FORM 10-KSB

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

[X] ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 1997

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ___ to ___

Commission file number: 001-13467

COMMONWEALTH BIOTECHNOLOGIES, INC.
(Name of small business issuer in its charter)

Virginia	56-1641133
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

911 East Leigh Street, Suite G-19
Richmond, Virginia 23219
(Address of principal executive offices) (Zip Code)

Issuer's telephone number: (804) 648-3820

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Securities registered pursuant to Section 12(b) of the Act:	Securities registered pursuant to Section 12(g) of the Act:
None	Common Stock, without par value per share

</TABLE>

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No ___

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB [ ].

The issuer's revenues for the year ended December 31, 1997 were $1,761,308.

The aggregate market value of the shares of common stock, without par value ("Common Stock"), of the registrant held by non-affiliates on March 23, 1998 was approximately $13,355,029, based upon the closing sales price of these shares as reported on the Nasdaq SmallCap Market on March 23, 1998.

As of March 30, 1998 there were 1,620,514 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for its Annual Meeting of Shareholders to be held on April 14, 1998 are incorporated by reference into Part III of this Form 10-KSB.

Portions of the registrant's 1997 Annual Report to Shareholders are incorporated by reference into Part II of this Form 10-KSB.

Transitional Small Business Disclosure Format (check one:)
Yes ___ No X.

PART I

Item 1. Description of Business.

Overview

Commonwealth Biotechnologies, Inc. (the "Company") was founded in 1992

by four experienced research scientists to provide sophisticated research and development support services on a contract basis to the biotechnology industry. The Company's customers consist of private companies, academic institutions, and government agencies, all of which use biological processes to develop products for health care, agricultural and other purposes. The Company's revenues are derived principally from providing macromolecular synthetic and analytical services (protein/peptide, and DNA/RNA chemistries) to researchers in the biotechnology industry or who are engaged in life sciences research in government or academic labs.

The Company provides these services to customers on a contract basis and derives its revenues from these services, and not from sales of commercial products resulting from the research. This arrangement distinguishes the Company from many other biotechnology companies in that the Company's revenues are not directly dependent on successfully commercializing a new biotechnology product. The Company has developed a strong reputation as a leading provider of biotechnology research and development analytical services. The Company is focusing its expansion efforts on the maintenance and expansion of long-term relationships with customers in the biotechnology industry and in establishing new customer relationships. The Company has implemented new technologies to provide new services to its customers, and is continuing to develop new products and services to meet the changing needs of its customers.

In general terms, the Company serves two types of customers: those who require a discrete set of services ("short-term projects"), and those who contract with the Company on an extended basis for performance of a variety of integrated services ("long-term projects"). More often than not, short-term and long-term project customers send the Company repeat business.

The Company also derives a portion of its revenues from research grants funded by various Federal government agencies. These research grants support the bulk of the Company's research efforts on its own proprietary technologies. The Company is developing its own technologies in the areas of anti-coagulation, cell targeting, and genomic sequence analysis.

Growth Strategy

The Company's strategy for growth includes:

Expansion of its Instrumentation Capacity. The Company believes there is significant demand for additional services of the type the Company currently offers. The Company's capacity to service this demand has been constrained by the limitations of its facilities and need to make significant capital expenditures on equipment. By securing a significantly larger laboratory facility and additional research equipment, the Company will have the capacity to generate substantially greater revenues from its core services, to offer new technologies, and to improve profit margins through more efficient operations.

Expansion of its Marketing Capabilities. The Company has expanded its customer base primarily through placement of print-ads in several periodicals and industry sourcebooks, by attendance at a limited number of trade shows, seminars, and meetings, through its own World Wide Web Home Page, and by word-of-mouth recommendations. The Company has increased its print-ad marketing and will continue to utilize these other strategies to attract customers. However, the Company will also expand its sales and marketing capabilities in three areas:

The Company is currently recruiting sales representatives to cover three major biotechnology areas of the Country: the Boston/New York/New Jersey area, the San Diego area, and the San Francisco Bay area. It is anticipated that two (2) full-time sales representatives will be trained in the field and that these individuals will be primarily targeting pharmaceutical and biotechnology companies and government agencies.

The Company has engaged Advantage Consulting, Inc. to facilitate its ability to successfully compete for contracts with the U.S. Department of Defense and the Department of Justice, both of which have an interest in DNA technologies.

The Company plans to engage an advertising and marketing firm to advise the Company on new strategies and tools to enhance both the Company's visibility, and its ability to identify and reach new customers.

Regulatory Compliance. The Company expects to come into compliance with GLP (Good Laboratory Practices) and CLIA (Clinical Laboratory Improvement Act) guidelines, which will enable the Company to offer

services to customers requiring compliance with those standards.

Expansion into New Service Technologies. The Company continues to critically examine new technologies with a view to expanding its customer base and sources of revenue. The Company has already made inroads in establishing new service technologies and offering these services to its customers. In 1998, the Company will increase its capacity or improve its analytical service offerings in the following areas:

DNA Sequence Analysis. The Company has positioned itself to be at the forefront in the development and application of new genome based technologies. The Company has expanded its contract DNA sequencing services and offers sophisticated sequence data analysis. The Company will continue to expand these services in 1998 through the acquisition of additional sequencing instrumentation, and through the development of a Bioinformatics Group.

Genome Sequencing. The Company is developing comprehensive genome sequencing capabilities in parallel with the development of the Bioinformatics Group. The Company is already sequencing human microbial pathogens.

Genetic Analysis. The Company has established a Genetic Testing Group and is evaluating several likely applications, including screening for mutations in several genes associated with human hereditary diseases, and for genes in which mutations confer an increased probability for the development of specific cancers during the lifetime of the individual.

Identity Testing by Genetic Analysis. Many states have mandated that people passing through the criminal justice system be sampled and that their genetic fingerprints be determined. However, most state laboratories lack the facilities and people necessary to perform these assays. The Company is positioned to provide these services and is establishing a DNA Reference Laboratory containing all the necessary work areas required to provide these services. The Company expects to become accredited for performance of this service in early 1998.

Centralized Computer Facilities. The Company will acquire and maintain a more centralized server for databasing and analysis, and to develop a more sophisticated company-wide intranet. We are also evaluating powerful software packages to permit more efficient data handling, storage, backup, and analysis.

Expanded DNA Synthesis Services. DNA analogs called "Protein Nucleic Acids" or PNAs, are insensitive to nucleases that degrade DNA, and hybridize with more specificity and stability to complementary DNA. The Company has negotiated an agreement with Perseptive Biosystems, Inc. to synthesize and distribute PNAs in the Mid-Atlantic region of the United States. In addition, demand for DNA/RNA synthesis continues to increase, and in particular, the Company is one of the few offering commercial RNA synthesis.

Bioorganic Mimetic Chemistry. Incorporation of organic "mimetic" structures into drugs often leads to enhanced stability and oral availability of the drug. The Company now offers synthesis of these mimetic structures, and expects demand to increase for this service.

Expanded Mass Spectroscopy Services and Carbohydrate Analytical Services. The Company is studying whether to establish a full-service mass spectral facility in its new laboratories and whether sufficient demand exists for initiating detailed carbohydrate analytical services.

Analytical Support Services

In order to experiment with cell components and macromolecules, researchers need to analyze, sequence, purify, synthesize, and characterize those components. Thus, the Company's business is dependent upon the use of sophisticated, scientific and analytical equipment. In light of increasing cost pressures, many companies, universities, and research institutions seek to avoid incurring the costs to equip and staff laboratories which can perform these analytical services, and instead they choose to contract with the Company for these services.

The Company is a fee-for-service contractor and typically takes no ownership position in the intellectual property rights of the services it performs under contract for either short-term or long-term contract customers. A key to the growth of the Company has been to integrate a number of foundation technologies and provide a broad range of capabilities to customers who otherwise must go to several different sources for their needs. Since commencing operations, the Company has become noted for providing a wide range of services relating to design, synthesis, purification, and analysis of peptides, proteins, and oligonucleotides.

Providing a wide range of services is an important element of the Company's competitive strategy. Virtually all of its closest competitors provide either DNA level technologies or protein/peptide level technologies. There are few major competitors which offer integrated DNA/RNA and protein/peptide technologies and none that offer these technologies combined with sophisticated biophysical techniques, such as RNA synthesis, DNA synthesis, PNA synthesis, calorimetry, spectroscopy, and mass spectral analysis. Thus, the Company can provide complete research programs to its customers. "One stop biotechnology shopping" has proved attractive in securing long-term contracts with customers ranging from major players in the pharmaceutical industry to major government sponsors of research, such as the National Institutes of Health ("NIH"). The Company believes it has earned a reputation as a leading provider of high quality DNA sequencing - a reputation which has enabled it to obtain key contracts with universities, major pharmaceutical, and biotechnology companies throughout the world.

