective and that no significant changes to the Policy and its implementation are currently required.

As a reminder, we operate a simple and transparent structure comprising salary, benefits and pension and, subject to stretch performance conditions, an annual bonus. In addition, we regularly make awards of equity incentives to encourage longer-term commitment and sustainable performance. The Committee considers that the Policy provides a fair basis for the remuneration of Executive Directors, rewarding performance against short-term objectives which provide the foundations for the achievement of longer-term corporate goals, and making the enhancement of shareholder value a critical success factor, both in the short and the long-term.

In 2022 one change to how we implement the current Policy has been made with the creation of a Deferred Compensation Plan under the Company's existing 2019 Non-Employee Equity Incentive Plan. Under the new Deferred Compensation Plan, Non-Employee Directors may voluntarily elect, on an annual basis, to receive Deferred Restricted Share Units ("RSUs") over ADSs in lieu of their cash fees, which are then held until settlement following separation of service.

In the year ended December 31, 2021, all decisions taken on remuneration were in accordance with the terms of reference of the Remuneration Committee and involved the exercise of appropriate commercial judgment. No discretions were exercised in relation to directors' remuneration in the year beyond the exercise of the commercial judgment of the Remuneration Committee.

Yours sincerely,

Dr. Deepa Pakianathan
Chair of the Remuneration Committee,

March 31, 2022

Annual Report on Remuneration

2.1 Single total figure of remuneration of each Director (audited)

The Directors proportion of fixed and variable remuneration is shown in the below table for the years ended December 31, 2021 and 2020. Fixed remuneration is the sum of salary, taxable benefits and pension (columns a, b and e of the single total figure table). Variable remuneration is the sum of any annual bonus, share options or other types of remuneration (columns c, d and other of the single total figure table). Further information about share option grants can be found on page 25.

Year Ended December 31, 2021 (in £)	(a) Salary/fees	(b) Benefits (i)	(c) Bonus	(d) Share options (iv)	(e) Pensions	Other (ii/iii)	2021 Total	Fixed Remuneration (a, b and e)	Variable remuneration (c, d and other)
Executive									
Dr. Denise Scots-Knight[1]	398,808	9,050	239,284	–	58,155	940,000	1,645,297	466,013	1,179,284
Non-Executive									
Dr. Peter Fellner	100,000	–	–	–	–	56,942	156,942	100,000	56,942
Peter Bains[2]	37,218	–	–	–	–	56,942	94,160	37,218	56,942
Dr. Jeremy Bender	40,375	–	–	–	–	105,444	145,819	40,375	105,444
Dr. Anders Ekblom	47,175	–	–	–	–	56,942	104,117	47,175	56,942
Kunal Kashyap[3]	43,750	–	–	–	–	56,942	100,692	43,750	56,942
Dr. Deepa Pakianathan	44,150	–	–	–	–	56,942	101,092	44,150	56,942
Dr. Brian Schwartz	39,550	–	–	–	–	105,444	144,994	39,550	105,444
Michael Wyzga	49,500	–	–	–	–	56,942	106,442	49,500	56,942
Pierre Jacquet[4]	9,962	–	–	–	–	–	9,962	9,962	–

(1) Pension figure included in the table above for Dr. Denise Scots-Knight includes payments in lieu of pension of £54,155.
(2) Peter Bains resigned on September 20, 2021. Refer to Payments for loss of office on page 23.
(3) Kunal Kashyap resigned on October 26, 2021. Refer to Payments for loss of office on page 23.
(4) Pierre Jacquet was appointed on September 20, 2021. The figure included in the table represents the amount accrued and unpaid as of December 31, 2021. On February 1, 2022, Mr. Jacquet was granted 33,393 market value options under the 2019 NED EIP plan which vested on grant in lieu of this amount.

Year Ended December 31, 2020 (in £)	(a) Salary/fees	(b) Benefits (i)	(c) Bonus	(d) Share options (iv)	(e) Pensions	Other (ii/iii)	2020 Total	Fixed Remuneration (a, b and e)	Variable remuneration (c, d and other)
Executive									
Dr. Denise Scots-Knight[1]	398,808	8,784	398,808	–	61,488	175,596	1,043,484	469,080	574,404
Richard Jones[2]	230,513	4,839	–	–	–	147,790	383,142	235,352	147,790
Michael Wyzga[3]	113,424	–	76,929	–	–	–	190,353	113,424	76,929
Non-Executive									
Dr. Peter Fellner	100,000	–	–	–	–	11,037	111,037	100,000	11,037
Peter Bains	48,000	–	–	–	–	11,037	59,037	48,000	11,037
Dr. Jeremy Bender[4]	10,000	–	–	–	–	–	10,000	10,000	–
Dr. Anders Ekblom	48,000	–	–	–	–	11,037	59,037	48,000	11,037
Kunal Kashyap	40,000	–	–	–	–	11,037	51,037	40,000	11,037
Dr. Deepa Pakianathan	44,000	–	–	–	–	11,037	55,037	44,000	11,037
Dr. Brian Schwartz[4]	10,000	–	–	–	–	–	10,000	10,000	–
Michael Wyzga[3]	23,333	–	–	–	–	11,037	34,370	23,333	11,037
Paul Blackburn[5]	48,000	–	–	–	–	11,037	59,037	48,000	11,037

(1) Pension figure included in the table above for Dr. Denise Scots-Knight includes payments in lieu of pension of £55,988.
(2) Richard Jones resigned on June 29, 2020. Per the Settlement Agreement, £37,500 representing the first instalment of the bonus is included within "Salary/fees" and remaining £62,500 representing the second and third instalments of the bonus is included within "Other".
(3) Michael Wyzga was appointed interim Chief Financial Officer on August 1, 2020. Remuneration shown above is for the period August 1, 2020 to December 31, 2020 in his Executive capacity, and for the period January 1, 2020 to July 31, 2020 in his Non-Executive capacity.
(4) Dr. Jeremy Bender and Dr. Brian Schwartz were appointed on October 1, 2020
(5) Paul Blackburn resigned on October 1, 2020.

(i) Benefits represent private medical insurance during the years ended December 31, 2021 and 2020.
(ii) During the years ended December 31, 2021 and 2020, market value options were granted as an equity incentive award to the CEO. The market value options do not have performance conditions and are therefore presented as other variable remuneration. The value of the market value options granted to the Executive Director included in the single figure table is the grant date fair value as computed in accordance with IFRS 2 (Share Based Payments) using a Black-Scholes option pricing model. No outstanding equity incentive awards with performance conditions vested during the year ended December 31, 2021.
(iii) During the years ended December 31, 2021 and 2020, other share-based awards were granted as an equity incentive award to Non-Executive Directors. The other share-based awards do not have performance conditions and are therefore presented as other variable remuneration. The value of the other share-based awards granted to Non-Executive Directors included in the single figure table is the grant date fair value as computed in accordance with IFRS 2 (Share Based Payments) using a Black-Scholes option pricing model.
(iv) During the years ended December 31, 2021 and 2020, no equity incentive awards with performance conditions or measures were granted or vested.

Annual performance bonus

The Company has a discretionary bonus scheme for all employees and the Executive Director (CEO). Bonus payments for employees are a percentage of base salary based on performance-based measures against personal and Company-wide target objectives. Bonus payments for CEO are a percentage of base salary, based on performance-based measures against Company-wide target objectives.

For the 2021 performance period, the CEO was entitled to an annual performance bonus of 60% of base salary for a target level of performance, which could be increased with stretch performance up to a maximum of 74.25% of base salary. The agreed Company-wide target objectives were met at 100% of target, meaning the bonus pay-out for the 2021 performance period is 60% of base salary for the CEO.

Specific details of the actual Company-wide target objectives are considered commercially sensitive and therefore not disclosed in detail. However, the objectives used to measure the performance of the Chief Executive Officer for 2021 included the following:

- Successful public offering of ADSs with aggregate gross proceeds of $115.1 million, securing cash runway into Q1 2024
- Successful partnership with Cancer Focus Fund, in collaboration with The University of Texas MD Anderson Cancer Centre, to support a Phase 1b/2 study of etigilimab in clear cell ovarian cancer
- On etigilimab, promising interim efficacy, safety and biomarker data from the ongoing Phase 1b/2 study in a range of tumor types
- On alvelestat, enrollment of 99 patients in the ongoing Phase 2 study in AATD with top-line data expected in early Q2 2022, successful application of orphan drug designation in the US, data from the investigator-sponsored Phase 1b/2 in BOS that supports further evaluation for this indication, and encouraging top-line results from the investigator-led Phase 1b/2 study in COVID-19 infected patients
- On setrusumab, successful completion of the knowledge transfer to Ultragenyx Pharmaceutical Inc. under the license and collaboration agreement
- In manufacturing, successful production of sufficient drug product for the Phase 1b/2 study for etigilimab
- Successful achievement of milestones on intellectual property

In addition, the Committee took into account the following achievements which were not specifically incorporated into the corporate objectives:

- Development of assays for additional primary endpoints in the ongoing Phase 2 study in AATD and a FDA Type C meeting granted to discuss clinical endpoints for potential Phase 3 study in AATD ahead of top-line data expected in early Q2 2022
- Appointment of new board members

Long-term incentive awards granted during the financial year (audited)

Directors may be granted long-term incentive awards at the discretion of the Committee. During the year ended December 31, 2021:

– The CEO was awarded options under the Company's 2019 Equity Incentive Plan ("EIP") to subscribe for market value options over a four-year vesting period. The awards vest 25% after one year and in 36 equal monthly instalments thereafter. The options awarded under the EIP were in respect of ADSs and do not have performance conditions.

– All Non-Executive Directors were awarded options under the Company's 2019 Non-Executive Director Equity Incentive Plan ("NED EIP") to subscribe for share-based awards over a one-year vesting period. The awards vest monthly over an annual period from the grant date. The share-based awards granted under the NED EIP were in respect of ADSs and do not have performance conditions.

All awards granted under the EIP and NED EIP during the year ended December 31, 2021, are subject to a service condition and may be exercised at any time between the relevant vesting date and the tenth anniversary of the date of grant. Awards which do not vest at the end of the vesting period will lapse permanently.

Director	Grant date	ADSs Underlying Grant	Exercise Price per ADS ($)	Face value ($)	Expiration Date
Dr. Denise Scots-Knight	February 1, 2021	520,000	2.72	1,414,400	February 1, 2031
Dr. Peter Fellner	February 1, 2021	31,500	2.72	85,600	February 1, 2031
Peter Bains	February 1, 2021	31,500	2.72	85,600	February 1, 2031
Dr. Jeremy Bender	January 19, 2021	22,000	3.32	73,040	January 19, 2031
Dr. Jeremy Bender	February 1, 2021	31,500	2.72	85,600	February 1, 2031
Dr. Anders Ekblom	February 1, 2021	31,500	2.72	85,600	February 1, 2031
Kunal Kashyap	February 1, 2021	31,500	2.72	85,600	February 1, 2031
Dr. Deepa Pakianathan	February 1, 2021	31,500	2.72	85,600	February 1, 2031
Dr. Brian Schwartz	January 19, 2021	22,000	3.32	73,040	January 19, 2031
Dr. Brian Schwartz	February 1, 2021	31,500	2.72	85,600	February 1, 2031
Michael Wyzga	February 1, 2021	31,500	2.72	85,600	February 1, 2031

The exercise price of all options granted during the year under the 2019 EIP and 2019 NED EIP was the market value of the ADSs upon closing on the last business day before the grant.

Awards lapsed during the year to December 31, 2021 (audited)

During the year to December 31, 2021, certain awards previously made to Dr. Denise Scots-Knight under a long-term incentive plan ("LTIP") were eligible to vest, however they lapsed as they did not meet the relevant vesting criteria (a share price performance condition).

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.

Director	Form of award	Grant date	Options outstanding (December 31, 2020)	Options lapsed	Options outstanding (December 31, 2021)
Dr. Denise Scots-Knight	LTIP	June 9, 2016	230,770	(230,770)	–

There were no LTIP awards granted during the year to December 31, 2021.

No other awards lapsed during the year to December 31, 2021.

2.2 Payments to past Directors (audited)
There were no payments to past Directors made during the financial year ending December 31, 2021.

2.3 Payments for loss of office (audited)
Peter Bains resigned from the Board and ceased to be a Director on September 20, 2021. In accordance with his letter of appointment and the terms agreed for his departure, Peter received the following in 2021:

- Fees up to the termination date, including payment in lieu of notice (total of £37,218);
- For the purposes of his outstanding Share Option Plan and 2019 EIP awards Mr. Bains will be treated as a 'good leaver' within the meaning of the scheme rules. As a result, he was allowed to retain 142,116 outstanding Share Option Plan awards and 40,375 outstanding vested 2019 NED EIP awards. He will be entitled to exercise these options for a period up to the tenth anniversary of the grant date for each award.

Kunal Kashyap resigned from the Board and ceased to be a Director on October 26, 2021. In accordance with his letter of appointment and the terms agreed for his departure, Mr. Kashyap received the following in 2021:

- Fees up to the termination date, including payment in lieu of notice (total of £43,750);
- For the purposes of his outstanding Share Option Plan and 2019 EIP awards Kunal will be treated as a 'good leaver' within the meaning of the scheme rules. As a result, he was allowed to retain 43,252 outstanding Share Option Plan awards and 43,000 outstanding vested 2019 NED EIP awards. He will be entitled to exercise these options for a period up to the tenth anniversary of the grant date for each award.

2.4 Directors' service contracts and letters of appointment
Dr. Denise Scots-Knight joined the Company as an employee on July 29, 2015 and her current service contract is dated September 3, 2021. She has a rolling service agreement with a notice period of twelve months from either party.

The dates of appointment of each of the Non-Executive Directors serving at December 31, 2021, are summarized in the table below:

Non-Executive Director	Date of appointment
Dr. Peter Fellner	July 29, 2015
Dr. Anders Ekblom	July 29, 2015
Michael Wyzga	April 23, 2019
Dr. Deepa Pakianathan	April 23, 2019
Dr. Brian Schwartz	October 1, 2020
Dr. Jeremy Bender	October 1, 2020
Dr. Pierre Jacquet	September 20, 2021

2.5 Statement of Directors' Shareholding and Share Interests (audited)

The table below sets out, as at December 31, 2021, the beneficial interest in the Company's shares of the Directors (together with interests held by his or her connected persons). In addition, the table below also sets out the total number of shares held by Directors which are unvested, the total number of options held by Directors which are vested but not yet exercised and the total number of options held by Directors which are unvested.

The total number of shares which are unvested are disclosed by those with and without performance conditions. The table below is presented in ADS equivalent when the underlying interest is in ordinary shares.

Director	Shares Vested Beneficially owned[1]	Shares Vested DBSP (vested, without performance conditions) (ADS equivalent)	Awards Vested 2015 Plan/ Share Option Plan (equivalent ADS vested but not yet exercised)	Awards Vested 2019 EIP/NED EIP (ADSs vested, not yet exercised)	Awards Unvested 2019 EIP/NED EIP (ADSs, unvested)
Dr. Denise Scots-Knight	209,213	6,441	308,949	189,582	680,418
Dr. Peter Fellner	13,100	–	338,534	48,250	5,250
Peter Bains[2]	41,359	–	142,116	40,375	–
Dr. Jeremy Bender	–	–	–	46,416	7,084
Dr. Anders Ekblom	37,940	–	43,252	48,250	5,250
Kunal Kashyap[2]	299,547	–	43,252	43,000	–
Dr. Deepa Pakianathan[3]	256,734	–	–	48,250	5,250
Dr. Brian Schwartz	20,000	–	–	46,416	7,084
Michael Wyzga	–	–	–	48,250	5,250

(1) Each ADS represents five ordinary shares; ordinary shares held have been converted into equivalent ADSs.
(2) Figures for Peter Bains and Kunal Kashyap are as of the date they resigned from the Board, September 20, 2021 and October 26, 2021, respectively.
(3) Delphi Ventures VIII, L.P. ("Delphi VIII") directly holds 254,327 ADSs. Delphi Bio Investments VIII, L.P. ("DBI VIII") directly holds 2,407 ADSs. Delphi Management Partners VIII, L.L.C. ("DMP VIII") is the general partner of Delphi VIII and DBI VIII (together, the "Delphi VIII Funds"), and may be deemed to have sole voting and dispositive power over the ADSs held by the Delphi VIII Funds. DMP VIII and each of James J. Bochnowski, David L. Douglass, Douglas A. Roeder and Deepa R. Pakianathan, Ph.D., the Managing Members of DMP VIII who may be deemed to share voting and dispositive power over the reported securities, disclaim beneficial ownership of the reported securities held by the Delphi VIII Funds except to the extent of any pecuniary interest therein.

The Company does not have a formal policy on Executive or Non-Executive Director shareholdings in the Company.

As at December 31, 2021, no unvested equity incentive awards are subject to performance conditions. The table below shows the interests of the Directors in the Company's share options as at December 31, 2021. The underlying grants for the 2015 Plan, LTIP and Deferred Bonus Share Plan ("DBSP") are in ordinary shares and have been presented here in equivalent ADS, which represents five ordinary shares.

Director	Equity Award Plan	Ordinary Shares (equivalent ADS) Underlying Grant	Exercise Price Per ADS ($)	ADSs Underlying Grant	Exercise Price Per ADS ($)	Grant Date	Expiration Date
Executive							
Dr. Denise	2015 Plan	308,948	8.63	–	–	September 25, 2015	September 25, 2025
Scots-Knight	DBSP	6,441	nil	–	–	April 26, 2018	January 31, 2022
	2019 EIP	–	–	87,500	5.40	May 20, 2019	May 20, 2029
	2019 EIP	–	–	87,500	3.00	July 23, 2019	July 23, 2029
	2019 EIP	–	–	175,000	1.84	February 20, 2020	February 20, 2030
	2019 EIP	–	–	520,000	2.72	February 1, 2021	February 1, 2031
Non-Executive							
Dr. Peter Fellner	2015 Plan	338,534	8.63	–	–	September 29, 2015	September 29, 2025
	2019 NED EIP	–	–	5,500	5.40	May 20, 2019	May 20, 2029
	2019 NED EIP	–	–	5,500	3.00	July 23, 2019	July 23, 2029
	2019 NED EIP	–	–	11,000	1.84	February 20, 2020	February 20, 2030
	2019 NED EIP	–	–	31,500	2.72	February 1, 2021	February 1, 2031
Peter Bains[1]	2015 Plan	142,116	8.63	–	–	September 29, 2015	September 29, 2025
	2019 NED EIP	–	–	5,500	5.40	May 20, 2019	May 20, 2029
	2019 NED EIP	–	–	5,500	3.00	July 23, 2019	July 23, 2029
	2019 NED EIP	–	–	11,000	1.84	February 20, 2020	February 20, 2030
	2019 NED EIP	–	–	18,375	2.72	February 1, 2021	February 1, 2031
Dr. Jeremy	2019 NED EIP	–	–	22,500	3.32	January 19, 2021	January 19, 2031
Bender	2019 NED EIP	–	–	31,500	2.72	February 1, 2021	February 1, 2031
Dr. Anders	2015 Plan	43,252	8.63	–	–	September 29, 2015	September 29, 2025
Ekblom	2019 NED EIP	–	–	5,500	5.40	May 20, 2019	May 20, 2029
	2019 NED EIP	–	–	5,500	3.00	July 23, 2019	July 23, 2029
	2019 NED EIP	–	–	11,000	1.84	February 20, 2020	February 20, 2030
	2019 NED EIP	–	–	31,500	2.72	February 1, 2021	February 1, 2031
Dr. Brian	2019 NED EIP	–	–	22,500	3.32	January 19, 2021	January 19, 2031
Schwartz	2019 NED EIP	–	–	31,500	2.72	February 1, 2021	February 1, 2031
Kunal Kashyap[1]	2015 Plan	43,252	8.63	–	–	September 29, 2015	September 29, 2025
	2019 NED EIP	–	–	5,500	5.40	May 20, 2019	May 20, 2029
	2019 NED EIP	–	–	5,500	3.00	July 23, 2019	July 23, 2029
	2019 NED EIP	–	–	11,000	1.84	February 20, 2020	February 20, 2030
	2019 NED EIP	–	–	21,000	2.72	February 1, 2021	February 1, 2031
Dr. Deepa	2019 NED EIP	–	–	5,500	5.40	May 20, 2019	May 20, 2029
Pakianathan	2019 NED EIP	–	–	5,500	3.00	July 23, 2019	July 23, 2029
	2019 NED EIP	–	–	11,000	1.84	February 20, 2020	February 20, 2030
	2019 NED EIP	–	–	31,500	2.72	February 1, 2021	February 1, 2031
Michael Wyzga	2019 NED EIP	–	–	5,500	5.40	May 20, 2019	May 20, 2029
	2019 NED EIP	–	–	5,500	3.00	July 23, 2019	July 23, 2029
	2019 NED EIP	–	–	11,000	1.84	February 20, 2020	February 20, 2030
	2019 NED EIP	–	–	31,500	2.72	February 1, 2021	February 1, 2031

(1) Figures for Peter Bains and Kunal Kashyap are as of the date they resigned from the Board, September 20, 2021 and October 26, 2021 respectively.

Executive Director (CEO)

- Under the 2019 EIP, we have granted market value options to our CEO, Dr. Denise Scots-Knight. These market value options vest over four years with 25% vesting 12 months after the grant date and the balance vesting equally over the next 36 months. There are no performance conditions attached to share options granted under the 2019 EIP. Subject to the terms of the grant, awards under the 2019 EIP can be granted in respect of ordinary shares, ADSs, cash or a combination thereof. All grants to our Executive Director since 2019 were in respect of ADSs.

- Under the 2015 Plan, we have granted market value options to our CEO. These market value options vest over four years with 25% vesting 12 months after the grant date and the balance vesting equally over the next 36 months. There are no performance conditions attached to share options granted under the 2015 Plan.

- Under the DBSP, we have granted share awards to our CEO. These share awards vest three years from grant date and are exercisable within one year of vesting. There are no performance conditions, nor any service conditions attached to share awards granted under the DBSP.

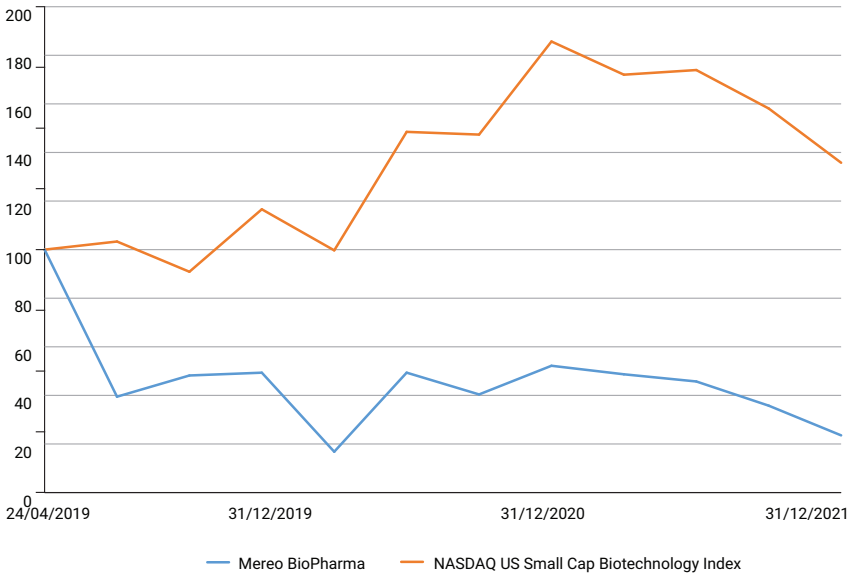
Non-Executive Directors

- Under the 2015 Plan, we have granted share options to our Non-Executive Directors. These share options vested over three years from grant date in three equal annual instalments. There are no performance conditions attached to share options granted under the 2015 Plan.

- Under the 2019 NED EIP, we have granted other share-based awards to our Non-Executive Directors. These other share-based awards vest in equal monthly instalments over the one-year period following their grant date. There are no performance conditions attached to the other share-based awards granted under the 2019 NED EIP. Subject to the terms of the grant, awards under the 2019 NED EIP can be granted in respect of ordinary shares, ADSs, cash or a combination thereof. All grants to Non-Executive Directors since 2019 were in respect of ADSs.

2.6 Performance Graph and Table

The graph below shows the Company's performance, measured by total shareholder return, relative to the Nasdaq US Small Cap Biotechnology Index, which has been selected for this comparison because the Company has been trading on the Nasdaq exchange since the date it became a quoted company for the purposes of the U.K. remuneration reporting regulations (in April 2019) and is therefore considered to be the most suitable comparator index.



Chief Executive Officer Total Remuneration History

The Chief Executive Officer's remuneration over the period since the Company's listing on Nasdaq in April 2019 is set out below. This will eventually build up to cover a rolling ten-year remuneration history.

	2021	2020	2019
Total CEO remuneration	£1,645,297	£1,043,484	£1,176,187
CEO bonus (as a % of maximum available)	81%	100%	75%
CEO LTIP(1) vesting (as a % of maximum available)	100%	100%	100%

(1) Awards of market value options were granted under the 2019 EIP Plan as an equity incentive to the CEO in 2021, 2020 and 2019. As the options granted in 2021, 2020 and 2019 are not subject to performance conditions the vesting percentage has been recorded as 100%.

2.7 Percentage Change in Remuneration of Directors and Employees

The following table shows the percentage change in each Executive and Non-Executive Directors' remuneration compared with the average change for all employees of the Company for the year ended December 31, 2021. Going forward, this disclosure will build up over time to cover a rolling five-year period.

	2021			2020		
	Salary/ fee (%)	Benefits (%)	Annual bonus (%)	Salary/ fee (%)	Benefits (%)	Annual bonus (%)
Dr. Denise Scots-Knight	0	3	(40)	2.0	3.4	36
Dr. Peter Fellner	0	N/A	N/A	0	N/A	N/A
Peter Bains[1]	3	N/A	N/A	2.9	N/A	N/A
Dr. Jeremy Bender	1	N/A	N/A	0	N/A	N/A
Dr. Anders Ekblom	(2)	N/A	N/A	0	N/A	N/A
Dr. Pierre Jacquet[2]	N/A	N/A	N/A	N/A	N/A	N/A
Kunal Kashyap[1]	9	N/A	N/A	0	N/A	N/A
Dr.Deepa Pakianathan	0	N/A	N/A	0	N/A	N/A
Dr. Brian Schwartz	(1)	N/A	N/A	0	N/A	N/A
Michael Wyzga	24	N/A	N/A	0	N/A	N/A
Average of all employees (other than Directors)	1	30	8	2.0	6.0	(19.7)

(1) Resigned from the Board during the year – figures have been annualized.
(2) Joined the Board during the year – no prior year comparison available.

2.8 Relative Importance of Spend on Pay

The Remuneration Committee considers the Company's research and development ("R&D") expenditure relative to salary expenditure for all employees, to be the most appropriate metric for assessing overall spend on pay due to the nature and stage of the Company's business. Dividend distribution and share buy-back comparators have not been included because the Company has no history of such transactions. The table below illustrates the gross pay to all employees, per year, as compared to R&D expenditure and illustrates the year-on-year change.

	2021 £'000s	2020 £'000s	% change
Gross pay to all employees	£12,183	10,669	14%
R&D expenditure	23,559	16,347	44%

2.9 External appointments

Dr. Denise Scots-Knight (CEO) is currently a Non-Executive Director of Elanco Animal Health Incorporated ("Elanco") (NYSE: ELAN).

2.10 Membership of the Remuneration Committee and its Advisors

The Remuneration Committee currently comprises of three independent Non-Executive Directors: Dr. Deepa Pakianathan (Chair), Dr. Anders Ekblom and Dr. Brian Schwartz (from April 1, 2021). Peter Bains was also a member of the Remuneration Committee until April 1, 2021. The Chief Executive Officer, Chief Financial Officer

and General Counsel, as well as others, are invited to attend Remuneration Committee meetings as required to provide advice and assistance. The terms of reference of the Committee can be found on our website at www.mereobiopharma.com.

During the year, the Committee was assisted in its work by FIT Remuneration Consultants LLP ("FIT") and Compensia, Inc. ("Compensia"). FIT was appointed in 2020 and has provided advice in relation to general remuneration matters. Fees paid to FIT in relation to advice provided to the Committee during the year to December 31, 2021 were £41,445 (excluding VAT) (2020: £23,668), charged on a time/cost basis. FIT did not provide any other services to the Company. FIT is a member of the Remuneration Consultants Group and, as such, voluntarily operates under the Code of Conduct in relation to executive remuneration consulting in the U.K. Compensia was appointed in 2021 and has provided advice in relation general remuneration matters and did not provide any other services to the Company. Fees paid to Compensia in relation to the advice provided to the Committee during the year were $76,891. The Committee is satisfied that the advice they received from FIT and Compensia was objective and independent.

The Committee met 6 times during the year and addressed the following main topics:

– Reviewed and approved the remuneration package of our CEO;

– Approved the annual bonus payments to the CEO in 2021 and the annual bonus plan for the 2021 financial year;

– Reviewed and approved the increase in the number of shares available for grant under the 2019 EIP plans.

– Reviewed and confirmed the vesting of equity incentive awards and reviewed and approved the terms of the 2021 equity incentive awards.

2.11 Statement of Voting at a general meeting of the Company

The shareholder votes on the non-binding approval of the Directors' Remuneration Report and the binding approval of the Directors' Remuneration Policy at the Annual General Meeting which took place on May 27, 2021 was as follows:

Resolution	Votes for	% for	Votes against (excluding withheld)	% against	Total (excluding withheld)	Withheld
Approval of the Directors' Remuneration Report	211,349,035	82.34%	45,322,225	17.66%	256,671,260	209,055
Approval of the Directors' Remuneration Policy	210,914,645	82.31%	45,338,865	17.69%	256,253,510	626,805

2.12 Statement of Implementation of Remuneration Policy for the Year Ending December 31, 2022

Annual salary

For 2022, the CEO was granted a 5% increase in annual salary.

Benefits and pension

The CEO will continue to receive pension contributions (or cash payments in lieu) to the value of 15% of basic salary. No changes will be made to the provision of other benefits.

Bonus

The CEO will be eligible for an annual bonus of 60% of basic salary for achievement of target level or 72% of basic salary for achievement of stretch goals for the 2022 financial year.

The bonus will be subject to the achievement of short-term performance targets which have been set by the Committee with respect to the FY2022 performance period. The performance targets cover key objectives that relate to the achievement of the Group's wider strategic goals including, for 2022, measures relating to clinical development, corporate development, commercial planning, finance, manufacturing and intellectual property/legal.

The amount of bonus payable is at the discretion of the Committee subject to review of performance against the short-term performance targets at the end of the performance period (which is aligned with the financial year).

The Committee has chosen not to disclose, in advance, the detailed performance targets for the forthcoming year as these include matters which the Committee considers commercially sensitive. Retrospective disclosure of the performance against the corporate objectives will be made in next year's Annual Report on Remuneration to the extent any such disclosure is considered not to be commercially sensitive at that time.

Long-term incentive plan

In line with the Policy, the Committee has issued market value options to the CEO during 2022.

On January 14, 2022, equity incentive awards were granted to the Chief Executive Officer under the 2019 EIP. These equity incentive awards were market value options over ADSs, and the vesting period is four years; 25% of the award vesting on the first anniversary of the grant date and the balance vesting in equal monthly instalments over the following three years. No performance conditions were attached to the awards.

	ADS options granted	Exercise Price per ADS ($)	Face value ($)
Dr. Denise Scots-Knight	1,100,000	1.40	1,540,000

Non-Executive Directors' fees

Non-Executive Directors may now, voluntarily, elect to convert their annual cash fees into Deferred RSUs (over ADSs) that are then held until settlement following separation of service. This new Deferred Compensation Plan is delivered under the terms of the existing 2019 Non-Executive Equity Incentive Plan.

In addition to fees paid, market value options have been issued to Non-Executive Directors during 2022.

In February 2022 and March 2022, equity incentive awards were granted to Non-Executive Directors in line with the 2019 EIP. These equity incentive awards were market value options over ADSs, and the vesting period is one year; vesting in equal monthly installments over the one-year period following grant date. No performance conditions were attached to the awards.

	ADS options granted	Exercise Price per ADS ($)	Face value ($)
Granted on February 1, 2022			
Dr. Peter Fellner	55,000	1.31	72,050
Dr. Jeremy Bender	55,000	1.31	72,050
Dr. Anders Ekblom	55,000	1.31	72,050
Dr. Pierre Jacquet	55,000	1.31	72,050
Dr. Deepa Pakianathan	55,000	1.31	72,050
Dr. Brian Schwartz	55,000	1.31	72,050
Michael Wyzga	55,000	1.31	72,050
Granted on March 1, 2022			
Anne Hyland	50,416	1.24	62,516

This directors' remuneration report has been approved by the Board and signed on behalf of the Board,

Dr. Deepa Pakianathan
Director

March 31, 2022

The Directors present their report together with the audited financial statements for the year ended December 31, 2021.

Principal activities
The Strategic Report on pages 3 to 18 describes the Group's principal development activities, strategy and future developments.

Results and dividends
The Group recorded a total comprehensive loss for the year attributable to equity holders of the parent of £12.5 million (2020: £163.3 million). Further details are given in the Strategic Report and in the consolidated financial statements.

The Directors do not recommend payment of a dividend.

Research and development
For the financial year ended December 31, 2021, we spent £23.6 million (2020: £16.3 million) on research and development activity.

Research and development spend primarily reflects the underlying activity on clinical trials for our product candidates as well as the manufacturing of drug products together with the internal costs, including payroll directly attributable to these activities. Further details of our product programs and research and development spend can be found within the Strategic Report.

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

Executive directors
Dr. Denise Scots-Knight (Chief Executive Officer)

Non-executive directors

Dr. Peter Fellner (Chairman)	
Dr. Jeremy Bender	
Peter Bains	(resigned September 20, 2021)
Dr. Anders Ekblom	
Anne Hyland	(appointed March 1, 2022)
Dr. Pierre Jacquet	(appointed September 20, 2021)
Kunal Kashyap	(resigned October 26, 2021)
Dr. Deepa Pakianathan	
Dr. Brian Schwartz	
Michael Wyzga	

As at the date of this report, the Directors held shares representing 0.46% of the equity of the Company. Details of the Directors' shareholdings and their options over shares in the Company are disclosed in the Directors' Remuneration Report on pages 19 to 29.

Information on environmental matters
The Company is required to measure and report its greenhouse gas emissions. This information is outlined in the "Social and environmental matters" section of the Strategic Report on page 16.

Future developments
Details of future developments can be found in the Strategic Report on pages 4 to 7 and form part of this report by cross-reference.

Post-balance sheet events
Further information on post-balance sheet events is provided in Note 28 within the consolidated financial statements contained within this report.

Going concern
The going concern basis has been applied in these consolidated financial statements as the Company has adequate resources to meet its liabilities as they fall due for the foreseeable future and at least 12 months from the date of these consolidated financial statements.

The Company expects to incur significant operating losses for the foreseeable future as it continues its research and development efforts, seeks to obtain regulatory approval of its product candidates and pursues any future product candidates the Company may develop.

Until such time as the Company can generate significant revenue from product sales, or other commercial revenues, if ever, or through licensing and/or collaboration agreements for its oncology or rare disease product candidates, the Company will seek to finance its operations through a combination of public or private equity or debt financings or other sources.

As of December 31, 2021, the Company has cash and short term deposits available of £94.3 million.

The Directors have prepared detailed cash flow forecasts for the period from approval of these accounts to June 30, 2023. The Directors have considered the impact of COVID-19, the continuing economic uncertainty, as well as unprecedented burden on health systems in impacted countries around the world on these forecasts. Clinical centers have diverted resources away from the performance of clinical trials and, accordingly, the Company's clinical activities may face some delays, including enrollment in its Phase 1b/2 study with etigilimab in a range of tumor types.

The Company's existing funds provide the Company with sufficient cash resources to meet its liabilities as they fall due and for the period through June 30, 2023. Therefore, although the Company continues to generate losses, the Directors consider that there is sufficient headroom between the forecast expenditure and cash resources such that the likelihood of the headroom being exhausted is remote. Therefore, the Directors determined that it is appropriate to adopt the going concern basis of accounting in preparing these consolidated financial statements.

Financial risk management objectives and policies (including information on exposure to price risk, credit risk, liquidity risk and cash flow risk)
Refer to Note 24 of the financial statements for further details on our financial risk management objectives and policies.

Health and safety
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.

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, 2021 and December 31, 2020.

Share capital
As at the date of this report, the Company had total issued and fully paid up share capital of £1,754,725 representing 584,908,239 ordinary shares of £0.003, all of which rank pari passu. Since December 18, 2020 the Company's ordinary shares are no longer admitted to trading on the AIM Market of the London Stock Exchange. Each share carries the right to one vote at general meetings of the Company. No shareholder holds shares carrying special rights with regard to control of the Company.

The Company's ADSs are traded on the Nasdaq Global Market under the symbol "MREO". Each ADS represents five ordinary shares.

Purchases of own shares during the year
The Company's Employee Benefit Trust ("EBT") was established for the purpose of holding ordinary shares (subsequently ADSs) to satisfy the exercise of options for employees under the Company's share-based incentive schemes. There were no loans made to the EBT by the Company during the year ended December 31, 2021 (2020: nil). During the year ended December 31, 2021, no ordinary shares were purchased by the EBT (2020: 7). A total of 31,205 ADSs (2020: nil) held by the EBT were used in the year-ended December 31, 2021 to satisfy the exercise of options under the Company's share-based incentive schemes. As of December 31, 2021, the EBT holds 216,251 ADSs (2020: 247,456) along with £17,866 in cash (2020: £21,762).

Branches outside the U.K.
As at December 31, 2021, the Group consists of certain subsidiaries which are incorporated outside the United Kingdom. Further information can be found in Note 5 of the financial statements. There are no branches of the Company outside the United Kingdom.

Annual general meeting ("AGM")
The AGM of the Company is planned to be held on May 16, 2022. The notice of the meeting, 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 on our website.

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.

Independent auditors
The auditors, BDO LLP, have indicated their willingness to continue in office and a resolution concerning their re-appointment will be proposed at the forthcoming AGM.

Directors' and officers' liability insurance
The Company has, as permitted by the Companies Act 2006, purchased and maintained throughout the financial year suitable insurance cover on behalf of the directors, indemnifying them against certain liabilities which may be incurred by them in relation to the Group. We have also entered into a deed of indemnity with each of our directors as permitted by the Companies Act 2006 and with each of our executive officers.

Effective date
This report was approved by the Board of Directors on March 25, 2022 and signed on its behalf by:

Dr. Peter Fellner	**Charles Sermon**
Chairman	General Counsel and Company Secretary
March 31, 2022	March 31, 2022

The Directors are responsible for preparing the annual 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. For the financial year ended December 31, 2021, we have chosen to prepare our Group and Company accounts in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006 and our Company accounts in conformity with applicable law and United Kingdom Accounting Standards.

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 accounting estimates that are reasonable and prudent;
- State whether they have been prepared, for the Group, in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006, and, for the Company, in accordance with applicable law and United Kingdom Accounting Standards; 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.
- Prepare a directors' report, a strategic report and directors' remuneration report which comply with the requirements of the Companies Act 2006.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006.

They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities. The Directors are responsible for ensuring that the annual report and accounts, taken as a whole, are fair, balanced, and understandable and provides the information necessary for shareholders to assess the group's performance, business model and strategy.

Website publication
The directors are responsible for ensuring the annual report and the financial statements are made available on a website. Financial statements are published on the Company's website in accordance with legislation in the United Kingdom governing the preparation and dissemination of financial statements, which may vary from legislation in other jurisdictions. The maintenance and integrity of the Company's website is the responsibility of the directors. The directors' responsibility also extends to the ongoing integrity of the financial statements contained therein.

Directors' confirmations
In the case of each Director in office at the date the Directors' Report is approved:

- So far as the director is aware there is no relevant audit information of which the Group and parent company's Auditor is unaware; and
- They have 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 and parent company's Auditor is aware of that information.