The services offered by the Company are fully detailed in its promotional brochures, and on its World Wide Web page. Some of these services include:

Oligonucleotide Synthesis. Nucleotides are the building blocks of DNA and RNA. The Company provides both routine syntheses and custom synthesis chemistries for design of special nucleotide derivatives. Very few commercial companies offer custom RNA synthesis or synthesis of RNA/DNA hybrid molecules, and the Company has been successful in supplying

these specialized products to academic and commercial customers. In addition, the Company now produces PNAs.

Protein/Peptide Synthesis. Assembly of amino acids into chains creates synthetic peptides. Equipment purchased with a portion of the proceeds from its initial public offering (the "IPO") have substantially increased the Company's capacity for peptide synthesis. The Company plans to add two additional synthesizers in the near future.

DNA Sequencing. Sequencing is essentially the reverse process of synthesis. In a typical experiment, a customer will require 10-20 sequencing reactions. However, a number of customers require thousands of sequencing reactions, for which the Company offers aggressive discounts in pricing.

Peptide/Protein Sequencing. Analysis of the order of amino acids in proteins and enzymes is an important analytical tool. The Company provides N-terminal sequence analysis. New instruments which have been ordered will allow the Company to offer automated C-terminal sequence analysis.

Peptide/Protein Compositional Analysis. Analysis of the amino acids that compose a protein or peptide is used to verify purity of synthesized peptides and to determine the make-up of newly discovered proteins or enzymes.

Customers

The Company currently provides similar products and support to more than 400 researchers at more than 350 different institutions world-wide.

Short-Term Research Projects. On average, in 1997, the Company added 16 new customers per month. Of its domestic customers, 59% work in private companies, and 41% are located in university or governmental labs. In 1997, the Company added 19 new foreign research institutes in Japan, India, Greece, Columbia, Korea, Norway, Spain, Sweden, and Canada.

In 1997, the Company averaged 66 new orders per month. The nature of these orders vary widely; some are for relatively straight-forward chemistries which take a minimum amount of time to complete, while other orders are for more complicated procedures which take several weeks to complete.

The Company's customers come from many sources. The Company advertises in the professional journals, exhibits at trade shows, and has its own Web page from which a potential customer may directly download order forms and place an order, if desired. The Company is also cross listed on several biotechnology, biochemistry, and molecular biology search services, so that potential customers may find the Company using simple key word search terms. Of course, favorable word-of-mouth advertising is key to our success, and has brought us many new investigators within a single research-based institution. All inquiries to the Company receive immediate and personal attention. Quotations are usually sent

back to a potential customer within

the day, and certainly within 24 hours. Customers continue to comment favorably on their phone, fax, and email interactions with the Company's staff personnel.

Long-Term Research Projects. The Company actively pursues long-term research contracts with government, private, and university research institutes. Some contracts are to perform services to a customers' list of specifications, while other contracts are to perform basic research into a problem of interest to the customer. The Company is able to attract these customers because of the breadth of technologies that it offers. In 1997, one private industry customer, with research facilities in 4 locations in 3 different states (27 different principal investigators), accounted for approximately 21% of the Company's total gross revenues. The Company regularly bills this (and other) customers against numerous standing purchase orders. The Company completed several research contracts in 1997 resulting in total aggregate revenue of $561,007.

Operations

Requests for quotes from potential customers are received via phone, e-mail, from the Company's World Wide Web page, or by hard copy directed to the Company's business coordinator or laboratory manager. All inquiries are answered by direct mail of the Company brochure and price lists, with follow up phone calls, where appropriate. Price quotes for small projects or routine analytical procedures are generated by scientists who possess the expertise necessary to respond appropriately. Quotes for more complex projects are developed collaboratively by the Company personnel having the requisite expertise. Most quotations are sent back to the inquiring scientist within one working day.

Incoming orders are logged onto the Company's project management system, assigned a work order number, and delivered to the appropriate scientist designated to oversee and coordinate all aspects of the particular project. The work to be done is scheduled on the appropriate instruments, and all necessary reagents or other supplies needed to complete the project are ordered as needed. Every customer is required to sign a service agreement prior to the Company initiating any requested work.

As a long-term project is completed, progress reports are usually sent to the customer detailing the results found to date, and the conclusions to be drawn. If the project is relatively straight-forward, such as an amino acid analysis, spectroscopy, or DNA sequence analysis, the results are faxed or e-mailed to the customer prior to sending the customer the hard copy of his results. If the project entails a synthesis of a peptide or oligonucleotide, for example, the product is sent to the customer by express mail service. Every product is accompanied by a data sheet, which details the physicochemical properties of the compound, including the results of all analytical tests performed which support the claimed purity and composition. The customer is invoiced upon completion of the work, or at particular points in the work program. The customer pays for the services provided in accordance with the Company's standard fee structure and typically retains all rights to any developments resulting from the analysis.

All data generated at the Company are archived for the customer. Where appropriate, the data are archived on selected storage media, such as back up tapes or computer disks. A file is maintained for every customer, and these files are also archived. The Company employs appropriate security measures to ensure the confidentiality of customer information.

The Company operates under strict standard operating protocols ("SOPs") which detail the particular technologies used to complete the work in progress. SOPs are made available to the customer upon request. In addition, the Company's technical team follows standard operating procedures which help to produce consistent, high quality results.

Proprietary Research And Development

The Company generally does not retain intellectual property rights on work done for its customers. In contrast, in its proprietary research and development programs, the Company is developing its own technologies. CBI does not foresee itself as a manufacturer of any products that might result from these research efforts; rather, the goal of these projects is to bring a particular technology to a patentable stage, and then license the technology to another company. If the technology is commercialized, the Company may realize licensing and/or royalty fees. The Company has completed three different Phase I Small Business Technology Transfer Research ("SBTTR") grants from NIH ($100,000 each), has completed the first year of a Phase II SBTTR grant from NIH ($235,000), and is in the second year of the Phase II SBTTR grant from NIH ($265,000). The Company has also completed a Phase I Small Business Innovative Research Award ("SBIR") from the United States Department of Agriculture ($55,000), and has made application for the Phase II SBIR award ($ 250,000). The Company has several other grant applications pending with various Federal and

State agencies. Revenues from federally funded contracts are recognized on a cost reimbursement basis. The Company generally receives grant payments semi-monthly, with the amount of each payment being determined by the amount of the costs incurred in the immediately preceding two-week period.

Intellectual Property

The Company's principal intellectual property rights consist of a patent relating to an anti-coagulation technology it is developing. The Company's anti-coagulation technology is an experimental new compound that counteracts the effects of heparin, which is used to prevent blood clotting during open heart surgery and other surgical procedures involving significant intervention into the circulatory system. The only drug currently available to counteract heparin exhibits toxicity and other adverse side effects, so its use is primarily restricted to open heart surgery and emergencies. However, the inability to counteract the effects of heparin can result in bleeding complications. Initial tests indicate that compounds the Company has developed can neutralize heparin's anticoagulant activity without displaying the toxicity associated with the existing drug. The Company was issued a patent relating to its anti-coagulation technology in March 1998, but to yield commercial products, these technologies will require extensive

additional testing and government approval. As a result, there can be no assurance that commercial products will result from these technologies.

An unexpected finding from its heparin antagonist research program was that the Company's compounds are effective stabilizing agents for certain human peptide pharmaceuticals. In this respect, the compound has the potential to effectively replace protamine in these formulations. This would be desirable because patients who receive protamine-stabilized drug formulations are at increased risk of severe allergic response ("anaphylaxis") if they ever receive protamine in conjunction with heparin therapy. The Company intends to establish its patent position for this application of its technology, but there can be no assurance that a commercial product will result.

The Company has assigned to RhoMed Inc. its interest in a patent for high affinity chemotactic peptides which can be used in radiological detection of infections, inflammations, and deep seated abscesses. The peptide structures were designed with intellectual input from the Company's scientists, and the compounds themselves were prepared at the Company. The Company will receive a continuing royalty based on sales of a diagnostic kit which incorporates the peptides. To date, RhoMed has not commercialized a diagnostic kit based on the peptides under patent, and there can be no assurance that commercial products will result from these technologies.