On behalf of the Board:
Charles Sermon
General Counsel and Company Secretary

March 31, 2022

Opinion on the financial statements

In our opinion:

- 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, 2021 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with UK adopted International Accounting Standards;
- the Parent Company financial statements have been properly prepared in accordance with United Kingdom 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 (the 'Parent Company') and its subsidiaries (the 'Group') for the year ended December 31, 2021 which comprise the consolidated statements of comprehensive income/(loss), the consolidated and Parent Company balance sheet, the consolidated statement of cash flows, the consolidated and Parent Company statements of changes in equity and notes 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 UK adopted International Accounting Standards. The financial reporting framework that has been applied in the preparation of the Parent Company financial statements is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 101 *Reduced Disclosure Framework* (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) 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. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remain independent of the Group and the Parent Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Conclusions relating to going concern

In auditing the financial statements, we have concluded that the Directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Our evaluation of the Directors' assessment of the Group and the Parent Company's ability to continue to adopt the going concern basis of accounting included:

We obtained the Directors going concern assessment, including the detailed cash flow forecast for the period endingJune 30, 2023 and:

- Evaluated the Directors' method of assessment, including the relevance and reliability of underlying data used to make the assessment, and whether assumptions and changes to assumptions from prior years are appropriate and consistent with each other.
- Tested the assumptions used by management, including the level of forecast research and development (R&D) costs and general and administrative expenditure by corroborating a sample of costs to supporting evidence, including third party cost estimates for development projects.
- Tested that the cash flow model accurately reflects the impact of the fundraising and the partnering deal by agreeing proceeds to bank statements and reviewing the terms of related executed agreements.
- Determined through inspection and testing of the methodology and calculations that the methods utilised were appropriate to be able to make an assessment for the entity taking into consideration the nature of the Group's cost base and cash inflows.
- Reviewed the accuracy of historical forecasting against actual results.
- We reviewed the Directors' sensitivity analysis for reasonably possible changes in the cost base, tested the arithmetic accuracy of this analysis and challenged the assumptions applied.
- We performed our own sensitivity analysis removing all future cash inflows from the model and at considered the impact of that on the projected cash balance as June 30, 2023.
- We reviewed the period assessed by the Directors to determine that they had considered a period of at least 12 months from the date of approval of the financial statements. We also enquired whether the Directors had considered and identified any events or conditions that may exist beyond that period; reviewed board meeting minutes and press releases for any such events or conditions.
- Comparing the level of available financial resources with the Group's financial forecasts, including taking account of reasonably possible (but not unrealistic) adverse effects that could arise from risks, both individually and collectively.
- We reviewed the adequacy and appropriateness of disclosures in the financial statements regarding the going concern assessment.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Group and the Parent Company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the Directors with respect to going concern are described in the relevant sections of this report.

Overview

Coverage[1]	*89% of Group profit before tax* *100% of Group revenue* *86% of Group total assets*
Key audit matters	Assessment of carrying value of intangible assets Impairment of carrying value of investments in subsidiaries (Parent Company balance sheet) Ultragenyx transaction accounting
Materiality	*Group financial statements as a whole* £1,100,000 based on 2.6% of adjusted losses before tax

[1] These are areas which have been subject to a full scope audit by the group engagement team

An overview of the scope of our audit

Our Group audit was scoped by obtaining an understanding of the Group and its environment, including the Group's system of internal control, and assessing the risks of material misstatement in the financial statements. We also addressed the risk of management override of internal controls, including assessing whether there was evidence of bias by the Directors that may have represented a risk of material misstatement.

On December 31, 2021, the Group comprised of the Parent Company; four trading UK companies (Mereo BioPharma 1 Limited, Mereo BioPharma 2 Limited, Mereo BioPharma 3 Limited and Mereo BioPharma 4 Limited; one trading US company (Mereo BioPharma 5, Inc.) and 3 other entities.

The Parent Company and the US company (Mereo BioPharma 5, Inc.) were deemed to be the significant components for the Group and full scope audit procedures were performed by the group audit team. For the four UK trading companies, specific procedures were performed over material balances. The audit of all these entities was carried out by the group audit team for the purposes of this opinion.

The remaining entities were deemed insignificant to the Group due to the size of operations and balances within each company. The financial information of these entities were subject to analytical review procedures carried out by the group audit team.

Key audit matters

Key audit matters are those matters that, in our professional judgement, 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, including 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 forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter		How the scope of our audit addressed the key audit matter
Assessment of carrying value of intangible assets Refer to the accounting policies (pages 49 to 56) and Note 13 of the Consolidated Financial Statements (pages 66 to 67) £24.6 million (2020- £31.6 million)	The Group has significant intangible assets arising from the acquisition of products in development. Management's determination of fair values of the identifiable intangible assets is complex and includes management's judgments over significant unobservable inputs and assumptions utilised, including development costs, launch dates of products, probability of successful development, sales price and projections, expense and cash flow projections and discount rates. These assumptions are subjective in nature and are affected by expectations about future market, economic or industry conditions. As there are highly judgmental areas within the assessment of the carrying values, a significant risk was identified.	Our audit procedures included: • We assessed whether management's approach for assessing the impairment of its intangible assets was appropriate, and if the assessment complied with the requirements of the applicable accounting standards. • We obtained an understanding of the research and development activities for each intangible asset to assess and evaluate the existence of any internal or external indicators of impairment, by inspecting minutes of meetings, investor information, analyst notes and R&D investor presentation information, including launch dates; • With the assistance of our internal valuation experts, we tested the arithmetic accuracy and integrity of the models used in the valuation by sample-checking formulae, assessed the reasonableness of the discount rates and reviewed the methodology applied versus our expectations;

Key audit matter	How the scope of our audit addressed the key audit matter

	• We compared assumptions used in the current periods' models to prior periods. We assessed the appropriateness of changes made by inquiry of R&D staff, review of clinical trial progress and corroboration to supporting information. We also evaluated if there should be further changes to the assumptions based on our understanding of the intangible assets.
	• We performed a sensitivity analysis on the impairment models to identify which assumptions the impairment assessment was most sensitive to. For these assumptions, such as probability of successful development, market for therapeutic treatment and expected sales price, we assessed the reasonability by performing the following procedures;
	  • We agreed management's assumptions to their supporting evidence such scientific research studies and pricing analysis.
	  • We challenged management's assumptions through comparison to our own identified scientific research studies, and industry research on the expected therapeutic market and pricing points for each product candidate.
	  • Using our sensitivity analysis and market research of the assumptions, we further assessed the level at which an impairment would be required and the likelihood of this being reached.
	• We assessed the reliability of the forecasts by comparing prior year forecasts to actual results in the current year. We read analysts forecasts to identify whether there were any contrary views to be considered.
	• We assessed and challenged management's cash flow assumptions regarding future development costs necessary to be incurred for the intangible assets to reach a point of commercialisation.
	Key observations
	Based on the procedures performed we consider that the assumptions made by management in their impairment assessment are reasonable.

Key audit matter		How the scope of our audit addressed the key audit matter
Impairment of carrying value of investments in subsidiaries (Parent Company) Refer to the accounting policies (page 91) and Note 4 of the Company Financial Statements (page 93) Cost of investment £213.1 million (2020: £205.3 million) Impairment provision £20.8 million: (2020: £20.8 million) Net carrying value £192.3 million (2020: £184.5 million)	The Parent Company is a biopharmaceutical company focused on the development and commercialization of innovative therapeutics that aim to improve outcomes for oncology and rare diseases. Its existing portfolio consists of six clinical stage product candidates which are owned by its subsidiaries. The impairment assessment of the carrying value of investments in subsidiaries requires significant judgement to determine an appropriate recoverable amount for each investment. Judgement is required, as the recoverable amount is determined by taking into account future cash flows in relation to the development and commercialization activities of each subsidiary. There is a risk that the investments may be impaired below their carrying value and not properly accounted for.	Our audit procedures included: • We obtained management's analysis of the recoverable amounts for each subsidiary and tested the calculation of the recoverable amounts, leveraging the testing that was completed over the related intangible asset value in use calculation, where appropriate. For the investment not covered by intangible asset testing, we corroborated management's analysis of comparable product candidate sale or out licensing transactions, to third party sources, to assess estimated fair value. • We assessed whether the director's approach for assessing impairment of its investments was appropriate, and if the assessment complied with the applicable accounting standards. • We assessed whether the disclosure in the Parent Company financial statements met with the requirements of the financial reporting framework and our own understanding. **Key observations** Based on the procedures performed, we consider that the assumptions made by management in their impairment assessment are reasonable.
Ultragenyx transaction Refer to the accounting policies, Note 3, Note 6 and Note 13 of the Consolidated Financial Statements	Revenue for the Group includes income from licencing and collaboration agreements. During the year the Group entered into a licence and collaboration agreement with Ultragenyx for setrusumab. The licence and collaboration agreement has led to the recognition of revenue for the upfront proceeds received; cost of revenue for the partial de-recognition of the intangible asset and a contractual payment made to Novartis as part of the original asset purchase agreement.	Our audit procedures included: • We obtained an understanding of management's key judgements, critical assumptions and estimates applied to the transaction by reviewing management's accounting paper and supporting calculations, addressing the initial recognition and subsequent accounting treatment of the Revenue, Cost of Revenue, derecognition of the intangible asset and related Other Liability arising from the transaction;

Key audit matter		How the scope of our audit addressed the key audit matter
	There is judgment required in determining the appropriate accounting treatment for the proceeds arising from these arrangements and therefore there is a risk that management might incorrectly apply the principles of IFRS15 *Revenue from contracts with customers* in determining the accounting treatment for the transaction. Management is also required to determine an accounting policy for future variable consideration, including royalties, and assess whether any such variable consideration is to be recognised at each period-end. Judgement is also required in respect of: (a) determining the portion of the carrying amount of the intangible asset derecognised, relating to the Ultragenyx territory rights out licensed, relative to the value retained, and the related accounting treatment within cost of sales *(the "partial derecognition of intangible asset of £9.5m")*; and (b) calculating the "Novartis payment", in particular the estimate of the deferral for future costs to be offset, and the related accounting treatment, recognised within cost of sales. As there are judgmental areas within the determination of accounting policies for the above elements of the transaction, and the assessment of amounts to be recorded, a significant risk was identified.	• We reviewed the contractual agreements and other relevant documents with Ultragenyx; • With the assistance of our technical accounting team, we challenged management's judgements in regard to the transaction, most notably towards the revenue recognition accounting policy initially adopted and accounting treatment of the carrying value of the intangible asset derecognised. We assessed whether the accounting treatment adopted by management conforms to the requirements of the applicable accounting standards and the substance of the contractual agreement; *Revenue:* • We agreed the proceeds received to bank statements; • We performed procedures such as, inspecting minutes of meetings, press release information from Ultragenyx's website and bank receipts to identify indicators that could lead to the recognition of future milestones as variable consideration for the current year. *Partial derecognition of intangible asset of £9.5m* • We tested the Group's right to retain a portion of the intangible asset by inspecting that the agreement with Ultragenyx stipulated the Group's right to retain a portion of the commercialisation rights; • We tested management's calculation, which was based on the portion of the carrying amount of the intangible asset relating to the Ultragenyx Territory rights that were disposed of. We inspected the calculations and agreed the calculations for rights disposed of and retained to the contractual arrangement.

Key audit matter	How the scope of our audit addressed the key audit matter
	• We vouched key assumptions, which would affect the value of rights retained, to supporting external evidence. This included the market for therapeutic treatment, estimated development costs and sales prices. • We performed a sensitivity analysis over the assumptions in management's calculation to assess the level of sensitivity and the resulting impact on the value of the intellectual property de-recognised; *Novartis payment* • We obtained and read the 2015 asset purchase terms with Novartis supporting the contractual obligation for the payment; • We agreed the payment made to Novartis to the bank statements; • We tested the initial deferred cost liability by agreeing the amounts recorded to supporting schedules and forecasts. We tested the subsequent costs incurred by selecting a sample of the incurred costs and agreeing the amounts recorded to supplier invoices. We tested whether the initial and subsequent costs were eligible for deduction by considering the terms of the asset purchase agreement with Novartis; **Key observations** We consider the Group's accounting policy and journal entries recorded in relation to the various elements of the transaction to be appropriate and in line with the relevant accounting standards and the substance of the contractual arrangement with Ultragenyx.

Our application of materiality

We apply the concept of materiality both in planning and performing our audit, and in evaluating the effect of misstatements. We consider materiality to be the magnitude by which misstatements, including omissions, could influence the economic decisions of reasonable users that are taken on the basis of the financial statements.

In order to reduce to an appropriately low level the probability that any misstatements exceed materiality, we use a lower materiality level, performance materiality, to determine the extent of testing needed. Importantly, misstatements below these levels will not necessarily be evaluated as immaterial as we also take account of the nature of identified misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole and performance materiality as follows:

	Group financial statements	Parent company financial statements
	2021	2021
Materiality	£1,100,000	£990,000
Basis for determining materiality	2.6% Adjusted losses before tax (to exclude warrant liability revaluation gains)	90% of Group Materiality
Rationale for the benchmark applied	Adjusted losses before taxes is considered the most appropriate measure in assessing the performance of the Group given that the focus of the users are solely relating to research & development costs.	Materiality was capped at 90% Group materiality given the assessment of the components aggregation risk.
Performance materiality	£550,000	£495,000
Basis for determining performance materiality	50% of materiality based on our expectations of the level of misstatement and due to multiple account balances having a significant level of judgment involved in their estimation.	50% of materiality based on our expectations of the level of misstatement and due to certain account balances having a significant level of judgment involved in their estimation.

Component materiality

We set materiality for each component of the Group based on a percentage of between 80% and 90% of Group materiality dependent on the size and our assessment of the risk of material misstatement of that component. Component materiality ranged from £880,000 to £990,000. In the audit of each component, we further applied performance materiality levels of 50% of the component materiality to our testing to ensure that the risk of errors exceeding component materiality was appropriately mitigated.

Reporting threshold

We agreed with the Audit and Risk Committee that we would report to them all individual audit differences in excess of £22,000. We also agreed to report differences below this threshold that, in our view, warranted reporting on qualitative grounds.

Other information

The directors are responsible for the other information. The other information comprises the information included in the Annual Report and Accounts other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon. 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 course of 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 this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

Other Companies Act 2006 reporting

Based on the responsibilities described below and our work performed during the course of the audit, we are required by the Companies Act 2006 and ISAs (UK) to report on certain opinions and matters as described below.

Strategic report and Directors' report

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 the Directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Group and 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.

Matters on which we are required to report by exception

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, 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's and the 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 (UK) 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.

Extent to which the audit was capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below:

- We obtained an understanding of the legal and regulatory framework in which the Group operates, focussing on those laws and regulations that had a significant effect on the financial statements or that had a fundamental effect on the operations of the Group, namely: the accounting framework (UK-adopted International Accounting Standards and FRS101); the Companies Act 2006; relevant tax legislation; and the requirements for regulated products.
- We enquired of management, those charged with governance and in-house legal counsel, obtained and reviewed meeting minutes and other supporting documentation, concerning the Group's policies and procedures in relation to:
    - Identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
    - Detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud; and
    - The internal controls established to mitigate risks related to fraud and non-compliance with laws and regulations.
- We discussed among the engagement team regarding how and where fraud might occur in the financial statements and any potential indicators of fraud. As part of this discussion, we identified potential fraud in management override of controls, specifically in relation to management bias and the judgements involved in accounting estimates.
- We have considered the risk of fraud through management override of controls by:
    - Sample testing the appropriateness of journal entries and other adjustments by inquiry and corroboration to supporting evidence; and
    - Assessing whether the judgements made in accounting estimates are indicative of potential bias, in particular the estimates regarding accounting for the Ultragenyx out licensing and intangible asset and investments impairment reviews (refer to the key audit matters section above).
- We communicated relevant identified laws and regulations and potential fraud risks to all engagement team members and discussed how and where these might occur and remained alert to any indications of fraud and non-compliance with laws and regulations throughout the audit.

The engagement partner has assessed that the engagement team collectively had the appropriate competence and capabilities to identify or recognize non-compliance with laws and regulations.

Our audit procedures were designed to respond to risks of material misstatement in the financial statements, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery, misrepresentations or through collusion. There are inherent limitations in the audit procedures performed and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we are to become aware of it.

A further description of our responsibilities is available on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Use of our report

This report is made solely to the Parent 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 Parent 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 Parent Company and the Parent Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Ian Oliver (Senior Statutory Auditor)
For and on behalf of BDO LLP, Statutory Auditor
Reading, UK

March 31, 2022

BDO LLP is a limited liability partnership registered in England and Wales (with registered number OC305127).

	Notes	Year ended December 31, 2021 £'000s	2020 £'000s	2019 £'000s
Revenue	6	36,464	–	–
Cost of revenue	6	(17,908)	–	–
Research and development expenses		(23,559)	(16,347)	(23,608)
Administrative expenses		(15,933)	(21,222)	(15,909)
Operating loss		(20,936)	(37,569)	(39,517)
Net income recognized on acquisition of subsidiary		–	–	1,035
Finance income	9	1	44	377
Finance costs	9	(4,022)	(6,383)	(4,371)
Changes in the fair value of financial instruments	9	40,039	(109,849)	875
Gain/(loss) on disposal of intangible assets		113	(10,872)	–
Net foreign exchange loss		(954)	(1,821)	483
Profit/(loss) before tax	7	14,241	(166,450)	(41,118)
Taxation	10	(1,516)	2,822	6,274
Profit/(loss) for the year, attributable to equity holders of the parent		12,725	(163,628)	(34,844)
Items that may be reclassified subsequently to profit or loss:				
Currency translation of foreign operations		(191)	349	(499)
Total comprehensive income/(loss) for the year, attributable to equity holders of the parent		12,534	(163,279)	(35,343)
Basic profit/(loss) per share for the year (in £)	11	0.02	(0.48)	(0.39)
Diluted loss per share for the year (in £)	11	(0.05)	(0.48)	(0.39)

The accompanying notes form an integral part of these consolidated financial statements.

	Notes	As at December 31, 2021 £'000s	2020 £'000s
Assets			
Non-current assets			
Property, plant and equipment	12	2,530	1,573
Intangible assets	13	24,564	31,648
		27,094	33,221
Current assets			
Prepayments		2,799	1,619
R&D tax credits	10	–	2,818
Other taxes receivable		809	804
Other receivables	15	1,419	1,016
Cash and short-term deposits	16	94,296	23,469
		99,323	29,726
Total assets		126,417	62,947
Equity and liabilities			
Non-current liabilities			
Provisions	18	1,320	1,216
Convertible loan notes	21	14,384	16,142
Warrant liability	20	8,336	50,775
Lease liability	12	1,754	1,158
Other liabilities		80	62
		25,874	69,353
Current liabilities			
Trade and other payables	17	2,499	3,333
Accruals		3,826	4,178
Current tax liabilities		1,522	–
Provisions	18	2,803	418
Lease liability	12	622	636
Other liabilities	6	1,269	–
		12,541	8,565
Total liabilities		38,415	77,918
Net assets/(liabilities)		88,002	(14,971)
Equity			
Issued capital	22	1,755	1,017
Share premium	22	247,460	161,785
Other capital reserves	22	129,835	128,374
Employee Benefit Trust shares		(1,140)	(1,305)
Other reserves	22	7,401	5,001
Accumulated losses	22	(296,968)	(309,693)
Translation reserve		(341)	(150)
Total equity		88,002	(14,971)

The accompanying notes form an integral part of these consolidated financial statements.

Approved by the Board on March 25, 2022 and signed on its behalf by:

Dr. Denise Scots-Knight
Director and Chief Executive Officer

March 31, 2022

Company number: 09481161 (England and Wales)

	Notes	Year ended December 31, 2021 £'000s	2020 £'000s	2019 £'000s
Operating activities				
Profit/(loss) before tax		14,241	(166,450)	(41,118)
Adjustments to reconcile profit/(loss) before tax to net cash flows:				
Depreciation of property, plant and equipment	12	642	1,599	1,577
Share based payments expense	26	3,302	1,558	1,636
Net foreign exchange loss/(gain)		954	1,821	(483)
Increase/(decrease) in provisions and other liabilities		1,385	162	(517)
Finance income	9	(1)	(44)	(377)
Finance costs	9	3,797	6,226	4,606
Other non-cash movements		156	–	–
Modification gain on bank loan		–	–	(456)
Gain on bargain purchase		–	–	(3,681)
Gain on lease modification		–	(957)	–
Fair value remeasurement on contingent consideration		–	–	354
Fair value remeasurement on warrants	9	(40,039)	109,849	(875)
(Gain)/loss on disposal of intangible assets		(113)	10,872	–
Out-license of intangible asset	13	9,457	–	–
Working capital adjustments:				
(Increase)/decrease in receivables and prepayments		(589)	141	(936)
Decrease in trade and other payables and accruals		(1,256)	(3,551)	(6,730)
Tax credits received		2,825	10,433	1,069
Net cash flows used in operating activities		(5,239)	(28,341)	(45,931)
Investing activities				
Acquisition of subsidiary		–	(354)	10,074
Purchase of property, plant and equipment	12	(535)	(16)	(21)
Disposal of intangible assets (net of transaction costs)		113	1,821	–
Proceeds from sale of short-term investments		–	–	32,865
Interest earned	9	1	44	377
Net cash flows (used in)/from investing activities		(421)	1,495	43,295
Financing activities				
Proceeds from issuance of ordinary shares	22	78,532	20,136	–
Transaction costs on issuance of shares	22	(234)	(1,307)	(761)
Proceeds from exercise of employee share options		46	–	–
Proceeds from issuance of convertible loan notes		–	44,375	–
Transaction costs issuance of convertible loan notes		–	(3,598)	–
Repayment of bank loans		–	(19,802)	–
Transaction costs related to loans and borrowings		–	(81)	–
Interest paid on bank loan		–	(2,900)	(1,739)
Purchase of treasury shares		–	–	(998)
Payment of lease liabilities	12	(692)	(2,086)	(2,212)
Net cash flows from/(used in) financing activities		77,652	34,737	(5,710)
Net increase/(decrease) in cash and cash equivalents		71,992	7,891	(8,346)
Cash and cash equivalents at January 1		23,469	16,347	25,042
Effect of exchange rate changes		(1,165)	(769)	(349)
Cash and cash equivalents at December 31	16	94,296	23,469	16,347

The accompanying notes form an integral part of these consolidated financial statements.

MEREO BIOPHARMA GROUP PLC

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Notes	Issued capital £'000s	Share premium £'000s	Other capital reserves £'000s	Employee Benefit Trust Shares £'000s	Other reserves £'000s	Accum-ulated losses £'000s	Translation reserve £'000s	Total equity £'000s
At December 31, 2018		214	118,492	18,593	(307)	7,000	(111,221)	–	32,771
Loss for the year		–	–	–	–	–	(34,844)	–	(34,844)
Other comprehensive loss		–	–	–	–	–	–	(499)	(499)
Total		–	–	–	–	–	(34,844)	(499)	(35,343)
Share-based payments – share options	26	–	–	1,543	–	–	–	–	1,543
Share-based payments – LTIPs	26	–	–	93	–	–	–	–	93
Issuance of share capital on April 23, 2019	22	74	–	40,818	–	–	–	–	40,892
Transaction costs related to issuance of share capital on April 23, 2019	22	–	(761)	–	–	–	–	–	(761)
Issuance of share capital on conversion of loan note	22	3	2,366	–	–	–	–	–	2,369
Issuance of share capital on Novartis bonus shares	22	3	1,587	(1,590)	–	–	–	–	–
Equity element of convertible loan note		–	–	(310)	–	–	–	–	(310)
Purchase of treasury shares	22	–	–	–	(998)	–	–	–	(998)
At December 31, 2019		294	121,684	59,147	(1,305)	7,000	(146,065)	(499)	40,256
Loss for the year		–	–	–	–	–	(163,628)	–	(163,628)
Other comprehensive income		–	–	–	–	–	–	349	349
Total		–	–	–	–	–	(163,628)	349	(163,279)
Share-based payments	26	–	–	1,558	–	–	–	–	1,558
Issuance of share capital, net	22	347	18,715	–	–	(2,125)	–	–	16,937
Conversion of loan notes and warrants	22	375	21,386	34,188	–	–	–	–	55,949
Reclassification of loan notes embedded derivative	19	–	–	33,481	–	–	–	–	33,481
Conversion of warrants		1	–	–	–	126	–	–	127
At December 31, 2020		1,017	161,785	128,374	(1,305)	5,001	(309,693)	(150)	(14,971)
Profit for the year		–	–	–	–	–	12,725	–	12,725
Other comprehensive income		–	–	–	–	–	–	(191)	(191)
Total		–	–	–	–	–	12,725	(191)	12,534
Share-based payments	26	–	–	3,302	–	–	–	–	3,302
Issuance of share capital, net	22	601	78,609	–	–	–	–	–	79,210
Exercise of share options		–	–	(119)	165	–	–	–	46
Conversion of loan notes and warrants	22	137	7,066	(1,722)	–	2,400	–	–	7,881
At December 31, 2021		1,755	247,460	129,835	(1,140)	7,401	(296,968)	(341)	88,002

The accompanying notes form an integral part of these consolidated financial statements.

1. Corporate information

Mereo BioPharma Group plc (the "Company" or "Mereo") is a clinical-stage, United Kingdom ("UK") based biopharmaceutical company focused on oncology and rare diseases.

The Company is a public limited company incorporated and domiciled in the UK, and registered in England, with shares publicly traded on the Nasdaq Global Market via American Depositary Shares ("ADSs") under the ticker symbol "MREO". The Company's ordinary shares were previously admitted to trading on the AIM market of London Stock Exchange plc with admission cancelled with effect on December 18, 2020. The Company's registered office is located at Fourth Floor, 1 Cavendish Place, London, W1G 0QF, United Kingdom.

The consolidated financial statements of Mereo BioPharma Group plc and its subsidiaries for the year ended December 31, 2021 were authorized for issue in accordance with a resolution of the Directors on March 25, 2022. The principal activities of the Company are the development and commercialization of innovative therapeutic pharmaceutical products.

2. Significant accounting policies

Basis of preparation

The Company's consolidated financial statements have been prepared in accordance with UK adopted International Accounting Standards in conformity with the requirements of the Companies Act 2006.

The consolidated financial statements are presented in pound sterling ("£"), which is the presentational currency of the Company. The functional currencies of consolidated subsidiaries are pound sterling and US dollars ("$"). All amounts disclosed in the consolidated financial statements and notes have been rounded to the nearest thousand, unless otherwise stated. The financial statements have been prepared on the historical cost basis, except for the revaluation of certain financial instruments that are measured at fair values at the end of each reporting period, as explained in the accounting policies below.

Basis of consolidation

The consolidated financial information comprises the financial statements of Mereo BioPharma Group plc and its subsidiaries as at December 31, 2021. Subsidiaries are all entities over which the Company has control. The Company controls an entity when the Company 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 Company. They are deconsolidated from the date that control ceases. Intercompany transactions, balances and unrealized gains on transactions between subsidiaries are eliminated in preparing the consolidated financial statements. Accounting policies of subsidiaries are consistent with the policies adopted by the Company.

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 Company, it is consolidated into the Company'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 Company provides.

Segmental information

The Company has one operating segment. The Chief Operating Decision Maker ("CODM") is the Chief Executive Officer. The Company has a single portfolio of product candidates, with only direct research and development expenses monitored at a product candidate level. The CODM makes decisions over resource allocation at an overall portfolio level and the Company's financing is managed and monitored on a consolidated basis.

Following the acquisition of Mereo BioPharma 5, Inc. (formerly OncoMed Pharmaceuticals, Inc. or "OncoMed") in 2019, non-current assets held by the Company are located in the United Kingdom and United States. As at December 31, 2021, approximately £0.1 million (2020: £0.5 million) of non-current assets are located in the United States.

Going concern

The going concern basis has been applied in these consolidated financial statements as the Company has adequate resources to meet its liabilities as they fall due for the foreseeable future and at least 12 months from the date of these consolidated financial statements.

The Company expects to incur significant operating losses for the foreseeable future as it continues its research and development efforts, seeks to obtain regulatory approval of its product candidates and pursues any future product candidates the Company may develop.

Until such time as the Company can generate significant revenue from product sales, or other commercial revenues, if ever, or through licensing and/or collaboration agreements for its oncology or rare disease product candidates, the Company will seek to finance its operations through a combination of public or private equity or debt financings or other sources.

As of December 31, 2021, the Company has cash and short term deposits available of £94.3 million.

The Directors have prepared detailed cash flow forecasts for the period from approval of these accounts to June 30, 2023. The Directors have considered the impact of COVID-19, the continuing economic uncertainty, as well as unprecedented burden on health systems in impacted countries around the world on these forecasts. Clinical centers have diverted resources away from the performance of clinical trials and, accordingly, the Company's clinical activities may face some delays, including enrolment in its Phase 1b/2 study with etigilimab in a range of tumor types.

The Company's existing funds provide the Company with sufficient cash resources to meet its liabilities as they fall due and for the period to June 30, 2023. Therefore, although the Company continues to generate losses, the Directors consider that there is sufficient headroom between the forecast expenditure and cash resources such that the likelihood of the headroom being exhausted is remote. Therefore, the Directors determined that it is appropriate to adopt the going concern basis of accounting in preparing these consolidated financial statements.

Summary of significant accounting policies

a) Revenue

The Company's ordinary business activities are the development of product candidates to key clinical milestones and either strategically partnering them or further developing such product candidates through regulatory approval and potentially commercialization. The Company may enter into a range of different agreements with third parties, including, but not limited to: (i) licensing agreements where the global rights to a product candidate are licensed to a partner; and (ii) collaboration agreements where rights to a product candidate are licensed to a partner but the Company retains certain rights, for example to further develop or commercialize the product candidate in specified geographical territories. Under both licensing and collaboration agreements, rights to product candidates are provided to a partner typically in exchange for consideration in the form of upfront payments and/or development, regulatory, commercial or other similar milestones, and royalties on commercial sales, should regulatory approval be obtained for the product candidates.

Revenue includes income from licensing and collaboration agreements. Consideration received up front is recognized at the point in time in which the right to use an intangible asset is transferred and further payments received are recognized upon the achievement of specified development, regulatory, commercial or other similar milestones. For agreements with a right to access an intangible asset, revenue is recognized over time, typically on a straight-line basis over the life of the license or collaboration agreement. When there are other performance obligations in such agreements, the consideration is allocated using the residual approach and recognized when the performance obligations are satisfied.

Income from development, regulatory, commercial or similar milestones is recognized when considered highly probable that a significant reversal will not occur. Timing of the recognition of such milestones are considered to be a key judgment, as they are often dependent on third parties. In general, for milestones which are subject to the decisions of third parties (e.g. the acceptance or approval of a filing by a regulatory authority), the Company recognizes milestone income when the decision occurs.

We do not currently have any approved product candidates. Accordingly, we have not generated any commercial sales revenue during the year.

Intangible assets out-licensed under a license or collaboration agreement are recorded within "Cost of revenue" in the Company's consolidated statement of comprehensive income/(loss) based on an allocation of cost or value of the rights that have been out-licensed. Payments to third parties arising as a direct consequence of the income recognized are also recorded within "Cost of revenue" in the Company's consolidated statement of comprehensive income/(loss).

b) Research and development (R&D) expenses

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 Company 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 criteria for capitalization, including ongoing costs associated with acquired intellectual property rights and intellectual property rights generated internally by the Company, is recognized in the consolidated statement of comprehensive income as incurred. Intellectual property and in-process R&D from asset acquisitions are recognized as intangible assets at cost.

c) Taxation

Tax expense recognized in the consolidated statement of comprehensive income/(loss) comprises the sum of deferred tax and current tax not recognized in other comprehensive income or directly in equity.

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 that are unpaid at the reporting date. Current tax is payable on taxable profit, which differs from profit or loss in the consolidated financial statements. Calculation of current tax is based on tax rates and tax laws that have been enacted, or substantively enacted, by the end of the reporting period in the jurisdictions in which the Company operates.

Amounts receivable in respect of research and development tax credits are recognized in the consolidated financial statements provided there is sufficient evidence that the amounts are recoverable. These credits are recognized within income tax in the consolidated statement of comprehensive income/(loss).

A provision is recognized for matters in which the tax determination is uncertain but it is considered probable that there will be a future outflow of funds to a tax authority. The provisions are measured at the best estimate of the amount expected to become payable.

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 assets to be recovered.

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

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

d) Foreign currencies

Items included in the consolidated financial statements are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in pound sterling ("£"), which is the presentational currency of the Company. The functional currencies of consolidated subsidiaries are pound sterling and US dollars ("$").

Transactions in foreign currencies are initially recorded by the Company at the rate prevailing on the date the transaction first qualifies for recognition. Differences arising on settlement or translation of monetary items as well as gains or losses on the retranslation of foreign currency balances at the period-end are recognized in the consolidated statement of comprehensive income/(loss).

The results and financial position of subsidiaries that have a functional currency different from the presentational currency of the Company are translated into the presentational currency (pound sterling). The assets and liabilities of such entities are translated into pound sterling at the rate of exchange prevailing at the balance sheet date. Income and expenses are translated at the average rate for the period. Fair value adjustments arising on acquisition of such entities are treated as assets and liabilities of the relevant entity and translated into pound sterling at the closing rate. The exchange differences arising on translation for consolidation are recognized in other comprehensive income/(loss).

e) 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 computed using the straight-line method over the estimated useful lives of the related assets. Useful lives of various property, plant and equipment are as follows:

- Leasehold improvements — shorter of lease term or ten years
- Office equipment — five years
- IT equipment — three years

Property, plant and equipment 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 consolidated statement of comprehensive income/(loss) when the asset is derecognized.

The residual values, useful lives and methods of depreciation of property, plant and equipment are reviewed annually and adjusted prospectively, if appropriate.

f) Business combinations

Business combinations are accounted for using the acquisition method of accounting. At the date of acquisition, the Company initially recognizes the fair value of the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquired business.

The consideration transferred is measured at fair value at the date of acquisition. The excess of the consideration transferred over the fair value of net identifiable assets of the business acquired is recorded as goodwill, unless the amount of consideration transferred is less than the fair value of net identifiable assets of the business acquired in which case the difference is recognized directly in the consolidated statement of comprehensive income/(loss) as a bargain purchase. A valuation is performed of assets and liabilities assumed on each acquisition accounted for as a business combination based on our best estimate of fair value.

Where the settlement of any part of cash consideration is deferred, the amounts payable in the future are discounted to their present value. Contingent consideration is classified either as equity or a financial liability and is recognized at fair value on the acquisition date. Amounts classified as a financial liability are subsequently remeasured to fair value in accordance with IFRS 9 (Financial Instruments), with changes in fair value recognized in the consolidated statement of comprehensive income/(loss) as an administrative expense.

Directly attributable acquisition-related costs are expensed as incurred within the consolidated statement of comprehensive income/(loss).

g) Leases

Effective January 1, 2019, the Company adopted IFRS 16 (Leases) using the modified retrospective approach.

The Company assesses whether a contract is, or contains, a lease at inception of the contract. The Company recognizes a right-of-use asset and a corresponding liability with respect to all lease arrangements in which it is a lessee.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the rate implicit in the lease. If this rate cannot be readily determined, the Company uses its incremental borrowing rate.

Lease payments included in the measurement of the lease liability comprise of fixed lease payments, less any lease incentives receivable.

The lease liability is subsequently measured by increasing the carrying amount to reflect interest on the lease liability (using the effective interest method) and by reducing the carrying amount to reflect the lease payments made. The Company remeasures the lease liability (and makes a corresponding adjustment to the related right-of-use asset) whenever there is a significant change in lease term, lease payments or if the lease contract is modified and the lease modification is not accounted for as a separate lease.

The right-of-use assets comprise the initial measurement of the corresponding lease liability and lease payments made at or before the commencement date, less any lease incentives received and any initial direct costs. They are subsequently measured at cost less accumulated depreciation and impairment losses.

The right-of-use assets are presented within property, plant and equipment. Right-of-use assets are depreciated over the shorter period of lease term and useful life of the underlying asset:

- Right-of-use asset (building) six to nine years
- Right-of-use asset (equipment) one to two years

When the Company is an intermediate lessor, it accounts for the head lease and the sub-lease as two separate contracts. The sub-lease is classified as a finance or operating lease by reference to the right-of-use asset arising from the head lease. Rental income from operating leases is recognized on a straight-line basis over the term of the relevant lease.

h) Intangible assets

Intangible assets are initially recorded at cost which has been determined as the fair value of the consideration paid and payable. Assets that have been acquired through a business combination are initially recorded at fair value. The fair value of consideration is regularly reviewed based on the probability of achieving contractual milestones. Refer to policy on provision for deferred cash consideration below.

Where the consideration paid or payable is in shares, the cost is measured in accordance with IFRS 2 (Share Based Payments).

Intangible assets that are not yet available for use are reviewed for impairment at each reporting date by allocating the assets to the cash-generating units to which they relate. The estimated useful life is the lower of the legal duration and economic useful life. The estimated useful lives of intangible assets are reviewed at least annually.

Intangible assets are amortized from the date they are available for commercial use. No amortization has been recognized to date.

An intangible asset is derecognized on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognized in profit or loss when the asset is derecognized.

i) Financial instruments

Financial assets and liabilities are recognized in the consolidated balance sheet only when the Company becomes party to the contractual provisions of the instrument.

Financial assets

On initial recognition, a financial asset is classified into one of three primary measurement categories:

- Amortized cost;
- Fair value through other comprehensive income ("FVOCI"); or
- Fair value through profit or loss ("FVTPL").

The initial classification into a primary measurement category depends on the nature and purpose of the financial asset.

For short-term investments, interest income and impairment gains or losses are recognized directly in the consolidated statement of comprehensive income. The difference between cumulative fair value gains or losses and the cumulative amounts recognized in the consolidated statement of comprehensive income/(loss) is recognized in other comprehensive income until derecognition, when the amounts in other comprehensive income are reclassified to the consolidated statement of comprehensive income/(loss).

Classification as debt or equity

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

Embedded derivatives

An embedded derivative is a component of a hybrid contract that also includes a non-derivative host with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. Derivatives embedded in hybrid contracts with hosts that are not financial assets within the scope of IFRS 9 (e.g. financial liabilities) are treated as separate derivatives when they meet the definition of a derivative, their risks and characteristics are not closely related to those of the host contracts and the host contracts are not measured at FVTPL.

Convertible loan notes

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. This amount is recorded as a liability on an amortized cost basis using the effective interest method until extinguished upon conversion or at the instrument's maturity date. The difference between the proceeds from the issue of the convertible loan note and the fair value assigned to the liability component is included in equity and not subsequently remeasured. Upon conversion, the amount initially recognized in "Other capital reserves" will be transferred to "Share premium".

Financial liabilities

All financial liabilities are measured subsequently at amortized cost using the effective interest method or at FVTPL.

Borrowings (including interest-bearing loans) are initially recognized at fair value, net of transaction costs incurred. Borrowings are subsequently measured at amortized cost. Any difference between the proceeds

(net of transaction costs) and the redemption amount is recognized in profit or loss over the period of the borrowings using the effective interest method. Under the effective interest method, amortization is included as a finance cost in the consolidated statement of comprehensive income/(loss).

Non-substantial modifications to financial liabilities are measured at amortized cost with the associated gain or loss recognized in the consolidated statement of comprehensive income/(loss). The gain or loss is computed as the difference between the original contractual cash flows and the modified cash flows, discounted at the original effective interest rate. For substantial modifications, the existing financial liability is derecognized and a new financial liability is established.

Borrowings are derecognized from the balance sheet when the obligation specified in the contract is discharged, cancelled or expired.

The warrant instruments are recorded at fair value, with changes in the fair value recognized in the consolidated statement of comprehensive income/(loss), where the terms of the warrant instruments allow for cashless exercise.

j) 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 Company.

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 Company 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 consolidated financial statements are categorized 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 consolidated financial statements on a recurring basis, the Company determines whether transfers have occurred between levels in the hierarchy by reassessing 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.

k) 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 12
- Intangible assets not yet available for use — Notes 13 and 14

At each reporting date, the Company assesses whether there is any indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Company

estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's 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 cash-generating unit 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 consolidated statement of comprehensive income/(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 Company estimates the asset's or cash-generating unit'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 consolidated statement of comprehensive income/(loss) unless the asset is carried at a revalued amount, in which case the reversal is treated as a revaluation increase.

l) Cash and short-term deposits

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

m) Provisions

Provisions are recognized when the Company 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 Company 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 consolidated statement of comprehensive income/(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.

Where contingent payments relate to future use of the in-licensed IP, no liability or provision is recognized for variable amounts to be paid to the vendors based on future events unless such arrangements are onerous. The liability (and corresponding expense in the income statement) to the vendors is recognized as an obligation arises.

n) 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.

o) Share-based payments

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

Incentives in the form of shares are provided to employees and non-executive directors under various plans (Note 26). Executive officers also have outstanding shares under a deferred bonus share plan ("DBSP Plan") and a long-term incentive plan ("LTIP Plan").

In accordance with IFRS 2 Share-based Payments ("IFRS 2"), charges for these incentives are expensed through the consolidated statement of comprehensive income/(loss) on a straight-line basis over their vesting period, based on the Company'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 on grant date excludes the impact of any non-market vesting conditions, which are taken into account by adjusting the number of equity instruments included in the measurement of the share-based payment transaction and are adjusted each period until such time as the equity instruments vest.