The Company is actively pursuing development of an immunoassay for equine infectious anemia. All equids are at risk for equine infectious anemia (EIA). All animals must be tested for the virus, and any animal found positive must be destroyed. Current tests for the presence of the virus are subject to false positive (and false negative) results. False positive results are unacceptable because valuable animals (for instance, race horses) may be put-down. False negative results are potentially devastating because infected animals could then move freely amongst equine populations. Initially funded by a $ 55,000 grant from the United States Department of Agriculture (the "USDA") (the only award of its kind from the USDA for equid related health problems), the Company has developed a novel test which should effectively eliminate false positive and false negative reactions, and at the same time, afford a greater level of testing sensitivity. The Company will assess its patent position for its test, and hopes to enter into negotiations with a corporate partner interested in commercializing this diagnostic assay.

The Company anticipates that its ability to secure and protect patents and other intellectual property rights will become increasingly important to the business of the Company in the event its proprietary research programs yield technologies which can be commercialized. There can be no assurance that the Company will be successful in securing and protecting intellectual property rights, or that its activities will not infringe on the intellectual property rights of others.

The Company takes appropriate steps to protect its intellectual property rights and those of its customers. The Company's practice is to require its employees and consultants to execute non-disclosure and proprietary rights agreements upon commencement of employment or consulting arrangements with the Company. These agreements acknowledge the Company's exclusive ownership of all intellectual property developed by the individual during the course of

his work with the Company and require that all proprietary information disclosed to the individual by the Company or its customers remain confidential.

Marketing

The Company has expanded its customer base primarily through

word-of-mouth referrals and attendance at a limited number of trade shows, seminars and meetings. Because of its ability to offer a wide range of biotechnology research services, the Company enjoys a favorable reputation among its customers, and many new customers come to the Company by word-of-mouth recommendation. The Company has constructed its own World Wide Web Home Page (www.cbi-biotech.com) and is listed with several biotechnical and biomedical oriented sites on the World Wide Web.

Human Resources

The Company currently has 33 full time and three part time employees, including eight employees in administration, one employee in marketing and customer relations, eight employees in research and development, one computer network specialist, and 25 employees in laboratory operations. Some employees in research and development also participate in laboratory operations. Seven of the Company's employees hold doctorate degrees, and six have master's degrees. None of the Company's employees are represented by a labor union. The Company has experienced no work stoppages and believes its relations with its employees to be good.

Competition

The Company faces several types of competition. The Company believes there are between 12 and 15 companies concentrating on peptide synthesis and about 20 other companies offering DNA related services in the United States. Very few companies offer both DNA/RNA and protein/peptide analysis. Other competition comes from divisions of larger research oriented companies or university core facilities. The principal competitive factors are pricing, expertise, and range of services offered, and the Company believes that it competes effectively on all of these factors.

Government Regulation

The Company does not require government regulatory approvals to provide its current services. Numerous federal, state and local agencies, such as environmental, working condition and other similar regulators, have jurisdiction to take action that could have a material adverse effect upon the Company's ability to do business. The Company believes that it is in general compliance with existing federal, state and local laws and regulations and does not anticipate that

continuing compliance will have any material effect upon the capital expenditures, earnings or competitive position of the Company.

The Company anticipates that its pursuit of its growth strategy will subject the Company to a heightened level of government regulation of its operations. For example, in pursuing opportunities to provide analytical services to customers seeking the approval of the United States Food and Drug Administration (the "FDA") of products, the Company's operations will become subject to compliance with standards established by the FDA, including inspections by the FDA and other federal, state and local agencies regarding work performed by the Company on specific FDA submission projects. If significant violations are discovered during an inspection, the Company may be restricted from undertaking additional work on projects until the violations are remedied. The Company will also require a new license from the Nuclear Regulatory Commission ("NRC") for the operation of its planned new laboratory facility. The Company estimates that the time period of obtaining the NRC license should not exceed three months.

The commercialization of the Company's proprietary technologies would also be subject to extensive government regulation and approval requirements, including the need for pre-clinical laboratory and animal tests and human clinical trials for FDA approval of human pharmaceutical products. The Company does not have, and does not anticipate developing, the facilities and expertise necessary to obtain FDA approval for or to manufacture any pharmaceutical products that may result from its technologies. Instead, the Company would license these technologies to third parties having the necessary facilities and expertise, which would assume responsibility for and control of regulatory matters.

Item 2. Description of Property.

Facilities

The Company currently occupies 12,000 square feet of laboratory and office space in two adjacent buildings. The lease for one location continues through the year 2000 and is subject to cancellation by the Company upon nine months' notice. The lease for the other location continues through May 31, 1998, is renewable for additional one year terms and is subject to cancellation by the Company upon three months' notice.

As part of its growth strategy, the Company requires considerably more space for its laboratory facilities. On March 24, 1998, the Virginia Small Business Financing Authority (the "VSBFA") issued $4,000,000 in tax exempt industrial revenue bonds ("IRBs") for the benefit of the Company, the proceeds from the sale of which, together with other available funds, will be used to acquire, construct and equip a 30,000 square foot facility in Chesterfield, Virginia. The Company anticipates that it will relocate to its new facility in the fourth quarter of 1998.

Item 3. Legal Proceedings

The Company is not presently involved in any litigation nor, to the knowledge of the Company's management, is any litigation threatened against the Company.

Item 4. Submission of Matters to a Vote of Security Holders.

On September 1, 1997, the shareholders of the Company, by unanimous written consent, amended the Company's 1997 Stock Incentive Plan (the "Incentive Plan") to increase the number of shares of the Company's Common Stock issuable thereunder from 376,667 shares to 410,000 shares. Of the 410,000 shares issuable under the Incentive Plan, 270,000 shares were reserved for issuance to the Company's founders.

PART II

Item 5. Market for Common Equity and Related Stockholder Matters.

Market Information

The information set forth on page 9 of the Company's 1997 Annual Report to Shareholders under the caption "Market for Common Equity" is incorporated herein by reference.

Private Placements of Securities

On June 25, 1997, the Company sold subordinated convertible notes in an aggregate principal amount of $3,000,000 to 42 accredited investors in an offering exempt from registration pursuant to Rule 506 of Regulation D promulgated under the Securities Act of 1933, as amended (the "Securities Act"). Such notes accrued interest from June 25, 1997 until October 28, 1997, the date of the Company's IPO, at a rate of 20% per annum, payable in shares of Common Stock at a rate of $6.00 per share. Anderson & Strudwick Incorporated ("A&S") served as placement agent in connection with such private placement and received a $240,000 placement fee.

On June 25, 1997, the Company issued warrants to purchase an aggregate of 100,000 shares of Common Stock to the four founders of the Company for $.001 per warrant (the "Management Warrants"). Each Management Warrant entitles the holder to purchase one share of Common Stock at an exercise price of $9.90 per share. Such warrants are exercisable between June 25, 1998 and June 25, 2007. The sale and issuance of the Management Warrants were exempt from the registration provisions of the Securities Act by virtue of Section 4(2) thereof as

transactions not involving any public offering. The resale of the Management Warrants was registered pursuant to the Company's Registration Statement on Form SB-2, Registration No. 333-31731.

On October 28, 1997, the Company issued warrants to purchase an aggregate of 101,500 shares of Common Stock to A&S, the underwriter for the IPO (the "Underwriter Warrants"). The price paid by A&S for the Underwriter Warrants was $.001 per warrant. Such warrants have an exercise price of $9.90 per share and are exercisable between October 28, 1998 and October 17, 2002. The sale and issuance of the Underwriter Warrants were exempt from the registration provisions of the Securities Act by virtue of Section 4(2) thereof as transactions not involving any public offering. The resale of the Underwriter Warrants was registered pursuant to the Company's Registration Statement on Form SB-2, Registration No. 333-31731.

As of December 31, 1997, the Company issued incentive stock options to purchase an aggregate of 317,200 shares of Common Stock to certain employees of the Company pursuant to the Incentive Plan. Such options have exercise prices equal to the fair market value of the Common Stock on the date of grant. Each option granted pursuant to the Incentive Plan is exercisable for a period of ten

years following the grant thereof. The issuance by the Company of incentive stock options pursuant to the Incentive Plan was exempt from the registration provisions of the Securities Act by virtue of Rule 701 promulgated thereunder.

Use of Proceeds of IPO

On October 28, 1997, the Company completed its IPO of Common Stock. The underwriter of the IPO was A&S. Pursuant to the Company's Registration Statement on Form SB-2, Registration No. 333-31731, the Company registered an aggregate of 1,015,000 shares of Common Stock for an aggregate offering price of $6,090,000. The expenses incurred by the Company in connection with the IPO, including underwriting commissions and other expenses paid to A&S, were approximately $687,200, resulting in net proceeds to the Company of $5,402,800. As of December 31, 1997, the Company had not expended any of the IPO proceeds, which are currently invested in an interest-bearing account at a commercial bank.

Item 6. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The information set forth on pages 10 through 14 of the Company's 1997 Annual Report to Shareholders under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" is incorporated herein by reference.

Item 7. Financial Statements.

The Company's financial statements and the related notes thereto, together with the report of Goodman & Company, L.L.P., set forth on pages 15 through 27 of the Company's 1997 Annual Report to Shareholders are incorporated herein by reference.

Item 8. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

Goodman & Company, L.L.P. ("Goodman") served as the Company's independent public accountants for the fiscal years ended December 31, 1995, December 31, 1996 and December 31, 1997. For various business reasons, the Audit Committee recommended the dismissal of Goodman to the Company's Board of Directors, and on February 23, 1998, the Board officially terminated its business relationship with Goodman. Goodman's reports on the Company's financial statements for each of the last two fiscal years did not contain an adverse opinion or disclaimer of opinion. Similarly, Goodman did not modify either such report as to uncertainty, audit scope or accounting principles. There were no disagreements between the Company and Goodman regarding any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure.

Upon the recommendation of the Audit Committee of the Company's Board of Directors, the Board of Directors of the Company appointed on February 23, 1998, subject to the approval of the Company's shareholders, the firm McGladrey & Pullen, LLP as independent public accountants to audit the Company's consolidated financial statements for the fiscal year ended December 31,1998. If the appointment of McGladrey & Pullen, LLP is not approved by the shareholders, the matter will be referred to the Audit Committee for further review.

PART III

Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act.

Directors

The information relating to the directors of the Company set forth in the Company's definitive proxy statement relating to the Company's Annual Meeting of Shareholders to be held on April 14, 1998 (the "Proxy Statement") under the caption "Proposal 1: Election of Directors" is incorporated herein by reference.

Executive Officers

The information relating to the executive officers of the Company set forth in the Proxy Statement under the caption "Executive Compensation - Executive Officers of the Company" is incorporated herein by reference.

Compliance with Section 16(a) of the Securities Exchange Act of 1934

The information relating to compliance with Section 16(a) of the Securities Exchange Act of 1934, as amended, is set forth in the Proxy Statement under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" is incorporated herein by reference.

Item 10. Executive Compensation.

The information set forth in the Proxy Statement under the caption "Executive Compensation" is incorporated herein by reference.

Item 11. Security Ownership of Certain Beneficial Owners and Management.

The information set forth in the Proxy Statement under the caption "Voting Securities and Principal Holders Thereof" is incorporated herein by reference.

Item 12. Certain Relationships and Related Transactions.

The information set forth in the Proxy Statement under the caption "Certain Relationships and Related Transactions" is incorporated herein by reference.

Item 13. Exhibits and Reports on Form 8-K.

(a) Exhibits

Exhibit Number	Description of Exhibit
3.1	Amended and Restated Articles of Incorporation (1)
3.2	Amended and Restated Bylaws (1)
4.1	Form of Common Stock Certificate (1)
4.2	Form of Underwriter's Warrant, as amended (1)
4.3	Form of Management Warrant, as amended (1)
10.1	Placement Agreement by and between the Company and A&S (1)
10.2	Warrant Agreement between the Company and A&S (1)
10.3	Warrant Agreement between the Company and Richard J. Freer, as amended (1)
10.4	Warrant Agreement between the Company and Thomas R. Reynolds, as amended (1)
10.5	Warrant Agreement between the Company and Gregory A. Buck, as amended (1)
10.6	Warrant Agreement between the Company and Robert B. Harris, as amended (1)
10.7	Employment Agreement for Richard J. Freer (1)
10.8	Employment Agreement for Thomas R. Reynolds (1)
10.9	Employment Agreement for Gregory A. Buck (1)
10.10	Employment Agreement for Robert B. Harris (1)
10.11	Executive Severance Agreement for Richard J. Freer (1)
10.12	Executive Severance Agreement for Thomas R. Reynolds (1)
10.13	Executive Severance Agreement for Gregory A. Buck (1)
10.14	Executive Severance Agreement for Robert B. Harris (1)
10.15	1997 Stock Incentive Plan, as amended (1)
13.1	Portions of Annual Report to Shareholders for the Fiscal Year Ended December 31, 1997 Incorporated in Form 10-KSB (2)
16.1	Letter on change in certifying accountant (3)
27.1	Financial Data Schedule (2)

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(1) Incorporated by reference to the Company's Registration Statement on Form SB-2, Registration No. 333-31731.

(2) Filed herewith.

(3) Incorporated by reference to Amendment No. 1 to the Company's Current Report on Form 8-K, filed on March 12, 1998.

Executive Compensation Plans and Arrangements

The following is a list of all executive compensation plans and arrangements filed as exhibits to this annual report on Form 10-KSB or incorporated herein by reference:

<TABLE>
<CAPTION>

<S> <C>

1.	Warrant Agreement between the Company and Richard J. Freer, as amended (1)
2.	Warrant Agreement between the Company and Thomas R. Reynolds, as amended (1)
3.	Warrant Agreement between the Company and Gregory A. Buck, as amended (1)
4.	Warrant Agreement between the Company and Robert B. Harris, as amended (1)
5.	Employment Agreement between the Company and Richard J. Freer (1)
6.	Employment Agreement between the Company and Thomas R. Reynolds (1)
7.	Employment Agreement between the Company and Gregory A. Buck (1)
8.	Employment Agreement between the Company and Robert B. Harris (1)
9.	Executive Severance Agreement between the Company and Richard J. Freer (1)
10.	Executive Severance Agreement between the Company and Thomas R. Reynolds (1)
11.	Executive Severance Agreement between the Company and Gregory A. Buck (1)
12.	Executive Severance Agreement between the Company and Robert B. Harris (1)
13.	1997 Stock Incentive Plan (1)

</TABLE>

- ------------------------

(1) Incorporated by reference to the Company's Registration Statement on Form SB-2, Registration No. 333-31731.

(b) Reports on Form 8-K

During the three months ended December 31, 1997, the Company filed the following report on Form 8-K:

1. Form 8-K, dated December 23, 1997, relating to the announcement of the Company's plans to develop a new research facility.

SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

COMMONWEALTH BIOTECHNOLOGIES, INC.

Date: March 30, 1998

By: /s/ Robert B. Harris, Ph.D.

Robert B. Harris, Ph.D
President

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<TABLE>
<CAPTION>

Name	Title(s)	Date
<S> <C>		
/s/ Richard J. Freer, Ph.D. - ----------	Chairman and Director (Principal	March 30, 1998
Richard J. Freer, Ph.D.	Executive Officer)	
/s/ Robert B. Harris, Ph.D. - ----------	President and Director	March 30, 1998
Robert B. Harris, Ph.D.		
/s/ Gregory A. Buck, Ph.D. - ----------	Senior Vice President, Chief	March 30, 1998
Gregory A. Buck	Scientific Officer, Secretary and Director	
/s/ Thomas R. Reynolds, Ph.D.	Senior Vice President and Director	March 30, 1998

- ----------
Thomas R. Reynolds, Ph.D.

/s/ Charles A. Mills, III - ---------- Charles A. Mills, III	Director	March 30, 1998
/s/ Peter C. Einselen - ---------- Peter C. Einselen	Director	March 30, 1998

</TABLE>

The Company

Overview of the Company

The Company was founded in 1992 by four experienced research scientists to provide sophisticated research and development support services on a contract basis to the biotechnology industry. The Company's customers consist of private companies, academic institutions, and government agencies, all of which use biological processes to develop products for health care, agricultural, and other purposes. The Company has developed a strong reputation as a leading provider of biotechnology research and development analytical services.

The Company's revenues are derived principally from providing macromolecular synthetic and analytical services (protein/peptide, and DNA/RNA chemistries) to researchers in the biotechnology industry or those who are engaged in life sciences research in government or academic labs. This arrangement distinguishes the Company from many other biotechnology companies because the Company's revenues are not directly dependent on successfully commercializing a new biotechnology product.

In general terms, the Company serves two types of customers: those who require a discrete set of analyses ("short-term projects"); and, those who contract with the Company on an extended basis for performance of a variety of integrated analytical services ("long-term projects"). More often than not, short-term and long-term project customers send the Company repeat business.

The Company also derives a portion of its revenues from research grants funded by various Federal agencies. These research grants support the bulk of the Company's research efforts on its own proprietary technologies.