Equity-settled share-based payment transactions with parties other than employees are measured at the fair value of the goods or services received, except where that fair value cannot be estimated reliably, in which case they are measured at the fair value of the equity instruments granted, measured at the date the entity obtains the goods or the counterparty renders the service.

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.

p) Costs of issuing capital

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.

q) Employee Benefit Trust

The Company operates an Employee Benefit Trust ("EBT"), the Mereo BioPharma Group plc Employee Benefit Trust.

The EBT holds ADS's to satisfy the exercise of options under the Company's share-based incentive schemes (Note 26). The EBT is a Jersey-based trust which was initially funded by a loan from the Company, which it utilized to purchase shares in sufficient quantity to fulfill the envisaged awards. The Company will issue ordinary shares to a custodian for conversion by a depositary bank to ADS's and delivery to the EBT. These ordinary shares will be deducted from the shareholders' funds on the consolidated balance sheet at their nominal value.

Shares held by the EBT are included in the consolidated balance sheet as a reduction in equity.

r) Pension contribution costs

Payments to defined contribution retirement benefit plans are recognized as an expense when employees have rendered service entitling them to the contributions.

3. Significant judgments, estimates and assumptions

The preparation of these consolidated financial statements 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.

Judgments

a) Revenue

Judgment is required to determine the appropriate accounting policy for the license and collaboration agreement with Ultragenyx Pharmaceutical, Inc. ("Ultragenyx"). Management has determined that the upfront proceeds from the license and collaboration agreement represent proceeds from the Company's ordinary business activities and, therefore, represent revenue within the scope of IFRS 15, Revenue from Contracts with Customers. Judgment is also required to determine the portion of the carrying amount of the intangible asset to derecognize, relative to the value retained, as a result of the license and collaboration agreement with Ultragenyx.

b) 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 Company's intangible assets (see Note 14), right-of-use assets, leasehold improvements, office equipment and IT equipment as at December 31, 2021.

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 recognized as an impairment in the consolidated statement of comprehensive income/(loss). The assessment of intangible assets involves a number of significant judgments regarding the likelihood of successful product approval, the costs of attaining approval, the estimated useful life of intangible assets following commercialization and the subsequent commercial profitability of the product once approved.

c) Incremental borrowing rate and lease modification

Future lease payments are discounted using the interest rate implicit in the lease, or, if that rate cannot be readily determined, the incremental borrowing rate. IFRS 16 (Leases) defines the incremental borrowing rate as the rate of interest a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of similar value to the right-of-use assets in a similar economic environment.

For the year ended December 31, 2020, the determination of an appropriate discount rate has a significant effect on the lease liabilities recognized. For the current lease portfolio, the incremental borrowing rate was determined based on relevant and available information as the interest rate implicit in the lease arrangements cannot be readily determined.

In addition to the determination of an appropriate discount rate, the Company was also required to assess the lease term for qualifying leases. The determination of the lease term is judgmental as for certain qualifying leases held by the Company, the contract includes an extension option beyond the non-cancellable period for which the Company has the right to use the underlying asset. In applying this judgment, the Company considered the period over which it was reasonably certain to make use of the extension option.

In August 2020, a lease for office space was modified to reduce the size of the office space leased. At the time of this lease modification, judgment was applied in determining the new lease term and remeasuring the lease liability by discounting the revised lease payments using a revised incremental borrowing rate.

d) Identification and classification of financial instruments

On June 3, 2020, the Company completed a private placement transaction (Note 19) which comprised the issue of ordinary shares, Loan Notes and Warrants. Judgment is applied under IAS 32 (Financial instruments: Presentation) in determining the features of the identified financial instruments on both the transaction date and the date of the general meeting at which Resolutions relating to the private placement were voted on by the Shareholders, to determine the appropriate recognition in accordance with IAS 32. In applying this

judgment, management considered the probability of passing the Resolutions at the general meeting and the likelihood of a change of control prior to the passing of the Resolutions, which impact the settlement terms of the financial instruments, and the classification of the financial instruments as liabilities or equity. Management concluded that a change of control event was uncertain and outside of the Company's control, and therefore the conversion feature on the Loan Notes at the transaction date represented a financial liability with an embedded derivative for the conversion option. On the passing of the Resolutions, judgment was applied to determine that the effective terms of the Loans Notes changed and the embedded derivative financial liability representing the conversion option was reclassified to equity at its fair value, with no associated gain or loss recognized in profit or loss.

e) Business combination

On April 23, 2019, the Company obtained a 100% controlling interest in Mereo BioPharma 5, Inc. (formerly OncoMed), a company based in the United States ("US"). The value of the net identifiable assets acquired was £44.6 million. Total consideration paid, being the fair value of 24.8 million ordinary shares of the Company, was £40.9 million. As the Company acquired Mereo BioPharma 5, Inc. for an amount less than the fair market value of the net assets acquired, a gain on bargain purchase of £3.7 million was recognized.

Judgment was applied under IFRS 3 (Business Combinations) in determining whether a transaction meets the definition of a business combination, and so accounted for in accordance with its requirements. In applying this judgement, management has considered the underlying economic substance of the transaction in addition to the contractual terms. Our assessment is that Mereo BioPharma 5, Inc. meets the definition of a 'business' and the transaction has therefore been accounted for as a business combination.

Estimates and assumptions

a) Deferred consideration

Deferred consideration represents contingent cash consideration and is recognized as a provision at each balance sheet date, to the extent its amount is quantifiable at the inception of the arrangement (see Note 18). The amount provided is based on estimates regarding the timing and progress of the related research and development activities (see Note 24).

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

b) Fair value of financial instruments

As part of the private placement transaction (Note 19), the Company performed a valuation of the fair value of the identified financial instruments including the embedded derivative and the warrants on the transaction date and the general meeting date. For qualifying financial instruments, the fair value is reassessed at each balance sheet date. Specific consideration was applied to the estimation of implied share price on the transaction date, the volatility, credit spread and discount rate (see Note 24).

c) Contingent consideration

The Company makes a provision for the estimated fair value of amounts payable to the former shareholders of Mereo BioPharma 5, Inc. under the Contingent Value Rights Agreement ("CVR"), which is accounted for as a contingent consideration liability.

At December 31, 2021, the Company estimates the fair value of the contingent consideration liability to be £nil (2020: nil). Total potential payments under the CVR on a gross, undiscounted basis, are approximately £58.6 million ($80.0 million).

The estimated contingent consideration payable is based on a risk-adjusted, probability-based scenario. Under this approach the likelihood of future payments being made to the former shareholders of Mereo BioPharma 5, Inc. under the CVR is considered. The estimate could materially change over time in line with the development plan and potential subsequent commercialization of the product.

4. Changes in accounting policies

a) New standards, interpretations and amendments adopted from January 1, 2021

In the current year, the Company has applied the below amendments to IFRS issued by the IASB that are effective for an annual period that begins on or after January 1, 2021. Their adoption has not had any material impact on the disclosures or on the amounts reported in these consolidated financial statements:

- Amendments to IFRS 4 Insurance Contracts
- Amendments to IFRS 9, IAS 39 and IFRS 7 – Interest Rate Benchmark Reform – Phase 2
- Amendments to IFRS 16 Covid-19 related rent concessions

b) New standards, interpretations and amendments not yet effective

At the date of authorization of these consolidated financial statements, the Company has not applied the following new and revised IFRS that have been issued but are not yet effective:

Effective January 1, 2022

- Annual Improvements to IFRS Standards 2018-2020 (Amendments to IFRS 1, IFRS 9, IFRS 16 and IAS 41)
- Amendments to IAS 16 – Proceeds before Intended Use
- Amendments to IAS 37 – Onerous Contracts – Cost of Fulfilling a Contract
- Amendments to IFRS 3

Effective January 1, 2023

- Amendments to IAS 1 – Classification of Liabilities as Current or Non-current
- Amendments to IFRS 17 – Insurance Contracts
- Amendments to IAS 12 – Deferred tax related to assets and liabilities arising from a single transaction
- Amendments to IAS 8 – Definition of accounting estimates
- Amendments to IAS 1 and IFRS Practice Statement 2 – Disclosure of accounting policies

The Company does not expect the adoption of these IFRS amendments will have a material impact on the Company in the current or future reporting periods and on foreseeable future transactions.

5. Group information

Information about subsidiaries

The consolidated financial statements of the Company include:

Name	Principal activities	Country of incorporation	% Equity interest December 31, 2021	% Equity interest December 31, 2020
Mereo BioPharma 1 Limited	Pharmaceutical R&D	UK	100	100
Mereo BioPharma 2 Limited	Pharmaceutical R&D	UK	100	100
Mereo BioPharma 3 Limited	Pharmaceutical R&D	UK	100	100
Mereo BioPharma 4 Limited	Pharmaceutical R&D	UK	100	100
Mereo BioPharma Ireland Limited	Pharmaceutical R&D	Ireland	100	100
Mereo BioPharma 5, Inc.	Pharmaceutical R&D	U.S.	100	100
Navi Subsidiary, Inc.	Pharmaceutical R&D	U.S.	100	100
Mereo US Holdings, Inc.	Holding company	U.S.	100	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. The

registered office of Mereo BioPharma Ireland Limited is Rocktwist House, Block 1, Western Business Park, Shannon, County Clare, V14 FW97, Republic of Ireland.

Mereo US Holdings Inc. was incorporated on December 3, 2018 for the sole purpose of effecting the business combination with Mereo BioPharma 5, Inc. (formerly OncoMed Pharmaceuticals, Inc.) on April 23, 2019. The registered office of Mereo US Holdings Inc., Mereo BioPharma 5, Inc. and its wholly owned subsidiary, Navi Subsidiary, Inc., is 251 Little Falls Drive, City of Wilmington, County of New Castle, Delaware 19808, US.

6. Revenue

The Company recognized upfront proceeds of £36.5 million ($50.0 million) from the license and collaboration agreement with Ultragenyx for setrusumab as revenue in the year ended December 31, 2021. The variable consideration relating to future milestones and sales royalties will be recognized in the statement of comprehensive income/(loss) when the milestones are achieved or the underlying commercial sales are made, in the event regulatory approval is achieved.

As a consequence of the license and collaboration agreement with Ultragenyx and in accordance with terms of the 2015 asset purchase with Novartis, the Company made a payment to Novartis of £7.2 million ($10.0 million). The payment included a deduction for costs of £2.4 million which was deferred and will be recognized in the statement of comprehensive income/(loss) when the associated costs are incurred. In the year ended December 31, 2021, £1.1 million of these deductions were recognized within "Cost of revenue" in the consolidated statement of comprehensive income/(loss). As of December 31, 2021 the remaining balance to be recognized of £1.3 million is included within "Other liabilities" in the consolidated balance sheet. See Note 13 for additional details.

7. Profit/(loss) before tax

Profit/(loss) before tax is stated after charging:

	Year ended December 31,		
	2021 £'000s	2020 £'000s	2019 £'000s
Fees payable to the Company's Auditor for the audit of the consolidated accounts	358	449	514
Fees payable to the Company's Auditor for other services:			
Audit of subsidiary accounts	46	49	45
Audit-related assurance services	57	318	311
Gain on modification of lease	–	(957)	–
Income from sub-lease	–	(646)	(855)
Depreciation of right-of-use assets	570	1,531	1,505
Depreciation (excluding right-of-use assets)	72	68	52

Gain on modification of lease, sub-lease income and transaction costs associated with lease modification are included within administrative expenses within the consolidated statement of comprehensive income/(loss).

8. Employees

The average monthly number of persons employed by the Company during the year was:

	Year ended December 31,		
	2021	2020	2019
By activity:			
Administrative	26	22	28
Research and development	19	17	18
Total	45	39	46

Total compensation costs for persons employed by the Company (including Directors) during the year was:

	Year ended December 31,		
	2021 £'000s	2020 £'000s	2019 £'000s
Included in research and development expenses:			
Salaries	4,126	3,046	2,824
Social security costs	402	397	110
Pension contributions	73	66	62
Share-based payment expenses	1,210	446	152
Included in administrative expenses:			
Salaries	3,763	4,832	3,384
Social security costs	418	681	(124)
Pension contributions	99	89	114
Share-based payment expenses	2,092	1,112	1,485
Total	12,183	10,669	8,007

Total compensation costs for Directors during the year was:

	Year ended December 31,		
	2021 £'000s	2020 £'000s	2019 £'000s
Salaries and fees	810	1,114	1,106
Benefits in kind	9	14	17
Pension contributions	58	61	25
Bonus	239	538	294
Total	1,116	1,727	1,442

During 2021, one Director was a member of a defined contribution pension scheme (2020: one, 2019: two). Further details concerning the remuneration of key management personnel can be found in Note 27.

9. Other income/expenses and adjustments

Finance income

	Year ended December 31,		
	2021 £'000s	2020 £'000s	2019 £'000s
Bank interest earned	1	5	42
Interest earned on short-term investments	–	–	141
Gain on short-term investments	–	39	194
Total	1	44	377

Finance costs

	Year ended December 31,		
	2021 £'000s	2020 £'000s	2019 £'000s
Interest on convertible loan notes	(3,549)	(2,241)	(20)
Interest on bank loan	–	(2,900)	(1,739)
Interest on lease liabilities	(227)	(1,085)	(1,314)
Accreted interest on bank loan	–	–	(1,523)
Modification gain on bank loan	–	–	456
Discounting of provision for deferred cash consideration	(225)	(157)	(221)
Other	(21)	–	(10)
Total	(4,022)	(6,383)	(4,371)

Changes in the fair value of financial instruments

	Year ended December 31,		
	2021 £'000s	2020 £'000s	2019 £'000s
Changes in the fair value of warrants – private placement	39,535	(45,977)	–
Changes in the fair value of warrants – bank loan	504	(714)	875
Changes in the fair value of embedded derivative	–	(63,158)	–
Total	40,039	(109,849)	875

10. Taxation

	Year ended December 31,		
	2021 £'000s	2020 £'000s	2019 £'000s
Tax charge	(1,516)	–	–
UK corporation tax R&D credit	–	2,822	5,149
Other tax income	–	–	1,125
Total	(1,516)	2,822	6,274

U.K. income tax

The Company is entitled to claim tax credits in the United Kingdom 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, 2020 have been received by the Company.

U.S. income tax

As at December 31, 2021, £0.8 million is receivable related to Alternative Minimum Tax ("AMT") credits, recognized as other taxes recoverable within the consolidated balance sheet. The Company generates R&D tax credits for U.S. federal and state purposes. In respect of these R&D tax credits, no deferred tax assets have been recognized in any periods presented. As of December 31, 2021, the Company had an uncertain tax position of £2.6 million, representing approximately 20% of these historic R&D tax losses claimed.

Reconciliation of effective tax rate

	Year ended December 31,		
	2021 £'000s	2020 £'000s	2019 £'000s
Profit/(loss) on ordinary activities before income tax	14,241	(166,450)	(41,118)
Tax on profit at standard U.K. rate of 19%	(2,706)	31,626	7,812
Expenses not deductible for income tax purposes (permanent differences)	(708)	(13,270)	(317)
Income not taxable	78	4	–
Temporary timing differences	(65)	–	(343)
R&D relief uplift	1,435	1,214	2,540
Losses (unrecognized)	(345)	(14,479)	(4,380)
Deferred income from MBG loan guarantee costs	–	–	(54)
Foreign tax	505	184	–
Differences in overseas tax rates	286	261	340
Derecognition of deferred tax	–	(2,686)	–
Gain on bargain purchase	–	–	699
Other	4	(32)	(23)
Tax (charge)/credit for the year	(1,516)	2,822	6,274

Deferred tax
The analysis of unrecognized deferred tax is set out below:

	Year ended December 31,		
	2021 £'000s	2020 £'000s	2019 £'000s
Losses	44,683	37,021	19,443
Loan relationships	73	421	–
U.S. tax credits	10,557	9,880	10,032
Accruals	–	–	947
Fixed assets	–	414	400
Share options	151	55	–
Other US deferred tax	31	86	–
Other	–	137	202
Temporary differences	56	18	4
Net deferred tax asset (unrecognized)	55,551	48,032	31,028

The analysis of recognized deferred tax is set out below:

	At January 1, 2021 £'000s	Recognized in income £'000s	At December 31, 2021 £'000s
Deferred tax liabilities			
Intangible asset and right-of-use asset	(96)	76	(20)
Deferred tax asset	96	(76)	20
Net operating losses and lease liability	–	–	–

Net deferred tax asset/(liability)

A deferred tax asset on losses has been recognized up to the level of the deferred tax liability, resulting in a net deferred tax liability of £nil.

The remaining deferred tax assets, as set out in the table above, have not been recognized as there is uncertainty regarding when suitable future profits against which to offset the accumulated tax losses will arise.

U.K. deferred tax

The deferred tax assets have 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.

The standard rate of corporation tax applied to the reported profit/(loss) before tax is 19% (2020: 19%). The Finance Act 2021, which was substantively enacted on May 24, 2021, included provisions to increase the standard rate of tax from 19% to 25%, effective from April 1, 2023. As a result, U.K. deferred tax assets and liabilities have been measured at a rate of 25%.

At December 31, 2021, the Company had UK tax losses to be carried forward of approximately £122.6 million.

U.S. deferred tax

U.S. deferred tax assets and liabilities are calculated at a blended rate of approximately 21%.

For Mereo BioPharma 5, Inc, with respect to accumulated tax losses carried forward prior to its acquisition by the Company, there is a change of control restriction which will limit the amount available in any one year.

At December 31, 2021, the Company had U.S. federal tax losses to be carried forward of approximately £65.6 million, of which £59.4 million can be carried forward indefinitely and £6.2 million which will begin to expire in 2022. At December 31, 2021, the Company had U.S. state tax losses to be carried forward of approximately £3.5 million which begin to expire in 2027.

11. Earnings per share

Basic profit/(loss) per share is calculated by dividing the profit/(loss) attributable for the year to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year. Diluted loss per share is based on dividing the profit attributable for the year, adjusted for the effect of diluted ordinary shares, by ordinary share equivalents, which includes the weighted average number of ordinary shares outstanding and the effect of dilutive ordinary share equivalents.

	Year ended December 31,		
	2021	2020	2019
Numerator – Basic earnings per share (£'000s):			
Profit/(loss) attributable to equity holders of the parent	12,725	(163,628)	(34,844)
Denominator – Basic earnings per share:			
Weighted average number of ordinary shares	527,818,648	338,953,141	89,424,476
Profit/(loss) per share – basic (£)	0.02	(0.48)	(0.39)
Numerator – Diluted earnings per share (£'000s):			
Profit/(loss) attributable to equity holders of the parent	12,725	(163,628)	(34,844)
Effect of dilutive ordinary shares	(38,523)	–	–
Numerator – Diluted earnings per share	(25,798)	(163,628)	(34,844)
Denominator – Diluted earnings per share:			
Number of ordinary shares used for basic earnings per share	527,818,648	338,953,141	89,424,476
Weighted average effect of dilutive ordinary shares	27,457,163	–	–
Weighted average number of diluted ordinary shares outstanding	555,275,811	338,953,141	89,424,476
Loss per share – diluted (£)	(0.05)	(0.48)	(0.39)

For the year ended December 31, 2021, the effect of dilutive ordinary shares, net of current year tax charge, is related to Company's outstanding warrants. For the years ended December 31, 2020 and 2019, share options, convertible loan notes and warrants were considered to be anti-dilutive as they would have decreased the loss per share and were therefore excluded from the calculation of diluted loss per share. Therefore, the weighted average shares outstanding used to calculate both the basic and diluted per share was the same.