Analytical Support Services

Providing a wide range of services is an important element of the Company's competitive strategy. There are few major competitors which offer integrated DNA/RNA and protein/peptide technologies, and none that offer these technologies combined with sophisticated biophysical techniques, such as calorimetry, spectroscopy, and mass spectral analysis. Thus, the Company can provide "one stop shopping" for biotechnology services.

The services offered by the Company are fully detailed in its promotional brochures and on its Web page. Some of these services include:

Oligonucleotide Synthesis. Nucleotides are the building blocks of DNA and RNA. The Company provides both routine syntheses and custom synthesis chemistries for design of special nucleotide derivatives. Very few commercial companies offer custom RNA synthesis or synthesis of RNA/DNA hybrid molecules, and the Company has been successful in supplying these specialized products to academic and commercial customers. In addition, the Company now produces peptide nucleic acids (PNAs) under a broad license from Perseptive Biosystems, Framingham, MA.

Protein/Peptide Synthesis. Assembly of amino acids into chains creates synthetic peptides. Recently purchased equipment has added to the Company's capacity for peptide synthesis.

DNA Sequencing. Sequencing is essentially the reverse process of synthesis. In a typical experiment, a customer will require 10-20 sequencing reactions. However, a number of customers require thousands of sequencing reactions, for which the Company offers aggressive discounts in pricing.

Peptide/Protein Sequencing. Analysis of the order of amino acids in proteins and enzymes is an important analytical tool. The Company provides N-terminal sequence analysis, and with new instruments to be installed in 1998, the Company will offer automated C-terminal sequence analysis.

Peptide/Protein Compositional Analysis. Analysis of the amino acids that compose a protein or peptide is used to verify purity of synthesized peptides and to determine the make-up of newly discovered proteins or enzymes. Usually, two or three analyses are required for a complete compositional determination.

Short-term Research Projects.

On average, in 1997, the Company added 16 new customers per month. At the end of 1997, the Company's customer base included over 400 researchers at more than 350 different institutions world-wide. Of its domestic customers, 59% work in private companies, and 41% are located in university or governmental labs. In 1997, the Company added 19 new foreign research institutes in Japan, India, Greece, Columbia, Korea, Norway, Spain, Sweden, and Canada.

Of the Company's domestic customer base, 59% work in private labs, and 41% work in university or government labs

In 1997, the Company averaged 66 new orders per month. The nature of these orders vary widely; some are for relatively straight-forward chemistries which take a minimum amount of time to complete, while other orders are far more complicated procedures which take several weeks to complete.

Number of orders for new work received monthly by the Company in 1997.

Customers come to the Company from many sources. The Company advertises in professional journals, exhibits at trade shows, and has its own Web page from which potential customers may directly download order forms

and place an order, if desired. The Company is also cross listed on several biotechnology, biochemistry, and molecular biology search services, so that potential customers may find us using simple key word search terms. Of course, favorable word-of-mouth advertising is key to the Company's success, and has brought many new investigators within a single research based institution. All inquiries to the Company receive immediate and personal attention. Quotations are usually sent back to a potential customer within the day, and certainly within 24 hours. Customers continue to comment favorably on their phone, fax, and e-mail interactions with CBI staff personnel.

Long-term Research Projects

The Company actively pursues long-term research contracts with government, private, and university research institutes. Some contracts are to perform research services to a customer's list of specifications, while other contracts are to perform basic research into a problem of interest to the customer. The Company is able to attract these customers because of the breadth of technologies that it offers. In 1997, revenues realized from contract research customers totaled $561,007 and in the first quarter of 1998, the Company has already signed research contracts totaling over $300,000.

Proprietary Research And Development

As a rule, the Company does not retain intellectual property rights on work done for short-term projects, and only rarely retains intellectual property rights for work done on long-term projects. In contrast, the Company is developing its own technologies in its proprietary research and development programs. CBI does not foresee itself as a manufacturer of any products that might result from these research efforts; rather, the goal of these projects is to bring a particular technology to a patentable stage, and then license the technology to another company. If the technology is commercialized, the Company may realize licensing and/or royalty fees.

Presently, the Company's Research and Development activities fall into five general areas.

Development of heparin antagonists for clinical use. Heparin is a complex, negatively charged, polysaccharide molecule which is used worldwide as an anti-coagulant ("blood thinner"). Virtually every patient who undergoes invasive cardiovascular surgery (bypass, angioplasty, etc.) receives heparin as an anti-coagulant. Unfortunately, humans do not metabolize heparin very well, and in many acute surgical situations, the patient is administered another drug, "protamine," to rid the body of heparin.

Protamine therapy, however, is fraught with potential complications, including hypotension, platelet lysis, and in some cases, death.

CBI has developed a protamine replacement (the "Compound"). Initially funded by a $ 100,000 grant from the National Institutes of Health (NIH), CBI is now in the second year of a $500,000 award for this project. The Company has filed patent applications for the Compound, and CBI management is hopeful that these patents will issue in 1998.

Research work is continuing in 1998 to assess the efficacy and toxicity of the Compound in animal models of cardiovascular surgery. Further, in 1998, the Company hopes to enter licensing discussions with potential corporate partners.

Stabilization of peptide drugs; a novel application of the Company's lead heparin antagonist Compound. An unexpected finding from the Company's heparin antagonist research program was that the Compound is an effective stabilizing agent for particular human peptide pharmaceuticals. In this respect, the Compound has the potential to effectively replace protamine in these formulations. This would be desirable because patients who receive protamine-stabilized drug formulations are at increased risk of severe allergic response ("anaphylaxis") if they ever receive protamine in conjunction with heparin therapy.

In 1998, CBI expects to seek patent protection for this use of the Compound as a stabilizing agent.

Creation of heparin structures with defined biological activities. Heparin is a mixture of molecules which are "pluripotent"; that is, heparin possesses diverse biological activities, including anti-coagulant, anti-platelet, and anti-smooth muscle cell proliferative activities.

The Company, and its collaborators at the Upstate VA Medical Center, Syracuse, NY, have developed methods to refine heparin into sub-fractions which

possess defined bio-activities. If successful, the clinician will have an array of heparins at his disposal for use in particular surgical situations; a purely anti-thrombotic heparin for use in surgeries involving the venous system (for example, phlebitis), an anti-platelet heparin for use in surgeries involving the arterial system (for example, angioplasty or bypass), and a heparin which will be useful to prevent re-occlusion of arteries by smooth muscle cells following surgical intervention ("restenosis").

Initially funded by a research grant from the NIH, work is continuing on this project under the auspices of a 4-year, $220,000 renewable contract from the Central New York Research Institute. In 1998, CBI will continue its work to identify and characterize defined chemical structures of heparin based on this initial research.

Development of an immunoassay for equine infectious anemia. All horses are at risk for Equine Infectious Anemia (EIA) and must be tested for the virus. Any animal found positive must be destroyed. Current tests for the presence of the virus are subject to false positive (and false negative) results. False positive results are unacceptable because valuable animals (for instance, race horses), may be euthanized. False negative results are potentially devastating because infected animals could then move freely amongst equine populations.

Initially funded by a $55,000 grant from the United States Department of Agriculture (the only award of its kind from the USDA for equid related health problems), the Company has developed a novel test which should effectively eliminate false positive and false negative reactions, and at the same time, afford a greater level of testing sensitivity.

The Company has made application to the USDA for a $250,000 grant to continue this research project. Further, in 1998, CBI will assess its patent position for its test, and hopes to enter into negotiations with a corporate partner interested in commercializing this diagnostic assay.

Novel approaches to genomic sequence analysis; detection of MDR (Multi-drug resistant) M. tuberculosis. The goal of this project is to develop a test for the rapid detection of multi-drug resistant Myobacterium tuberculosis from clinical samples. Studies have shown that mutations in particular genes of the bacterium result in drug resistance, and therefore, to accurately determine the precise nature of the infectious organism, it is necessary to know the sequence of the genes. Under the auspices of a $ 100,000 grant from the NIH, the Company is developing a direct genomic DNA sequencing technology for application to such diagnostic and prognostic infectious disease problems.

In addition to these research programs, the Company is a named co-inventor on US Patent #5,700,444, "Chemotactic Peptide Pharmaceutical Applications," issued to RhoMed Inc., Albuquerque, NM. This patent describes the synthesis and use of peptides which bind and carry medically useful metal ions to sites of infection and inflammation. The compounds are intended for radiological detection and imaging of deep seated abscesses which will allow the physician to administer the appropriate antibiotic.