12. Property, plant and equipment

	Right-of-use asset (building) £'000s	Right-of-use asset (equipment) £'000s	Leasehold improve-ments £'000s	Office equipment £'000s	IT equipment £'000s	Total £'000s
Cost or valuation						
At January 1, 2021	1,848	1,169	164	71	132	3,384
Additions	923	–	393	109	48	1,473
Lease modification	133	30	–	–	–	163
Disposals	–	(868)	–	(7)	–	(875)
Currency translation effects	(1)	(36)	–	–	–	(37)
At December 31, 2021	2,903	295	557	173	180	4,108
Depreciation						
At January 1, 2021	(531)	(1,023)	(85)	(65)	(107)	(1,811)
Disposals	–	868	–	7	–	874
Depreciation for the year	(494)	(76)	(39)	(11)	(22)	(642)
At December 31, 2021	(1,025)	(231)	(124)	(69)	(129)	(1,578)
Net book value						
At January 1, 2021	1,318	146	79	6	25	1,573
At December 31, 2021	1,878	64	433	104	51	2,530

	Right-of-use asset (building) £'000s	Right-of-use asset (equipment) £'000s	Leasehold improve-ments £'000s	Office equipment £'000s	IT equipment £'000s	Total £'000s
Cost or valuation						
At January 1, 2020	11,877	1,024	164	71	116	13,252
Additions	–	–	–	–	16	16
Lease modification	(10,220)	149	–	–	–	(10,071)
Currency translation effects	191	(4)	–	–	–	187
At December 31, 2020	1,848	1,169	164	71	132	3,384
Depreciation						
At January 1, 2020	(996)	(509)	(69)	(30)	(90)	(1,694)
Lease modifications	1,482	–	–	–	–	1,482
Depreciation for the year	(1,017)	(514)	(16)	(35)	(17)	(1,599)
At December 31, 2020	(531)	(1,023)	(85)	(65)	(107)	(1,811)
Net book value						
At January 1, 2020	10,881	515	95	41	26	11,558
At December 31, 2020	1,318	146	79	6	25	1,573

In June 2021, the Company entered into a new lease agreement for additional office space in London, UK. The Company also extended the lease term of the existing office space, which resulted in the modification of the right-of-use asset.

In August 2020, the Company modified the scope of the leased office space in the US included in the right-of-use asset (building). The revised lease payments were allocated between lease and non-lease components, determining a new lease term, and remeasuring the lease liability using a revised discount rate. This resulted in a reduction in the right-of-use asset of £8.7 million and a reduction in lease liability of £9.5 million, with the associated gain on modification of £0.7 million recognized in the consolidated statement of comprehensive income/(loss). Related transaction costs of £2.5 million were also recognized in the consolidated statement of comprehensive income/(loss).

The Company leases office space and equipment for use in research and development activities. In the year-ended December 31, 2021, the Company made lease payments of £0.7 million (2020: £2.1 million). The maturity of lease liabilities as of December 31, 2021 are as follows:

	Within 1 year £'000s	Between 1 and 3 years £'000s	Between 3 and 5 years £'000s	Over 5 years £'000s	Total £'000s
Maturity of lease liabilities	622	972	782	–	2,376

Further details on the movements within lease liability are included in Note 23.

13. Intangible assets

	Acquired development programs £'000s
Cost	
At January 1, 2020	45,527
Disposals	(13,386)
Currency translation effects	864
At December 31, 2020	33,005
At December 31, 2021	33,005
Revisions to estimated value	
At January 1, 2020	(1,071)
Revisions to estimated value	(286)
At December 31, 2020	(1,357)
Revisions to estimated value	2,373
Out-license of intangible asset	(9,457)
At December 31, 2021	(8,441)
Net book value	
At January 1, 2020	44,456
At December 31, 2020	31,648
At December 31, 2021	24,564

The Company's strategy is to acquire and develop clinical-stage development programs for the treatment of oncology and rare diseases.

On January 25, 2021, the Company's license and collaboration agreement with Ultragenyx for the development and commercialization of setrusumab for OI became effective. Under the terms of the agreement, the Company received an upfront payment of £36.5 million ($50 million). Additionally, the Company will be eligible to receive up to $254 million in future milestones and royalties. The license and collaboration agreement grants Ultragenyx an exclusive license to develop and commercialize setrusumab in the US and rest of the world, excluding Europe where the Company retains commercial rights. As a result, intangible assets with a carrying value of £9.5 million were derecognized and recorded within "Cost of revenue" in the Company's consolidated statement of comprehensive income/(loss).

In October 2017, the Company acquired the exclusive license for alvelestat and included the option to acquire certain assets from AstraZeneca AB ("AstraZeneca"). On that date the fair value of alvelestat was measured at £7.2 million, which consisted of upfront cash and equity payments as well as deferred cash and equity consideration. The provision for deferred cash consideration is re-measured to fair value at each balance sheet date and recognized as an increase to, or reduction of, the intangible asset. During the year, the provision for deferred cash consideration has increased by £2.4 million (2020: decrease of £0.3 million) due to changes in timelines and the probability of contractual milestones being achieved. Refer to Note 18 and Note 24 for additional information.

During the year the Company did not revise the value of any other intangible assets. As the intangible assets remain under development, no amortization charge has been recognized (2020: £nil).

On April 23, 2019, the Company acquired an intangible asset of £12.7 million following the acquisition of Mereo BioPharma 5, Inc. The intangible asset represented the intellectual property associated with etigilimab and navicixizumab, among others, for which the fair value at acquisition was fully attributed to navicixizumab. On January 13, 2020, the Company entered into a license agreement with OncXerna under which an exclusive worldwide license was granted in respect of intellectual property rights for the development and commercialization of navicixizumab. Under the terms of the license agreement, the Company received an upfront gross payment of £3.1 million ($4 million), and derecognized the associated intangible asset, recording a loss on disposal of £10.9 million.

14. 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:

	December 31, 2021 £'000s	2020 £'000s
BPS-804 (setrusumab)	2,159	11,616
MPH-966 (alvelestat)	8,208	5,835
BSG-649 (leflutrozole)	9,886	9,886
BCT-197 (acumapimod)	4,311	4,311
Total	24,564	31,648

The Company considers the future development costs, the probability of successfully progressing each program to product approval and the 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 for the year ended December 31, 2021. Management believes that the likelihood of a materially different outcome using different assumptions is remote.

The acquired development programs are assets which are not used in commercialized 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 Company receives upfront payments, milestone receipts and royalties on commercial sales; therefore, the Company does not incur any costs of commercialization after out-licensing except when such terms are agreed.

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. Management 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 management's 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 – for all assets, cash flows are assessed over an industry-standard asset life of 20 years; and
- Discount rates – the discount rate is estimated on a pre-tax basis reflecting the estimated cost of capital of the Company and is applied consistently across each of the acquired development programs. The cost of capital was calculated at 12.0% (2020: 12.0%).

Where an out-licensing agreement has been reached with a third party, known and observable inputs replace management assumptions if available.

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

15. Other receivables

	December 31, 2021 £'000s	December 31, 2020 £'000s
Lease deposits	408	407
VAT recoverable	387	370
Other	624	239
Total	1,419	1,016

16. Cash and short-term deposits

	December 31, 2021 £'000s	December 31, 2020 £'000s
Cash	93,727	22,922
Short-term deposits	569	547
Total	94,296	23,469

Short-term deposits are available immediately and earn fixed interest at the respective short-term deposit rates and are held in various certificates of deposit.

17. Trade and other payables

	December 31, 2021 £'000s	2020 £'000s
Trade payables	2,285	3,165
Social security and other taxes	190	146
Other payables	24	22
Total	2,499	3,333

Trade and other payables are non-interest bearing and have an average term of one month.

18. Provisions

	December 31, 2021 £'000s	2020 £'000s
Social security contribution on vested share options	–	109
Provision for deferred cash consideration	4,123	1,525
Total	4,123	1,634
Current	2,803	418
Non-current	1,320	1,216

	Social security contribution on vested share options £'000s	Deferred cash consideration £'000s
At January 1, 2020	104	1,654
Arising/(released) during the year, net	5	–
Increase in provision due to the unwinding of the time value of money	–	157
Decrease in provision due to a change in estimates relating to timelines and probabilities of contractual milestones being achieved (revision to intangible asset, see Note 13)	–	(286)
At December 31, 2020	109	1,525
Arising/(released) during the year, net	(109)	–
Increase in provision due to the unwinding of the time value of money	–	225
Increase in provision due to a change in estimates relating to timelines and probabilities of contractual milestones being achieved (revision to intangible asset, see Note 13)	–	2,373
At December 31, 2021	–	4,123

The provision for social security contributions on share options is calculated based on the number of vested options outstanding at the reporting date that are expected to be exercised. The provision is based on the estimated taxable gain arising on exercise of the share options, using the best estimate of the market price at the balance sheet date.

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 13). This provision is calculated as the risk-adjusted net present value of future cash payments to be made by the Company. 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.

19. Private placement

On June 3, 2020, the Company completed a £56 million private placement transaction which comprised of the issuance of 89,144,630 ordinary shares of £0.003 each at a price of £0.174 per share for total proceeds of £15.5 million, and the issue of Tranche 1 convertible loan notes (the "Loan Notes") for total proceeds of £40.5 million. The investors also received conditional warrants to subscribe for an additional 161,048,366 ordinary shares (the "Warrants").

The terms of the Loan Notes and Warrants, and, in particular, their ability to be converted into ordinary shares was conditional on the passing of certain resolutions (the "Resolutions") at a subsequent general meeting of shareholders held on June 30, 2020. At that date, the Resolutions were passed, and the Loan Notes became convertible into ordinary shares.

Loan Notes

The Loan Notes bear interest at a rate of 6% per annum and have an initial maturity date of June 2023. The Loan Notes are convertible into ordinary shares at the discretion of the holder and, if not converted by the initial maturity date, may be extended for an additional seven years, but will cease to bear interest from any extension date. The Loan Notes were initially recognized at their fair value of £38.6 million (debt host instrument in the amount of £26.7 million and the embedded derivative in the amount of £11.9 million, before transaction costs).

Loan Notes in an aggregate principal amount of £40.5 million were issued on June 3, 2020 and became convertible upon the passing of the Resolutions. As a result, on June 30, 2020, Loan Notes in an aggregate principal amount of £21.8 million, together with accrued interest, were automatically converted into 125,061,475 ordinary shares, and Loan Notes in an aggregate principal amount of £18.9 million remained outstanding as of December 31, 2020. See Note 21.

During the year ended December 31, 2021, the Company issued and allotted 40,397,976 ordinary shares at a price of £0.174 per share on conversion of Loan Notes. As of December 31, 2021, Loan Notes in an aggregate principal amount of £12.4 million remain outstanding.

Warrants

Participants in the private placement transaction received conditional warrants to subscribe for further ordinary shares in an aggregate number equal to 50 percent of both the ordinary shares purchased and the ordinary shares issuable upon conversion of the Loan Notes. A total of 161,048,366 Warrants were issued. The fair value of the warrants at inception was £4.1 million.

The Warrants have an exercise price of £0.348 per share and are exercisable at any time until their expiry in June 2023. The Warrants can be exercised for cash or on a cashless basis at the discretion of the warrant holder. Certain Warrants outstanding at the expiry date may be converted into Tranche 2 Notes, with an expiry date of up to seven years from conversion, and do not bear interest. See Note 20.

The Loan Notes and the Warrants were recognized as separate financial instruments. Transaction costs directly attributable to the private placement transaction were apportioned across the ordinary shares, Loan Notes and Warrants.

20. Warrant liability

	December 31, 2021 £'000s	2020 £'000s
January 1	50,775	131
Issued during the year	–	4,080
Settled during the year	(2,400)	(127)
Fair value changes during the year	(40,039)	46,691
At December 31	**8,336**	**50,775**

The change in fair value of the warrant liability represents an unrealized gain in the year ended December 31, 2021.

Warrants – private placement

As a part of the private placement transaction on June 3, 2020, the participating investors received conditional warrants entitling them to subscribe for an aggregate of 161,048,366 ordinary shares in the Company. The warrants were conditional on certain Resolutions being passed at the Company's general meeting on June 30, 2020. On the passing of the Resolutions, the warrants entitled the investors to subscribe for ordinary shares at an exercise price of £0.348 per warrant and are exercisable until June 2023. The warrants are classified as liabilities as the Company does not have an unconditional right to avoid redeeming the instruments for cash. The fair value of the warrant liability was £8.0 million as of December 31, 2021 (£49.9 million as of December 31, 2020). The change in the fair value of £39.5 million was recognized as a gain in the consolidated statement of comprehensive income/(loss). During the year-ended December 31, 2021, 15,414,626 warrants were exercised (2020: 690,205). Refer to Note 22 for details of the warrant exercises.

Warrants – bank loan

As of December 31, 2021 and 2020, the former lenders of the Company have warrants outstanding to purchase a total of 1,243,908 ordinary shares at an exercise price of £2.95 per share and a total of 1,243,908 ordinary shares at an exercise price of $0.4144 per share.

At December 31, 2021, the fair value of these warrants were £0.3 million (2020: £0.8 million). There were no warrants exercised during the year ended December 31, 2021.

Total outstanding warrants

At December 31, 2021, a total of 147,431,351 warrants are outstanding (2020: 162,845,977). The warrants outstanding are equivalent to 25% of the issued ordinary share capital of the Company (2020: 48%).

The following table lists the weighted average inputs to the models used for the fair value of warrants:

	December 31, 2021	2020
Expected volatility (%)	75	84-85
Risk-free interest rate (%)	0.9	0.25-(0.05)
Expected life of warrants (years)	1.5	3
Market price of ADS ($)	$1.60	$3.58
Model used	Black-Scholes	Black-Scholes

21. Convertible loan notes

	December 31, 2021 £'000s	2020 £'000s
Novartis Loan Note	3,771	3,196
Loan Notes – private placement	10,613	12,946
Total	**14,384**	**16,142**
Current	–	–
Non-current	14,384	16,142

Convertible loan notes

On February 10, 2020, the Company entered into a convertible equity financing with Novartis Pharma (AG) ("Novartis") under which Novartis purchased a £3.8 million convertible loan note (the "Novartis Loan Note").

The Novartis Loan Note is convertible at the discretion of the holder, at a fixed price of £0.265 per ordinary share and bears an interest rate of 6% per annum with a maturity date of February 2025. In connection with the Novartis Loan Note, the Company issued 1,449,614 warrants which are exercisable until February 2025 at an exercise price of £0.265.

Loan Notes – private placement

The initial issuance of Loan Notes in an aggregate principal amount of £40.5 million were issued on June 3, 2020 and formed part of the private placement transaction (Note 19) were classified as a financial liability on initial recognition. Non-closely related embedded derivatives relating to the conversion feature, term-extension and change of control features were bifurcated and accounted for at FVTPL, with the debt host contract being measured at amortized cost.

The fair value of the embedded derivative liability was £11.9 million on initial recognition and the fair value of the liability component was £24.4 million (net of transaction costs). In 2020, between initial recognition and the passing of the Resolutions (Note 19), changes in the fair value of the embedded derivative totaling £63.2 million were recognized as an expense in the consolidated statement of comprehensive income/(loss).

The Loan Notes were not convertible until certain Resolutions were passed at the Company's general meeting on June 30, 2020, following which Loan Notes in an aggregate principal amount of £21.7 million (together with accrued interest) were automatically converted into 125,061,475 ordinary shares. Accordingly, a reduction in interest bearing loans of £13.3 million together with the derecognition of the embedded derivative relating to the conversion feature of £41.6 million was recognized; no gain or loss was recognized on conversion. The remaining portion of the embedded derivative relating to the conversion feature attributable to the Loan Notes outstanding of £33.5 million was reclassified to equity to reflect the effective change in the terms of the feature following the passing of the Resolutions.

The movements in the carrying value of the liability component of the Loan Notes is included in the table below. Refer to Note 22 for details of Loan Notes converted to equity.

	Year ended December 31, 2021 £'000s	2020 £'000s
January 1	12,946	–
Issued	–	24,417
Interest charge	2,974	1,803
Converted to equity	(5,307)	(13,274)
December 31	**10,613**	**12,946**

The movements in the carrying value of the embedded derivative relating to the conversion feature in the year-ended 2020 is included in the table below. There were no movements in the carrying value of the embedded derivative in the year-ended December 31, 2021 following the reclassification to equity on June 30, 2020.

	Year ended December 31, 2020 £'000s
January 1	–
Arising during the year	11,913
Change in fair value	63,158
Reclassified to equity	(75,071)
December 31	**–**

The change in fair value of the embedded derivative liability represented an unrealized loss (recognized within fair value changes on derivative financial instruments held at FVTPL) in the consolidated statement of comprehensive income/(loss) in the year ended December 31, 2020.

The fair value of the embedded derivative was determined by comparing the fair value of the hybrid instrument and the fair value of the host debt, which excludes the conversion features, using a discounted

cash flow model as well as Black-Scholes model for the hybrid contract. Inputs into the models used to fair value the embedded derivative at inception (June 3, 2020), at conversion (June 30, 2020) and at the balance sheet date are as follows:

	December 31, 2020	June 30, 2020	June 3, 2020
Expected volatility (%)	–	61	61
Risk-free interest rate (%)	–	0.19	0.27
Credit spread %	–	1.86	2.01
Expected life of share options (years)	–	3	3
Market price of ordinary shares (£)	–	0.46	0.19
Probability of resolutions passing (%)	–	100	90
Models used	–	Discounted cash flow/ Black-Scholes model	Discounted cash flow/ Black-Scholes model

Volatility was estimated by reference to the one-month historical volatility of the share price of the Company. The credit spread was determined based on the estimate of an implied credit rating of the Company between B and C. The volatility and credit spread are key unobservable inputs that require significant judgment and, therefore, the embedded derivatives were categorized within level 3 of the fair value hierarchy.

22. Issued capital and reserves

	Ordinary Shares Number	Ordinary Share capital £'000s	Share premium £'000s
As at January 1, 2019	**71,240,272**	**214**	**118,492**
Issued on April 23, 2019	24,783,320	74	–
Issued on June 21, 2019	1,936,030	6	3,953
Transaction costs for issued share capital	–	–	(761)
As at December 31, 2019	**97,959,622**	**294**	**121,684**
Issued on February 11, 2020	14,295,520	43	2,511
Issued on February 20, 2020	12,252,715	37	2,267
Issued on June 4, 2020	89,144,630	267	15,244
Issued on June 30, 2020	125,061,475	375	21,386
Issued on December 23, 2020	239,179	1	–
Transaction costs for issued share capital	–	–	(1,307)
As at December 31, 2020	**338,953,141**	**1,017**	**161,785**
Issued during the year	245,955,098	738	85,909
Transaction costs for issued share capital	–	–	(234)
As at December 31, 2021	**584,908,239**	**1,755**	**247,460**

Since January 1, 2019, the following alterations to the Company's share capital have been made. For each share issuance, ordinary shares of £0.003 in nominal value in the capital of the Company were issued.

- On April 23, 2019, the Company issued and allotted 24,783,320 ordinary shares as consideration for the acquisition of Mereo BioPharma 5, Inc. The fair value of the ordinary shares, measured on the date of acquisition, was £1.65;

- On June 21, 2019, Novartis converted £2.4 million of loan notes dated June 3, 2016 into 1,071,042 ordinary shares at a fixed conversion price of £2.21 per share. Under the terms of the notes, Novartis also received 864,988 bonus shares.

- On February 11, 2020, the Company issued and allotted 11,432,925 ordinary shares at a price of £0.20 per share to Aspire Capital Fund, LLC ("Aspire Capital"). Gross cash received was £2.3 million. Aspire Capital has also committed to subscribe for up to an additional $25 million of ordinary shares exchangeable for ADSs from time to time during a 30-month period at the Company's request. In consideration for this, the Company paid Aspire Capital a commission satisfied through a non-cash transaction wholly by the issue of a further 2,862,595 of the Company's ordinary shares (equivalent to 572,519 ADSs) at a price of £0.08.

- On February 20, 2020, the Company issued and allotted 12,252,715 ordinary shares at a price of £0.19 per share. Gross cash received was £2.3 million;

- On June 4, 2020, the Company issued and allotted 89,144,630 ordinary shares at a price of £0.174 per share to investors. Gross cash received was £15.5 million. The ordinary shares were in substance issued at a discount to the gross cash received. The fair value of the consideration of the ordinary shares was determined to be £13.4 million and therefore the ordinary shares were in substance issued at a discount of £2.1 million, which was recorded as a reduction to other reserves (other reserves represent amounts that relate to changes to the Company's paid up equity and which are not capital reserves) in the consolidated statement of changes in equity. The incremental directly attributable transaction costs in relation to the issue of the ordinary shares were included within share premium;

- On June 30, 2020, the Company issued and allotted 125,061,475 ordinary shares at a price of £0.174 per share to investors on conversion of the Loan Notes. The legal proceeds were £21.8 million;

- On December 23, 2020, 690,205 Warrants (equivalent to 138,041 ADSs) were exercised. This transaction was completed by way of a cashless exercise resulting in 47,835 ADSs being issued at the aggregate nominal value of the ordinary shares underlying the ADSs issued, in place of the exercise price of £0.348 per ordinary share.

- On February 12, 2021, the Company issued and allotted 198,375,000 ordinary shares of the Company with a nominal value of £0.003 at a price of £0.395 per share, equivalent to 39,675,000 ADS at a price of $2.726 per ADS, after underwriting discounts and commissions, resulting in proceeds of £78.4 million. Transaction costs incurred for the issuance of share capital was £0.2 million.