The peptide structures protected under this patent were designed with intellectual input from the Company's scientists, and the compounds themselves were prepared at the Company. The Company assigned its ownership rights to the invention to RhoMed Inc., in return for a continuing royalty against future worldwide sales of a diagnostic kit which incorporates these peptides, should such a kit ever be commercialized.

Each of these technologies is at an early stage of development and commercialization will require additional research. Therefore, the Company cannot determine at this time whether any of these technologies will prove commercially viable.

Growth Strategy

The Company intends to focus its expansion efforts on the maintenance and expansion of long term relationships with customers in the biotechnology industry as well as establishing new customer relationships. The Company will seek to identify trends that impact its customers and develop new products and services to meet the changing needs of its customers. In 1998, the Company will embark on:

- Expansion of its Instrumentation Capacity. The Company believes there is significant demand for additional services of the type the Company currently offers, but is unable to meet this demand because of

limitations in its instrumentation inventory and constraints of its current facilities. In securing a significantly larger laboratory facility and additional research equipment, the Company will have the capacity to generate substantially greater revenues from its core services and to improve profit margins through more efficient operations.

- Expansion of its Marketing Capabilities. The Company has expanded its customer base primarily through placement of print ads in several periodicals and industry sourcebooks, by attendance at a limited number of trade shows, seminars, and meetings, through its own World Wide Web Home Page, and by word-of-mouth recommendations. While the Company will continue to utilize these strategies to attract customers, in 1998, the Company will also be expanding its sales and marketing capabilities in three areas.

  First, the Company is currently recruiting sales representatives to cover the three major biotechnology areas of the United States: the Boston/New York/New Jersey area, the San Diego area, and the San Francisco Bay area. It is anticipated that two full-time sales representatives will be trained and in the field by the second quarter of 1998. These individuals will be primarily targeting pharmaceutical and biotechnology companies and government agencies.

  Second, the Company has engaged Advantage Consulting, Inc., of Annandale, VA, to facilitate its ability to successfully compete for contracts with

the U.S. Department of Defense and the Department of Justice, both of which have an interest in DNA technologies.

Finally, the Company plans to engage an advertising and marketing firm to advise the Company on new strategies and tools to enhance both the Company's visibility, and its ability to identify and reach new customers. The Company is currently interviewing several firms and expects to make a decision early in 1998.

- Regulatory Compliance. By enhancing its facilities and expertise, the Company believes it will be able to satisfy regulatory requirements for performance of its analytical services. For example, the Company performs only limited laboratory work under Good Laboratory Practices (GLP) conditions; in 1998, the Company expects to come into compliance with GLP and Clinical Laboratory Improvement Act (CLIA) guidelines for all its technologies.

- Expansion into New Service Technologies. The Company continues to critically examine new technologies with a view towards expanding its customer base and sources of revenue. Hence, in 1998, the Company will increase its capacity or improve its service offerings in the following areas:

DNA sequence analysis. The Company has positioned itself to be at the forefront in the development and application of new genome based technologies. We have expanded our contract DNA sequencing services and offer sophisticated sequence data analysis. We will continue to expand these services in 1998 through the acquisition of additional sequencing instrumentation and through the development of a Bioinformatics Group.

Genome Sequencing. We are developing comprehensive genome sequencing capabilities in parallel with the development of the Company's Bioinformatics Group. We are already sequencing human microbial pathogens.

Genetic Analysis. CBI has established a Genetic Testing Group and is evaluating several likely applications, including screening for mutations in several genes associated with human hereditary diseases, and for genes in which mutations confer an increased probability for the development of specific cancers during the lifetime of the individual.

Identity Testing by Genetic Analysis. Many states have mandated that people passing through the criminal justice system be sampled and that their genetic fingerprints be determined. However, most state laboratories lack the facilities and people necessary to perform these assays. The Company is positioned to provide these services and is establishing a DNA Reference Laboratory containing all the necessary work areas required to provide these services. The Company expects to become accredited for performance of this service in early 1998.

Centralized Computer Facilities. The Company will acquire and maintain a more centralized server for databasing and analysis and to develop a more sophisticated company-wide intranet. We are also

evaluating powerful software packages to permit more efficient data handling, storage, backup, and analysis.

DNA/RNA/PNA Synthesis. CBI now offers PNA synthesis and has developed a steady customer base for RNA synthesis. Currently, CBI is one of the few companies successfully offering RNA synthesis.

Bioorganic Mimetic Chemistry. Incorporation of organic "mimetic" structures into drugs often leads to enhanced stability and oral availability of the drug. CBI now offers synthesis of these mimetic structures, and expects demand to increase for this service.

Expanded mass spectroscopy services and Carbohydrate Analytical Services. The Company is studying whether to establish a full-service mass spectral facility in its new laboratories and whether sufficient demand exists for initiating detailed carbohydrate analytical services.

Stockholder Matters

Market for Common Equity

The Company completed its initial public offering on October 28, 1997 at a price per share of $ 6.00. Since that time, the Common Stock has traded on the Nasdaq Smallcap Market ("Nasdaq"). The following table sets forth the range of high and low sales price per share of Common Stock for the period following the completion of the Company's initial public offering.

Period	High Stock Price	Low Stock Price
Fourth Quarter (beginning October 28, 1997)	$ 9.00	$ 6.00

On March 6, 1998, the last reported sales price for a share of the Company's Common Stock on Nasdaq was $7 5/8. As of March 6, 1998, there were 81 holders of record of the Company's Common stock and approximately 892 beneficial holders.

The Company has not paid any cash dividends on its Common Stock. The Company intends to retain its earnings to finance the growth and development of its business and does not expect to declare or pay dividends in the foreseeable future. The declaration of dividends is within the discretion of the Company. However, the Company's ability to pay dividends may be constrained by certain provisions of its industrial revenue bond financing.

Prior to its initial public offering, the Company made distributions as an S corporation from undistributed earnings to its stockholders, including amounts to fund the payments of their individual tax liabilities attributable to their allocation of the Company's income. Such distributions totaled $79,533 and $96,851 in 1996 and 1997, respectively.

Selected Financial Data

Set forth below is selected financial data with respect to the Company for the years ended December 31, 1996 (as an S Corporation) and December 31, 1997, which has been derived from the audited financial statements of the Company. The selected financial data set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Conditions and Results of Operation."

<TABLE>
<CAPTION>

	For the years Ended December 31, 1997	December 31, 1996
<S>	<C>	<C>
Statement of Operations:		
Revenues:	$ 1,761,308	$ 989,925
Net Income (loss)	$ <1,168,821>	$ 110,088
Earnings per common and common equivalent share.	$ <3.55>	$ 1.54
Weighted average common shares outstanding	329,480	71,273
Net income (loss) before income tax expenses	$ <1,168,821>	$ 110,088
Income tax expense	--	$ 49,651
Proforma net income (loss)(1)	$ <1,168,821>	$ 60,437
Proforma earnings (loss) per common and common equivalent share	$ <0.72>	$ 0.12
Proforma Weighted average common and common equivalent shares outstanding(2)	1,620,514	506,273
Balance Sheet Data:		
Total Current Assets	$ 6,489,965	$ 377,874
Total Assets	$ 7,931,606	$ 634,193
Total Liabilities	$ 624,250	$ 471,924
Total Stockholders equity	$ 7,307,356	$ 162,269

</TABLE>

(1) The above financial data gives retroactive effect to conversion from S Corporation to C Corporation status for federal income tax purposes.
(2) The above financial data gives retroactive effect to the 93.78-for-one stock split effective June 24, 1997, to shares relating to the issuance of the Conversion Shares, and to the anti-diluitive effect of the Management Warrants converted using the Treasury Stock method.

Changes in and Disagreements with Accountants

Goodman and Company, LLP ("Goodman") served as the Company's independent pubic accountants for the fiscal years ended December 31, 1995, December 31, 1996 and December 31, 1997. For various business reasons, the Audit Committee of the Company's Board of Directors (the "Audit Committee") recommended the dismissal of Goodman to the Company's Board of Directors, and on February 23, 1998, the Company officially terminated its business relationship with Goodman. Goodman's reports on the Company's financial statements for each of the last two fiscal years did not contain an adverse opinion or disclaimer of opinion. Similarly, Goodman did not modify either such report as to uncertainty, audit scope, or accounting principles. There were no disagreements between the Company and Goodman regarding any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure.

Upon the recommendation of the Audit Committee of the Company's Board of Directors, the Board of Directors of the Company appointed on February 23, 1998, subject to approval of the Company's shareholders, the firm of McGladrey and Pullen, LLP, as independent public accountants to audit the Company's consolidated financial statements for the fiscal year ended December 31, 1998.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following should be read in conjunction with "Selected Financial Data" and the Company's Audited Financial Statements and Notes thereto included herein.

Overview

The Company's revenues are derived principally from providing protein/peptide and DNA/RNA chemistries and related analytical services to researchers in the

biotechnology industry. The biotechnology industry has experienced rapid growth in recent years based on the development of innovative technologies. The development process requires sophisticated laboratory techniques. Many participants in the industry do not have the facilities or personnel necessary to perform these techniques, and contract it out to the Company and other organizations. Since commencing operations in 1992, the Company has experienced significant growth in revenues as the Company's reputation in the industry has grown.

In general terms, the Company serves two types of customers: those who require a discrete set of services ("short-term projects"), and those who contract with the Company on an extended basis for performance of a variety of integrated services ("long-term projects"). More often than not, short-term and long-term project customers send the Company repeat business.

For the purpose of consistency between the financial reports of the Company's operations as reported in the Prospectus for the Company's IPO, the 10-QSB filing for the third quarter 1997, for the 10-KSB filing for 1997, and for this Annual Report to Shareholders, the term "Laboratory Services" is used to describe revenue and expenses associated with short-term projects, and the term "Contract Services" is used to describe revenue and expenses associated with long-term projects. As the Company goes forward, the terms Laboratory Services and Contract Services will be replaced with short-term and long-term project revenues and expenses, respectively.

The Company also derives a portion of its revenues from research grants funded by various Federal agencies. These research grants support the bulk of the Company's research efforts on its own proprietary technologies.

Year Ended December 31, 1997 versus December 31,1996

Revenues

Gross revenues increased by $771,382 or 77.9%, from $989,925 during the fiscal year ended December 31, 1996 ("1996" to $1,761,308 during the fiscal year ended December 31, 1997 ("1997").

Revenues realized from laboratory services increased $371,224 or 76.9% from $482,586 in 1996 to $853,810 in 1997, with the DNA sequence analysis service

showing the largest percentage revenue increase, in the amount of $220,599 or 144.9% from $152,256 in 1996 to $372,855 in 1997. Revenues attributable to peptide synthesis increased by $74,572 or 119.1%, from $62,638 in 1996 to $137,210 in 1997.

Revenue realized from various contract research projects increased by $234,232 or 71.7%, from $326,776 in 1996 to $561,007 in 1997. This increase was due primarily to funds received in early 1997 from one major private industry customer.

In addition, the Company experienced an increase in revenue realized from government grants in the amount of $165,928 or 91.9% from $180,563 in 1996 to $346,491 in 1997. These grants were provided by the National Institutes of Health and the United States Department of Agriculture, under the auspices of two different Small Business Technology Transfer Research Grants and a Small Business Innovative Research award. The government grants are expense reimbursement grants which provide for reimbursement of the Company's direct costs incurred, plus indirect costs as a percentage of direct costs. The Company generally receives grant payments semi-monthly, with the amount of each payment being determined by the amount of the costs incurred in the immediately preceding two week period.

Management believes that this increase in revenue is primarily attributable to an expanded customer base and to larger orders from individual customers, both of which result from the Company's enhanced reputation in the industry, and to more effective advertising activities.

The Company experiences quarterly fluctuations in revenues which arise primarily from variations in research contracts. Revenue fluctuations also result from the dynamic nature of the Company's laboratory services. Engagement for subsequent projects is highly dependent upon the customer's satisfaction with the services previously provided, and upon factors beyond the Company's control, such as the timing of product development and commercialization programs of the Company's customers. The Company is unable to predict for more than a few months in advance the volume and dollar amount of future projects in any given period. The combined impact of commencement and termination of research contracts from several large customers and unpredictable fluctuations in revenue for laboratory

services can result in very large fluctuations in financial performance from quarter to quarter.

The biotechnology industry is currently progressing through a consolidation stage wherein some potential customers are cutting back on research and development, while others are trying to perform their own research services in-house. In either situation, there is a reduced dependence on the Company to perform its services for customers. If this trend continues, the Company expects that it may derive a larger portion of its revenues from laboratory services. Thus, the Company may experience a pronounced shift from contract research to laboratory services, which may result in a less predictable revenue stream.

Performance of contract research for five customers was completed in 1997. Two of these customers have initiated a new contract research projects with the Company, and in addition, the Company has signed three additional research contracts which began in January, 1998. The Company has bids for several contracts pending, an award of any of which would have a significant impact on revenues.

Expenses

Cost of services consists primarily of labor and laboratory supplies. Cost of services increased by $556,510 or 234.1% from $237,726 in 1996 to $794,236 in 1997. The cost of services as a percentage of revenue was 24.0% and 45.1% in 1996 and 1997, respectively. These increased costs are directly attributable to hiring new personnel, to acquisition of reagents, chemicals, materials and so forth necessary to implement the Company's growth strategy. Labor costs increased by $234,291 or 223.8% from $104,703 in 1996 to $338,994 in 1997. The cost of reagents increased by $131,338 or 307.6% from $42,700 in 1996 to $174,038 in 1997. The cost of miscellaneous materials increased by $142,236 or 500.8% from $28,404 in 1996 to $170,641 in 1997. The cost of services is subject to fluctuation and can cause results of operations to fluctuate from quarter to quarter, particularly if the Company purchases supplies but does not record the revenue from the performance of services until a subsequent quarter.

Sales, general and administrative expenses consist primarily of compensation and related costs for administrative personnel, depreciation and amortization, professional fees and advertising. Sales, general and administrative expenses increased by $973,186 or 300.5% from $323,820 in 1996 to $1,297,005 in 1997. Sales, general and administrative expenses as a percentage of revenue were 32.7% in 1996 and 73.6% in 1997. Compensation and benefit expenses increased by $507,739 or 449.4% from $112,983 in 1996 to $620,722 in 1997. This was due in large part to the full-time employment of the four founders of the Company and to payment of bonuses to the executive officers totaling $150,000. Also included in compensation and benefit expenses is a $60,000 bonus paid to a former officer of the Company. Rent payments increased by $60,850 or 733.9% from $8,291 in 1996 to $69,641 in 1997. Professional fees increased by $62,025 or 145.8% from $42,544 in 1996 to $104,569 in 1997. This increase was primarily due to the Company's need for additional outside business and scientific consulting expertise. Depreciation increased by $104,262 or 200.8% from $51,936 in 1996 to $156,198 in 1997. Increased depreciation was attributable to the purchase of additional equipment in the latter part of 1997.

Expenditures for government grant related research and development activities increased by $138,911 or 118.2% from $117,544 in 1996 to $256,455 in 1997. Expenditures to perform research and development for establishing fundamental technologies in the Company, or expended in performance of grant related research activities supplemented by the Company increased by $149,683 or 550.2% from $27,203 in 1996 to $176,886 in 1997. Expenditures for research and development performed on behalf of contract research customers decreased by 13.6% or $22,219 from $163,737 in 1996 to $141,518 in 1997. Research and development activities performed by third parties at the behest of the Company amounted to $56,750 in 1997, and were zero in 1996. Total research and development costs as a percentage of revenue were 31.2% in 1996 and 32.6% in 1997.

Other Income and Expenses

The Company realized interest income in 1997 of $91,997; there was essentially no interest income in 1996. The increase in interest income was primarily due from investing the funds from the Private Placement (as described below) and the Company's initial public offering.

Interest paid by the Company in 1997 included (1) interest paid to financial institutions on loans made to the Company; (2) interest expenses associated incurred as a

consequence of completion of the Private Placement in June, 1997; and (3) interest expenses for amortization of loan costs also incurred as a consequence of the completion of the Private Placement.

Interest paid to financial institutions on loans made to the Company increased by $16,968 or 167.9% from $10,101 in 1996 to $27,069 in 1997. The Company experienced an increase in interest expenses associated with the Private Placement of $204,039 in 1997, and an increase in amortization of loan costs associated with the Private Placement of $124,918.

Liquidity and Capital Resources

On June 24,1997, the Company declared a 93.78-for-1 stock split. On June 25, 1997, the Company sold in a private placement of securities ("Private Placement"), 60 convertible subordinated notes with a principal amount of $50,000 per note. Each note had an interest rate of 20% and was payable upon the conversion of the note into shares of the Company's common stock. Interest, in the form of additional shares of common stock, was paid through the date of the conversion. Each note automatically converted into 8,333.33 shares (exclusive of interest) of the Company's common stock at the closing of the Company's initial public offering ("IPO") on October 28, 1997. The net proceeds of the Private Placement were $2,629,269.

On October 28, 1997, the Company completed its IPO of 1,015,000 shares of common stock at a price of $6.00 per share. The Company's net proceeds from the IPO were $5,417,578.