- During the year ended December 31, 2021, 14,954,491 warrants (equivalent to 2,990,898 ADSs) were exercised by way of a cashless exercise resulting in 4,621,147 ordinary shares (924,229 ADSs) being issued at the aggregate nominal value of the ordinary shares underlying the ADSs issued, in place of the exercise price of £0.348 per ordinary share. A further 460,135 warrants (equivalent to 92,027 ADSs) were exercised on a cash basis at the exercise price of £0.348, which resulted in aggregate proceeds of £0.2 million.

- On May 4, 2021, the Company issued and allotted 2,100,840 ordinary shares of £0.003 in nominal value in the capital of the Company at a price of £0.517 per share to Cancer Focus Fund, as part of a non-cash, equity-settled transaction where the Company entered into partnership with Cancer Focus Fund for a Phase 1b/2 study of etigilimab in Clear Cell Ovarian Cancer to be conducted at The University of Texas MD Anderson Cancer Center. The study will be financed by Cancer Focus Fund, in exchange for upfront consideration of $1.5 million (£1.09 million) of the Company's ordinary shares and additional payments based on the achievement of certain milestones. The Company initially recognized a prepayment of £1.09 million with reference to fair value of the ordinary shares granted, of which £0.2 million was subsequently recorded in the consolidated statement of comprehensive income/(loss) during the year ended December 31, 2021.

- During the year ended December 31, 2021, the Company issued and allotted 40,397,976 ordinary shares of £0.003 in nominal value in the capital of the Company at an exercise price of £0.174 per share on non-cash conversion of Loan Notes.

Other capital reserves

	Shares to be issued £'000s	Share-based payments £'000s	Equity component of convertible loan notes £'000s	Other warrants issued £'000s	Merger reserve £'000s	Other reserve £'000s	Total £'000s
At January 1, 2019	**1,590**	**16,649**	**310**	**44**	**–**	**–**	**18,593**
Acquisition of Mereo BioPharma 5, Inc.	–	–	–	–	40,818	–	40,818
Shares issued during the year	(1,590)	–	–	–	–	–	(1,590)
Convertible loan conversion	–	–	(310)	–	–	–	(310)
Share based payments expense during the year	–	1,636	–	–	–	–	1,636
At December 31, 2019	**–**	**18,285**	**–**	**44**	**40,818**	**–**	**59,147**
Share based payments expense during the year	–	1,558	–	–	–	–	1,558
Novartis convertible loan note instrument and warrants	–	–	1,084	–	–	–	1,084
Conversion of Loan Notes	–	–	–	–	–	33,104	33,104
Reclassification of the embedded derivative	–	–	33,481	–	–	–	33,481
At December 31, 2020	**–**	**19,843**	**34,565**	**44**	**40,818**	**33,104**	**128,374**
Share based payments expense during the year	–	3,302	–	–	–	–	3,302
Share options exercised	–	(119)	–	–	–	–	(119)
Conversion of Loan Notes	–	–	(1,722)	–	–	–	(1,722)
At December 31, 2021	**–**	**23,026**	**32,843**	**44**	**40,818**	**33,104**	**129,835**

Shares to be issued

At January 1, 2019, a maximum of 864,988 shares were remaining to be issued to Novartis pro-rata to their percentage shareholding as and when the Company issued further ordinary shares. The fair value of these shares was £1.84 per share.

On June 21, 2019, the remaining 864,988 shares were issued to Novartis as fully paid up bonus shares for £nil consideration. There were no movements in this reserve in 2020 and 2021 and the balance as at December 31, 2019, 2020 and 2021 was £nil.

Share-based payments

The Company has various share option schemes under which options to subscribe for the Company's shares have been granted to certain executives, non-executive directors ("NEDs") and employees.

The share-based payment reserve is used to recognize (i) the value of equity settled share-based payments provided to employees, including key management personnel, as part of their remuneration and (ii) deferred equity consideration. Refer to Note 26 for further details.

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. The value of the equity component (cost of the conversion option) as at December 31, 2021 is £1.08 million (December 31, 2020: £1.08 million).

On June 30, 2020, the Loan Notes in an aggregate principal amount of £21.8 million (together with accrued interest) were automatically converted into 125,061,475 ordinary shares. This resulted in £33.5 million recognized in other reserves in equity as a difference between the share capital and share premium recognized on conversion and the carrying value of the embedded derivative financial liability extinguished. See Note 19.

Other warrants issued

The funding arrangements with The Alpha-1 Project are a compound instrument consisting of a liability and an equity component. The value of the equity component (consideration received for the warrants) as at December 31, 2021, 2020 and 2019 is less than £ 0.1 million.

Merger reserve

The consideration paid to acquire Mereo BioPharma 5, Inc. was 24,783,320 ordinary shares with an acquisition date fair value of £40.9 million, based on the Company's quoted share price. The nominal value of the issued capital was £0.1 million with the excess, £40.8 million, classified within other capital reserves as a 'Merger reserve'.

Other reserves

On June 30, 2020, the Company issued and allotted 125,061,475 ordinary shares of £0.003 in nominal value in the capital of the Company at a price of £0.174 per share to investors following the partial conversion of the Loan Notes. The legal proceeds were £21.8 million. This resulted in £33.1 million recognized in other reserves as a difference between the carrying value of the financial liability extinguished and the legal proceeds.

Accumulated loss

	Year ended December 31,		
	2021 £'000s	2020 £'000s	2019 £'000s
Other reserves	7,401	5,001	7,000
Accumulated losses	(296,968)	(309,693)	(146,065)

Other reserves represent a capital reduction undertaken in 2016 which created a reserve of £7.0 million. On June 3, 2020, the Company issued and allotted 89,144,630 ordinary shares to investors. The difference between the gross proceeds, £15.5 million, and the fair value of the consideration of the ordinary shares, £13.4 million, of £2.1 million, was recognized as a reduction to other reserves. During the year ended December 31, 2021, 15,414,626 private placement warrants were exercised, resulting in a £2.4 million reduction in the warrant liability which was recognized as an addition to "Other reserves."

23. Changes in liabilities arising from financing activities

	Contingent consideration £'000s	Lease liability £'000s	Bank loan £'000s	Novartis Loan Note £'000s	Warrant liability £'000s	Deferred cash consideration £'000s	Loan notes – private placement £'000s	Other £'000s	Total £'000s
Carrying value at January 1, 2020	354	11,904	20,512	–	131	1,654	–	44	34,599
Settled during the year	(354)	–	(23,412)	–	(127)	–	–	–	(23,893)
Financing cash flows	–	(2,086)	–	2,758	–	–	36,330	18	37,020
Issuance of warrants	–	–	–	–	4,080	–	–	–	4,080
Interest expense	–	1,085	2,900	438	–	–	1,803	–	6,226
Lease modification	–	(9,547)	–	–	–	–	–	–	(9,547)
Changes in fair values	–	–	–	–	46,691	(129)	63,158	–	109,720
Changes in foreign exchange	–	438	–	–	–	–	–	–	438
Reclassified to equity	–	–	–	–	–	–	(88,345)	–	(88,345)
Carrying value at December 31, 2020	**–**	**1,794**	**–**	**3,196**	**50,775**	**1,525**	**12,946**	**62**	**70,298**
Financing cash flows	–	(692)	–	–	–	–	–	–	(692)
Non-cash changes									
Settled during the year	–	–	–	–	(2,400)	–	(5,307)	–	(7,707)
Interest expense	–	230	–	575	–	206	2,974	18	4,003
Lease addition	–	910	–	–	–	–	–	–	910
Lease modification	–	163	–	–	–	–	–	–	163
Changes in fair values	–	–	–	–	(40,039)	2,373	–	–	(37,666)
Changes in foreign exchange	–	(29)	–	–	–	19	–	–	(10)
Carrying value at December 31, 2021	**–**	**2,376**	**–**	**3,771**	**8,336**	**4,123**	**10,613**	**80**	**29,299**

24. Financial and capital risk management and fair value measurement

Capital risk management

The Company'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 Company's R&D activities and operations. The Company's principal methods of adjusting the capital available are through issuing new shares, licensing and/or collaboration agreements or arranging suitable debt financing. The Company's share capital and share premium are disclosed in Note 22. The Company's convertible loans are disclosed in Note 21. The Company monitors the availability of capital with regards to its committed and forecasted future expenditure on an ongoing basis.

The Company has an Employee Benefit Trust which holds ADSs to satisfy exercises of options under the Company's share option schemes (see Note 26).

Financial risk management objectives and policies

The Company seeks to maintain a balance between equity capital and convertible debt to provide sufficient cash resources to execute the business plan. In addition, the Company maintains a balance between cash held on deposit and short-term investments in pound sterling and other currencies to reduce its exposure to foreign exchange fluctuations in respect of its planned expenditure.

Company's principal financial instruments comprise warrants, convertible loan notes and trade payables which arise directly from its operations. The Company has various financial assets, including receivables and cash and short-term deposits.

Interest rate risk

The Company'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 the cost of is operating activities and future research and development activities.

The Company's interest payable on convertible loan notes is fixed. Consequently, there is no material exposure to interest rate risk in respect of interest payable.

Credit risk

The Company is dependent on a number of third parties for the delivery of its programs and, where required, pays upfront deposits and fees in advance of the delivery of services. The Company considers all of its material counterparties to be creditworthy and the credit risk for each of its major counterparties to be low, but continues to assess credit risk as part of its management of these third-party relationships. The Company's maximum exposure to credit risk for the components of the balance sheet at December 31, 2021 are the carrying amounts.

Liquidity risk

The Company's policy is to maintain adequate cash reserves at highly rated banks and financial institutions and also seeks to invest in short-term deposits to achieve a competitive rate of return. The Company's liquid resources are invested with regard to the timing of payments to be made in the ordinary course of business, while monitoring its funding requirements through preparation of short-term, mid-term and long-term forecasts.

The table below summarizes the maturity profile of the Company's financial liabilities based on contractual undiscounted payments at December 31, 2021:

	Up to 1 year £'000s	1–3 years £'000s	3–5 years £'000s	Over 5 years £'000s	Total £'000s
Leases	781	1,222	835	–	2,838
Trade and other payables	2,499	–	–	–	2,499
Accruals	3,826	–	–	–	3,826

The Company does not face a significant liquidity risk with regards to its lease liabilities.

The Company 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 Company entered into with various entities pursuant to which the Company 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 and no such amounts are included herein.

Foreign currency and market risk

Foreign currency risk arises from R&D activities, commercial transactions and recognized assets and liabilities in foreign currencies, with the principal currency exposure being fluctuations in pound sterling, U.S. dollars and Euros.

The functional currency of the Company and all subsidiaries is pound sterling, except for Mereo BioPharma 5, Inc. whose functional currency is U.S. dollars. The Company incurs expenditures in foreign currencies and is exposed to the risks of foreign exchange rate movements, with the impact recognized in the consolidated statement of comprehensive income/(loss).

Funding secured in 2021 and 2020 was principally in U.S dollars and, although the Company currently has no revenue from product sales, proceeds received from upfront milestones under its licensing and collaboration agreements are denominated in U.S. dollars, while the majority of operating costs are denominated in pound sterling, U.S. dollars and Euros.

The Company seeks to minimize this exposure by passively maintaining foreign currency cash balances at levels appropriate to meet foreseeable foreign currency expenditures. The Company does not hedge potential future cash flows or income.

The table below shows analysis of the pound sterling equivalent of period-end cash and short-term deposits balances by currency:

	December 31, 2021 £'000s	2020 £'000s
Pound sterling	92,104	17,809
U.S. dollars	2,018	5,586
Swiss francs	9	9
Euro	165	65
Total	**94,296**	**23,469**

The table below shows those transactional exposures that give rise to net currency gains and losses recognized in the consolidated statement of comprehensive income/(loss). Such exposures comprise the net monetary assets and monetary liabilities of the Company that are not denominated in the functional currency of the relevant subsidiary. As at December 31, these exposures were as follows:

	December 31, 2021 £'000s	2020 £'000s
Net foreign currency assets/(liabilities):		
U.S. dollars	920	4,088
Swiss francs	9	9
Euro	(142)	(513)
Total	**787**	**3,584**

The most significant currencies in which the Company transacts, other than pound sterling, are the U.S. dollar and the Euro. The Company also transacts in other currencies as necessary.

The following table illustrates the sensitivity to a 10% weakening or strengthening in the period-end rate in the U.S. dollar and the Euro against pound sterling:

December 31, 2021	US dollar £'000s	Euro £'000s
Profit before tax	(84)	13
Equity	(84)	13

December 31, 2020	US dollar £'000s	Euro £'000s
Profit before tax	(372)	47
Equity	(372)	47

Financial instruments by category

	Fair value through profit or loss December 31,		Amortized cost December 31,	
	2021 £'000s	2020 £'000s	2021 £'000s	2020 £'000s
Financial assets				
Cash and short-term deposits	–	–	94,296	23,469
Other receivables	–	–	1,032	646
Total financial assets	**–**	**–**	**95,328**	**24,919**
Financial liabilities				
Provisions	4,123	1,634	–	–
Convertible loan notes	–	–	14,384	16,142
Warrant liability	8,336	50,775	–	–
Trade and other payables	–	–	2,309	3,187
Accruals	–	–	3,826	4,178
Lease liability	–	–	2,376	1,794
Total financial liabilities	**12,459**	**52,409**	**22,895**	**25,301**

The carrying values of financial assets and financial liabilities recorded at amortized cost in the consolidated financial statements are approximately equal to their fair values.

Fair value hierarchy

			Fair value measurement using		
Liabilities measured at fair value	Date of valuation	Total £'000s	Quoted prices in active markets (Level 1) £'000s	Significant observable inputs (Level 2) £'000s	Significant unobservable inputs (Level 3) £'000s
Provision for deferred consideration (Note 18)	December 31, 2021	4,123	–	–	4,123
Warrant liability (Note 20)	December 31, 2021	8,336	–	341	7,995

			Fair value measurement using		
Liabilities measured at fair value	Date of valuation	Total £'000s	Quoted prices in active markets (Level 1) £'000s	Significant observable inputs (Level 2) £'000s	Significant unobservable inputs (Level 3) £'000s
Provision for deferred consideration (Note 18)	December 31, 2020	1,525	–	–	1,525
Warrant liability (Note 20)	December 31, 2020	50,775	–	845	49,930

There were no transfers between Level 1 and Level 2 during the years ended December 31, 2021 and 2020.

The following table presents the changes in Level 3 items for the periods ended December 31, 2021 and December 31, 2020:

	Provision for deferred cash consideration £'000s	Provision for contingent consideration £'000s	Warrant liability £'000s
January 1, 2020	1,654	354	–
Issued during the year	–	–	4,080
Settled during the year	–	(354)	(127)
Unwinding of the time value of money (recognized as a finance cost)	157	–	–
Change in estimate relating to probabilities (revision to intangible asset, see Note 13)	(286)	–	–
Change in fair value	–	–	45,977
December 31, 2020	**1,525**	**–**	**49,930**
Settled during the year	–	–	(2,400)
Unwinding of the time value of money (recognized as a finance cost)	225	–	–
Change in estimate relating to probabilities (revision to intangible asset, see Note 13)	2,373	–	–
Change in fair value	–	–	(39,535)
December 31, 2021	**4,123**	**–**	**7,995**

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.
- At December 31, 2021, the Company estimates the fair value of the contingent consideration liability to be £nil. An amount of £0.4 million was paid in 2020 relating to the Navi milestone received. The estimated contingent consideration payable is based on a risk adjusted, probability-based scenario. Under this approach the likelihood of future payments being made to the former shareholders of Mereo BioPharma 5, Inc. under the CVR arrangement is considered. The estimate could materially change over time as the development plan and subsequent commercialization of the Navi product progresses.
- The warrant liability is estimated using a Black-Scholes model, taking into account appropriate amendments to inputs in respect of volatility, remaining expected life of the warrants and rates of interest at each reporting date.

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, 2021 and 2020 are as follows:

	Valuation technique	Significant unobservable inputs	Input range (weighted average)	Sensitivity of the input to fair value
Provision for deferred cash consideration	Discounted cash flow	WACC	2021: 12%	1% increase/decrease would result in a decrease/increase in fair value by £31,000
		WACC	2020: 12%	1% increase/decrease would result in a decrease/increase in fair value by £25,000
		Probability of success	2021:40.6%–81.2%	10% increase/decrease would result in an increase/decrease in fair value by £0.5 million
		Probability of success	2020: 13.8%–95%	10% increase/decrease would result in an increase/decrease in fair value by £0.4 million
Contingent consideration liability	Discounted cash flow	Ongoing uncertainty in the clinical development of the Navi product Regulatory approval and commercialization risks		Total potential payments future payments relating to the contingent consideration liability on a gross, undiscounted basis are approximately $80 million Sensitivity of the input to fair value is primarily driven by uncertainty in the clinical development of the Navi product. Future potential payments under the CVR arrangement are contingent on i) future development milestones and ii) future sales of the Navi product, following regulatory approval and commercialization. In January 2020, the Company entered into the license agreement as detailed in Note 13. Although pursuant to the license agreement the Company is entitled to additional payments of up to $302 million, there continues to be significant uncertainty in respect of any milestone and royalty payments under the license agreement.
Warrant liability related to the private placement	Black-Scholes model	Expected volatility	2021:75.1%	Volatility was estimated by reference to the 1.4 years historical volatility of the historical share price of the Company, matching the maturity of the instrument. If the volatility is decreased to 67.4% based on 1-year historical volatility, the carrying value of the warrants as of December 31, 2021 would decrease to £6.7 million.
		Expected volatility	2020: 85.1%	Volatility was estimated by reference to the six-month historical volatility of the historical share price of the Company. If the volatility is increased to 93.8% based on three-month historical volatility, the carrying value of the warrants as of December 31, 2020 would have increased to £52.9 million.

25. Commitments and contingencies

Each of Mereo BioPharma 1 Limited, Mereo BioPharma 2 Limited and Mereo BioPharma 3 Limited (together, the "Subsidiaries") issued to Novartis loan notes (which were assigned by Novartis to the Company in exchange for ordinary shares pursuant to the Subscription Agreement) and each of the Subsidiaries 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 Subsidiary under the respective Purchase Agreements.

Each Subsidiary 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 Subsidiary 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 Company's wholly owned subsidiary Mereo BioPharma 4 Limited entered into an exclusive license and option agreement ("the License Agreement"), to obtain from AstraZeneca an exclusive worldwide, sub-licensable license under AstraZeneca's intellectual property rights relating to alvelestat, with an option to acquire such intellectual property rights following commencement of a pivotal trial and payment of related milestone payments ("the Option"), together with the acquisition of certain related assets. Upon entering into the License Agreement, the Company 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 Company 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 alvelestat. In addition, the Company has agreed to make payments to AstraZeneca based on specified commercial milestones of the product. The Company has also agreed to pay a specified percentage of sub-licensing revenue to AstraZeneca and to make royalty payments to AstraZeneca equal to ascending specified percentages of tiered annual worldwide net sales by the Company 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. The Company 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 Company for such product in such country will become fully paid and irrevocable. Prior to exercise of the Option, if at all, the Company 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.

The Company enters into contracts in the normal course of business with contract research organizations ("CROs"), contract manufacturing organizations ("CMOs") and other third parties to assist in the performance of research and development activities and other services and products for operating purposes. The contracts with CROs generally provide for termination on notice, and therefore, are cancellable contracts and not included herein. The Company has manufacturing commitments with CMOs of £1.4 million as of December 31, 2021.

26. Share-based payments

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

	Year ended December 31,		
	2021 £'000s	2020 £'000s	2019 £'000s
2019 Equity Incentive Plan	2,860	922	635
2019 NED Equity Incentive Plan	499	167	160
2015 Plan	–	3	63
Mereo BioPharma Group plc Share Option Plan	68	376	685
Long Term Incentive Plan	(125)	90	93
Total	**3,302**	**1,558**	**1,636**

2019 Equity Incentive Plan ("EIP") and 2019 Non-Executive Director Equity Incentive Plan ("NED EIP")

The 2019 EIP and 2019 NED EIP were adopted on April 4, 2019, and subsequently amended on February 3, 2020 and January 15, 2021. The 2019 EIP provides for the grant of market value options over ADSs (each ADS is represented by 5 ordinary shares) to executive directors and employees. The 2019 NED EIP provides for the grant of market value options over ADSs to non-executive directors.

During the years ended December 31, 2021, 2020 and 2019, market value options were granted to executive directors and employees under the 2019 EIP. Subject to the executive director or employees continued employment, one-fourth of each such market value option grant shall vest on the first anniversary of the grant date and the remainder shall vest in equal monthly installments over the three-year period following the first anniversary. No performance conditions apply to such market value options.

During the years ended December 31, 2021, 2020 and 2019, market value options were granted to non-executive directors ("NEDs") under the 2019 NED EIP. Subject to the NEDs holding their current office (or being otherwise employed) through each applicable vesting date, such awards shall vest in equal monthly installments over a one-year period following the grant date. No performance conditions apply to such market value options.

The fair value of share options granted were 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. The contractual term of the share options is 10 years.

The following table illustrates the number and weighted average exercise prices (WAEP) of, and movements in, options for the 2019 EIP and 2019 NED EIP during the year-ended December 31, 2021:

	2019 EIP		2019 NED EIP	
	Options over ADS Number	WAEP $	Options over ADS Number	WAEP $
Outstanding at January 1, 2021	1,567,873	2.94	149,416	3.06
Granted during the year	2,696,960	2.83	296,000	2.81
Cancelled during the year	(253,277)	2.66	(23,625)	2.72
Forfeited during the year	(28,521)	5.37	–	–
Exercised during the year	(39,333)	2.11	–	–
Outstanding at December 31, 2021	**3,943,702**	**2.88**	**421,791**	**2.90**
Exercisable at December 31, 2021	727,698	3.16	386,623	2.91

The following table illustrates the number and weighted average exercise prices (WAEP) of, and movements in, options for the 2019 EIP and 2019 NED EIP during the year-ended December 31, 2020:

	2019 EIP		2019 NED EIP	
	Options over ADS Number	WAEP $	Options over ADS Number	WAEP $
Outstanding at January 1, 2020	798,050	4.29	77,000	4.20
Granted during the year	1,167,836	2.00	77,000	1.84
Cancelled during the year	(406)	5.40	–	–
Forfeited during the year	(397,607)	2.87	(4,584)	1.84
Exercised during the year	–	–	–	–
Outstanding at December 31, 2020	**1,567,873**	**2.94**	**149,416**	**3.06**
Exercisable at December 31, 2020	259,829	4.42	138,412	3.15

The weighted average remaining contractual life for the share options outstanding as at December 31, 2021 for the 2019 EIP was 8.7 years (2020: 8.9 years) and for the 2019 NED EIP was 8.6 years (2020: 8.9 years).

The weighted average fair value of options granted during the year was $2.50 per ADS (2020: $2.23 per ADS).

Options outstanding at the end of the year had an exercise price of between $1.76 and $5.40.

The 2015 Plan

Under the Mereo BioPharma Group Limited Share Option Plan (the "2015 Plan"), the Company, 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. No share options were granted during the year under the 2015 Plan and no further share option grants are envisaged.

	2021		2020	
	Number	WAEP £	Number	WAEP £
Outstanding at January 1, 2021	8,923,600	1.32	8,923,600	1.32
Forfeited during the year	(625,906)	1.29	–	–
Outstanding at December 31, 2021	**8,297,694**	**1.31**	**8,923,600**	**1.32**
Exercisable at December 31, 2021	8,297,694	1.31	8,923,600	1.32

The weighted average remaining contractual life for the share options outstanding as at December 31, 2021 was 3.6 years (2020: 4.6 years). Options outstanding at the end of the year had an exercise price of between £1.28 and £2.19.

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 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, the Board of Directors may determine if the vesting of an option will be subject to the satisfaction of a performance condition. Following the introduction of the EIP and NED EIP, no further share option grants under the Share Option Plan are envisaged.

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

	2021		2020	
	Number	WAEP £	Number	WAEP £
Outstanding at January 1, 2021	1,411,395	3.14	1,524,065	3.07
Forfeited during the year	(87,430)	3.11	(112,670)	3.03
Outstanding at December 31, 2021	**1,323,965**	**3.04**	**1,411,395**	**3.14**
Exercisable at December 31, 2021	1,323,965	3.04	1,210,410	3.01

The weighted average remaining contractual life for the share options outstanding as at December 31, 2021 was 5.6 years (2020: 6.6 years). Options outstanding at the end of the year had an exercise price of between £2.73 and £3.22.

Long Term Incentive Plan

Under the Company's Long Term Incentive Plan (LTIP), initiated in 2016, the Company, 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 non-market based performance measures (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.

	2021 Number	2020 Number
Outstanding at January 1	482,748	910,072
Lapsed during the year	(482,748)	(427,324)
Outstanding at December 31	**–**	**482,748**
Exercisable at December 31	–	–

All LTIP options lapsed during the year ended December 31, 2021. The weighted average remaining contractual life for the LTIP options outstanding as at December 31, 2020 was 0.5 years.

No LTIP options were granted during the years ended December 31, 2020 and 2021 and no further grants are envisaged.

Deferred Bonus Share Plan

Under the previous terms of the Company's Deferred Bonus Share Plan (DBSP), 30% of the annual bonus for 2017 for the senior management team was payable in deferred shares, which are governed by the DBSP plan rules. At the date of grant of the awards, the monetary bonus amount was 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).

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

62,183 options lapsed during the year ended December 31, 2021. The outstanding number of options as at December 31, 2021 is 100,817 all of which were exercisable. The outstanding number of options as at December 31, 2020 was 163,000, of which 62,170 were exercisable.

The weighted average remaining contractual life for the DBSP options outstanding as at December 31, 2021 was 0.1 years (2020: 0.6 years).

For the 2018 and 2019 financial years, under the Deferred Bonus Plan ("2019 DBP"), 100% of the annual bonus was paid in cash, of which 30% of amounts granted to the senior management team (after deduction of income tax and the relevant employee's national insurance contributions) was required to be utilized to acquire shares in the Company in the open market within 12 months of the grant of the award. No further grants under the DBSP are envisaged.

Deferred equity consideration

In October 2017, the Company's wholly owned subsidiary Mereo BioPharma 4 Limited entered into an exclusive license and option agreement (the "License Agreement") to obtain from AstraZeneca an exclusive worldwide, sub-licensable license under AstraZeneca's intellectual property rights relating to MPH-966, with an option to acquire such intellectual property rights following commencement of a pivotal trial and payment of related milestone payments (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 Company has accounted for, but not yet issued, 429,448 ordinary shares with a grant date fair value of £3.10, representing a value of £1.3 million.

Weighted average inputs

The following table includes the weighted average inputs to the models used for the fair value of share options granted during the year ended December 31, 2021:

	2019 EIP	2019 NED EIP
Expected volatility (%)	97	98
Risk-free interest rate (%)	1.15	1.09
Expected life of share options (years)	10	10
Market price of ADS's ($)	2.83	2.81
Model used	Black-Scholes	Black-Scholes

During the year ended December 31, 2021, no grants were issued under any other scheme.

The following table includes the weighted average inputs to the models used for the fair value of share options granted during the year ended December 31, 2020:

	2019 EIP	2019 NED EIP
Expected volatility (%)	67	68
Risk-free interest rate (%)	0.59	0.64
Expected life of share options (years)	10	10
Market price of ADS's ($)	1.99	1.84
Model used	Black-Scholes	Black-Scholes

During the year ended December 31, 2020, no grants were issued under any other scheme.

27. Related party disclosures

Compensation of key management personnel of the Company

The remuneration of key management personnel of the Company is set out below in aggregate:

	Year ended December 31,		
	2021 £'000s	2020 £'000s	2019 £'000s
Short-term benefits	4,018	4,479	3,488
Post-employment benefits	173	144	64
Share-based payment charge	2,559	875	1,152
Total	**6,750**	**5,498**	**4,704**

The amounts disclosed in the table above are the amounts recognized as an expense during the reporting period related to key management personnel. In 2021, key management personnel of the Company consisted of the executive director (the Chief Executive Officer), non-executive directors, and other members of senior executive management (the Chief Financial Officer, the General Counsel, the Chief Portfolio Management and Pipeline Strategy, Chief Business Officer, Chief Scientific Officer and the Chief Patient Access and Commercial Planning).

Employee Benefit Trust

In 2016 the Company set up an Employee Benefit Trust ("EBT"). The EBT holds ADS's to satisfy the exercise of options under the Company's share-based incentive schemes (Note 26).

No funding was loaned to the EBT by the Company during the year ended December 31, 2021 (2020: nil). During the year ended December 31, 2021, no ordinary shares were purchased by the EBT (2020: 7). A total of 31,205 ADSs (2020: nil) held by the EBT were used in the year-ended December 31, 2021 to satisfy the exercise of options under the Company's share-based incentive schemes. As of December 31, 2021, the EBT holds 216,251 ADSs (2020: 247,456) along with £17,866 in cash (2020: £21,762).

28. Events after the reporting period

In February 2022, the Company received a milestone payment of $2.0 million under the Navi License Agreement with OncXerna which resulted in a payment to CVR holders of a total of approximately $0.9 million, after deductions of costs, charges and expenditures.

	Notes	As at December 31, 2021 £'000s	2020 £'000s
Assets			
Non-current assets			
Property, plant and equipment	6	2,397	1,112
Investments in subsidiaries	4	191,710	184,469
		194,107	185,581
Current assets			
Prepayments		1,249	1,490
Other receivables		1,019	720
Cash and short-term deposits		93,815	22,623
		96,083	24,833
Current liabilities			
Trade and other payables		2,074	2,726
Current tax liabilities		484	–
Intercompany payable	5	34,694	23,377
Accruals		2,420	3,624
Lease liability		362	240
		40,034	29,968
Net current assets/(liabilities)		56,048	(5,134)
Total assets less current liabilities		250,156	180,447
Non-current liabilities			
Provisions	8	–	109
Convertible loan notes	7	14,384	16,142
Warrant liability	9	8,336	50,775
Lease liability		1,753	902
Other liabilities		80	62
		24,553	67,990
Net assets		225,603	112,457
Equity shareholders' funds			
Share capital	10	1,755	1,017
Share premium	10	247,460	161,785
Other capital reserves	10	129,835	128,374
Other reserves	10	7,401	5,001
Employee Benefit Trust shares	12	(1,140)	(1,305)
Accumulated losses		(159,708)	(182,415)
Total equity shareholders' funds		225,603	112,457

The accompanying notes form an integral part of these financial statements.

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 profit for the financial year ended December 31, 2021 was £22.7 million (2020: loss of £128.9 million).

Approved by the Board on March 25, 2022 and signed on its behalf by:

Dr. Denise Scots-Knight
Director
March 31, 2022

Company number: 09481161 (England and Wales)

	Issued capital £'000s	Share premium £'000s	Other capital reserves £'000s	Employee Benefit Trust £'000s	Other reserves £'000s	Accum-ulated losses £'000s	Total equity £'000s
At January 1, 2020	294	121,684	59,147	(1,305)	7,000	(53,482)	133,338
Loss for the year	–	–	–	–	–	(128,933)	(128,933)
Share-based payments	–	–	1,558	–	–	–	1,558
Issuance of share capital, net	347	18,715	–	–	(2,125)	–	16,937
Issuance of share capital on conversion of loan notes	375	21,386	33,104	–	–	–	54,865
Issuance of share capital on conversion of loan notes	–	–	1,084	–	–	–	1,084
Reclassification of loan notes embedded derivative	–	–	33,481	–	–	–	33,481
Issuance of share capital on exercise of warrants	1	–	–	–	126	–	127
At December 31, 2020	1,017	161,785	128,374	(1,305)	5,001	(182,415)	112,457
Profit for the year	–	–	–	–	–	22,707	22,707
Share-based payments	–	–	3,302	–	–	–	3,302
Issuance of share capital, net	601	78,609	–	–	–	–	79,210
Exercise of share options	–	–	(119)	165	–	–	46
Conversion of loan notes and warrants	137	7,066	(1,722)	–	2,400	–	7,881
At December 31, 2021	1,755	247,460	129,835	(1,140)	7,401	(159,708)	225,603

1. Significant accounting policies

1.1 Basis of preparation

These financial statements were prepared in accordance with Financial Reporting Standard 101 *Reduced Disclosure Framework* (FRS 101).

In preparing these financial statements, Mereo BioPharma Group plc (the "Company") applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards but makes amendments where necessary in order to comply with the Companies Act 2006 and has set out below where advantages for the FRS 101 disclosure exemptions has been taken.

Under Section 408(4) of the Companies Act 2006, the Company is exempt from the requirement to present its own profit and loss account.

In these financial statements, the Company has applied the exemptions available under FRS 101 in respect of the following disclosures:

- Presentation of a cash flow statement and related notes;
- Comparative period reconciliations for share capital, tangible fixed assets and intangible assets;
- Transactions with wholly owned subsidiaries;
- The effects of new but not yet effective IFRSs;
- The compensation of key management personnel; and
- Required disclosures relating to capital management.

As the consolidated financial statements of Mereo BioPharma Group plc include the equivalent disclosures, the Company has also taken the exemptions under FRS 101 available in respect of the following disclosures:

- IFRS 2 (Share-Based Payments) in respect of Group-settled share-based payments;
- Certain disclosures required by IAS 36 (Impairment of Assets);
- Certain disclosures required by IFRS 13 (Fair Value Measurement);
- Certain disclosures required by IFRS 7 (Financial Instruments Disclosures).

The Company proposes to continue to adopt the reduced disclosure framework of FRS 101 in its next financial statements.

The financial information is presented in pound sterling and all amounts disclosed in the financial statements and notes have been rounded off to the nearest thousand currency units, unless otherwise stated.

1.2 Changes of accounting policies

New standards, interpretations and amendments effective from January 1, 2021.

There were a number of narrow scope amendments to existing standards which were effective from January 1, 2021. None of these had a material impact on the Company.

1.3 Summary of significant accounting policies

The Company's accounting policies are consistent with those described in the consolidated accounts of Mereo BioPharma Group plc, within Note 2 of the consolidated financial statements. Below are accounting policies which are specific to the Company.

a) Investment in subsidiaries

Investments in subsidiary undertakings are stated at cost less any provision for impairment. Amounts capitalized as investments in subsidiary undertaking are reviewed for impairment at each period end in accordance with IAS 36 (Impairment of Assets).

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.

Impairment of investments in subsidiaries

An assessment was made in respect of indicators of impairment in the carrying value of the Group's investment in subsidiaries as at December 31, 2021. 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 significant judgments regarding the likelihood of successful product approval, the costs of reaching approval, the estimated useful life of intangible assets following commercialization and the subsequent commercial profitability of the product once approved.

3. Loss for the year

The Company's profit for the year was £22.7 million (2020: loss of £128.9 million), which has been included in the Company's profit and loss account.

The Auditor's remuneration for audit and other services is disclosed in Note 7 of the consolidated financial statements.

The average number of employees employed by the Company (including executive Directors) in the year was 34 (2020: 30). Their aggregate remuneration comprised wages and salaries of £6.4 million (2020: £7.1 million), social security costs of £0.7 million (2020: £1.0 million) and pension contributions of £0.2 million (2020: £0.2 million). Further information about share-based payment transactions is provided in Note 11.

4. Company information

4.1 Investments in subsidiaries

Cost	£'000s
At January 1, 2020	**192,060**
Additions in the year	12,790
Share-based payments to Group employees	454
At December 31, 2020	**205,304**
Additions in the year	5,659
Share-based payments to Group employees	1,582
At December 31, 2021	**212,545**
Provision for impairment	
At January 1, 2020	**19,246**
Charge during the year	1,589
At December 31, 2020	**20,835**
At December 31, 2021	**20,835**
Net book value	
At December 31, 2021	**191,710**
At December 31, 2020	184,469

The Company grants rights to its own equity instruments to Group employees who are not employees of the Company. For these grants, the Company recognizes in equity the equity-settled share-based payment with a corresponding increase in the investment in the subsidiary in the separate financial statements.

No impairment loss was recorded during the year ended December 31, 2021. In the year-ended December 31, 2020, an impairment loss of £1.6 million was recorded. The impairment loss was due to the recoverable value of an investment in a subsidiary falling below the carrying amount (held at cost, in accordance with the Company's accounting policies). The recoverable value of the investment was measured based on the value in use and the discount rate used in the calculation of value in use was 12% (2020: 12%). Any change in assumptions could result in further impairment loss in the future.

4.2 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, 2021	% equity interest December 31, 2020
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	100
Mereo BioPharma Ireland Limited	Pharmaceutical R&D	Ireland	100	100
Mereo BioPharma 5, Inc	Pharmaceutical R&D	U.S.	100*	100*
Navi Subsidiary, Inc.	Pharmaceutical R&D	U.S.	100*	100*
Mereo US Holdings Inc.	Holding company	U.S.	100	100
Employee Benefit Trust	Employee share scheme	Jersey	–	–

*Indirect holdings

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. The registered office of Mereo BioPharma Ireland Limited is Rocktwist House, Block 1, Western Business Park, Shannon, County Clare, V14 FW97, Republic of Ireland.

Mereo US Holdings Inc. was incorporated on December 3, 2018 for the sole purpose of effecting the business combination with Mereo BioPharma 5, Inc. (formerly OncoMed Pharmaceuticals, Inc.) on April 23, 2019. The registered office of Mereo US Holdings Inc., Mereo BioPharma 5, Inc. and its wholly owned subsidiary, Navi Subsidiary, Inc., is 251 Little Falls Drive, City of Wilmington, County of New Castle, Delaware 19808, U.S.

A capital contribution of £7.2 million (2020: £13.2 million) by Mereo BioPharma Group plc to its subsidiaries was recorded in the year ended December 31, 2021. £1.6 million (2020: £0.5 million) has been recorded for the granting of employees' share options for services rendered by the employees to the subsidiaries. £5.7 million (2020: £12.8 million) has been recorded for the conversion of intercompany balances at original cost.

As at December 31, 2021, a total capital contribution of £6.0 million (2020: £4.5 million) 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, 2021, a total capital contribution of £165.6 million (2020: £160.0 million) by Mereo BioPharma Group plc to its subsidiaries has been recorded for the conversion of intercompany balances at original cost.

5. Amounts owed to Group undertakings

As at December 31, 2021, amounts owed by the Company to Group undertakings is £34.7 million (2020: £23.4 million). These amounts are repayable on demand and bear an interest rate between 0% and 2.4%.

6. Property, plant and equipment

	Right-of-use asset (building) £'000s	Right of use asset (equipment) £'000s	Leasehold improvements £'000s	Office equipment £'000s	IT equipment £'000s	Total £'000s
Cost						
At January 1, 2021	1,269	1,169	164	31	110	2,743
Additions	923	–	393	109	24	1,449
Lease modification	272	30	–	–	–	302
Disposals	–	(868)	–	–	–	(868)
Currency translation effects	–	(36)	–	–	–	(36)
At December 31, 2021	**2,464**	**295**	**557**	**140**	**134**	**3,590**
Depreciation						
At January 1, 2021	(410)	(1,023)	(85)	(28)	(81)	(1,627)
Disposals	–	868	–	–	–	868
Depreciation for the year	(292)	(76)	(39)	(8)	(18)	(433)
At December 31, 2021	**(702)**	**(231)**	**(124)**	**(36)**	**(99)**	**(1,192)**
Net book value						
At January 1, 2021	859	146	79	3	29	1,116
At December 31, 2021	**1,762**	**64**	**433**	**104**	**35**	**2,398**

7. Convertible loan notes

The Group's interest-bearing loans and borrowings all reside in the Company. Details on the convertible loan notes of the Company are provided in Note 21 of the consolidated financial statements.

8. Provisions

	Year ended December 31, 2021 £'000s	2020 £'000s
At beginning of year	109	104
Arising during the year	–	5
Released	(109)	–
At December 31,	**–**	**109**
Current	–	–
Non-current	–	109

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.

9. Warrant liability

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

10. Share capital, share premium and other reserves

The Group's share capital all resides in the Company. Details on the share capital of the Company are provided in Note 22 of the consolidated financial statements.

11. Share-based payments

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

	Year ended December 31, 2021 £'000s	2020 £'000s
2015 Plan	–	2
Mereo BioPharma Group plc Share Option Plan	35	237
Long Term Incentive Plan	(125)	77
2019 Equity Incentive Plan	1,310	625
2019 NED Equity Incentive Plan	499	163
	1,719	**1,104**

Details on the share-based payments of the Company, including deferred equity consideration, are provided in Note 26 of the consolidated financial statements.

12. Related party disclosures

Details on related parties are provided in Note 27 of the consolidated financial statements.

13. Events after the reporting period

Details on events after the reporting period are provided in Note 28 of the consolidated financial statements.