Operating cash flow for 1996 and 1997 was $409,136 and <$711,615>, respectively. Net working capital as of December 31, 1996 and 1997 was $91,637

and $5,865,715, respectively. Increases in cash and net working capital in 1997 were due to the private placement and initial public offerings. During the first quarter of 1997, the Company received the proceeds of a term loan from a financial institution in the amount of $102,800. The Company also financed the purchase of a vehicle under a term loan in the amount of $23,682. In addition, the Company received the proceeds of a demand loan from a financial institution in the amount of $42,000. During October 1997, the Company consolidated its demand and term notes into a single term loan, payable on demand.

For 1997, the Company made capital expenditures on new scientific instrumentation, including computers, amounting to $1,348,399, compared to expenditures of $194,798 in 1996. As part of it's growth strategy, the Company expects to incur approximately $3,100,000 of capital expenditures, consisting of approximately $2,100,000 for laboratory equipment and approximately $1,000,000 for fitting up of it's new facility. The Company expects to incur these expenditures during the next eighteen months. In the meantime, available funds are invested in interest bearing accounts at a commercial bank.

In 1997, the Company, as an S Corporation, made distributions to its shareholders which totaled an aggregate of $96,851 in 1997 and $79,533 in 1996. In June 1997, the Company altered its taxable status to that of a corporation governed by Subchapter C of the Internal revenue Code of 1986, as amended.

Year Ended December 31, 1996
versus December 31, 1995

Revenues

Gross revenue increased $620,624, or 168.0%, from $369,301 for the fiscal year ended December 31, 1995 ("1995") to $989,925 for the fiscal year ended December 31, 1996. This increase in revenue was attributable to an increase in new customer accounts, which contributed $453,502, or 73%, of the increase, and to larger orders with existing customers, which contributed $167,122, or 27%, of the increase, for all types of services provided by the Company in 1996, except for peptide synthesis which experienced a nominal decrease of $6,380, or 1.7% of total 1995 revenue. This decrease was more than offset by an increase in revenues from DNA sequencing services in the amount of $109,298, or 254.4%, from $42,958 in 1995 to $152,256 in 1996. The beneficial increase in revenue for 1996 was achieved with minimal advertising and marketing effort.

Revenue earned from government grants also increased approximately threefold from $109,820 in 1995 to $185,564 in 1996. All of the aforementioned grant revenue was used to fund research on the Company's proprietary technologies.

Management asserts that increases in revenues were attributable to the Company's enhanced reputation in the industry and to more effective advertising activities. These activities included the introduction of a tiered pricing structure with services billed at lower rates and initial price

concessions made as a component of the Company's aggressive entry into the government and academic sectors.

Expenses

Cost of services consists primarily of labor and laboratory supplies. Cost of services increased 197.3% from $79,948 to $237,726 for the years ended December 31, 1995 and 1996, respectively. This increase was consistent with the increased growth experienced in revenue. Cost of services as a percentage of revenue was 21.6% and 24.0% in 1995 and 1996, respectively.

Sales, general and administrative expenses consist primarily of compensation and related costs, depreciation and amortization, professional fees and advertising. Sales, general and administrative expenses increased from $220,891 to $323,820, or 46.6%, in 1995 and 1996, respectively. Sales, general and administrative expenses as a percentage of revenue were 59.8% and 32.7% in 1995 and 1996, respectively. The decrease in the percentage relationship of sales, general and administrative expenses to revenue was primarily attributable to cost containment measures and economies of scale realized with the growth in revenues.

Research and development costs in 1995 were primarily related to developing and improving protocols for the automated sequencing group. Research and

development costs in 1996 were related to the development of new and expanded services. Research and development costs were $69,861 and $308,484, or 18.9% and 31.2% of revenue, in 1995 and 1996, respectively. The increase of $238,623 in 1996 research and development costs represented an increase of 341.6% over the amount reported for 1995. Most of these costs, however, were funded by grant awards from government sources.

Year 2000 Project

The year 2000 presents problems for businesses that are dependent on computer hardware and software to perform date dependent calculations and logic comparisons. A great deal of software and microchip technology was developed utilizing two digit years rather than four digit years (example: 97 instead of 1997). Technology utilizing two digit years will most likely not be able to distinguish the year 2000 from 1900, and therefore may shut down or perform miscalculations and comparisons as much as 100 years off.

Management is fully aware this presents a potential business disruption, and has begun a program of due diligence in addressing the impact of the Year 2000 on the Company and its operations. Once identified, areas of exposure will be prioritized as to severity and time to cure, with a plan developed to make the Company Year 2000 compliant. Management anticipates the Company will be year 2000 compliant.

Forward-Looking Statements

Management has included herein certain forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. When used, statements which are not historical in nature, including the words "anticipate," "estimate," "should," "expect," "believe," "intend," and similar expressions are intended to identify forward-looking statements. Such statements are, by their nature, subject to certain risks and uncertainties. Among the factors that could cause actual results to differ materially from those projected are the following: business conditions and the general economy; the federal, state, and local regulatory environment; availability of tax exempt bond financing with favorable terms and conditions; lack of demand for the Company's services; the ability of the Company's customers to perform services similar to those offered by the Company "in-house"; and potential cost containment by the Company's customers resulting in fewer research and development projects. Other risks, uncertainties, and factors that could cause actual results to differ materially from those projected are detailed form time to time in reports filed by the Company with the securities and exchange commission, including Forms 8-K, 10-QSB, and 10-KSB.

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REPORT OF INDEPENDENT AUDITORS

Board of Directors and Stockholders

Commonwealth Biotechnologies, Inc.

We have audited the accompanying balance sheets of Commonwealth Biotechnologies, Inc. (the Company) as of December 31, 1997 and 1996, and the related statements of operations, changes in stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Commonwealth Biotechnologies, Inc. at December 31, 1997 and 1996, and the results of its operations and cash flows for the years then ended in conformity with generally accepted accounting principles.

GOODMAN AND COMPANY, LLP

7301 Forest Avenue
Richmond, Virginia
February 9, 1998

COMMONWEALTH BIOTECHNOLOGIES, INC.
BALANCE SHEETS

December 31,	1997	1996
	<C>	<C>
ASSETS		
Current assets		
Cash and cash equivalents	$ 6,273,765	$ 260,357
Accounts receivable	153,090	116,437
Interest receivable	137	0
Prepaid expenses	56,174	1,080
Inventory	6,799	0
Total current assets	6,489,965	377,874
Property and equipment, net	1,435,812	243,611
Other assets		
Organization costs, net	829	3,183
Deposits	5,000	9,525
Total other assets	5,829	12,708
	$ 7,931,606	$ 634,193
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 279,570	$ 48,944
Current portion of long-term debt	30,000	37,293
Demand note	314,680	0
Deferred revenue	0	200,000
Total current liabilities	624,250	286,237
Long-term debt	0	185,687
Total liabilities	624,250	471,924
Stockholders' equity		
Common stock, no par value, 10,000,000 shares authorized, 1,620,514 and 71,273 shares issued and outstanding, respectively, at December 31, 1997 and 1996	760	760
Additional paid in capital	8,761,704	134,662
Retained earnings (deficit)	(1,455,108)	26,847
Total stockholders' equity	7,307,356	162,269
	$ 7,931,606	$ 634,193

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

COMMONWEALTH BIOTECHNOLOGIES, INC.
STATEMENTS OF OPERATIONS

For the Years Ended December 31,	1997	1996
Revenue		
Laboratory services	$ 853,810	$ 482,586
Contract research	561,007	326,776
Government grants	346,491	180,563
Total revenue	1,761,308	989,925
Costs and expenses		
Cost of services	794,236	237,726
Sales, general and administrative	1,297,005	323,820
Research and development	574,859	308,484
Total cost and expenses	2,666,100	870,030
Operating income (expense)	(904,792)	119,895
Other income (expense)		
Loan fees	(124,918)	0
Interest expense	(231,108)	(10,102)
Interest income	91,997	295
Total other income (expense)	(264,029)	(9,807)
Net income (loss)	$ (1,168,821)	$ 110,088
Earnings (loss) per common share	$ (3.55)	$ 1.54
Weighted average common shares outstanding	329,480	71,273

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

COMMONWEALTH BIOTECHNOLOGIES, INC.
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Number of Shares Outstanding	Common Stock	Additional Paid-In Capital	Retained Earnings (Deficit)	Total
Balance at January 1, 1996	71,273	760	65,604	(3,708)	62,656
Net income	0	0	0	110,088	110,088
Contributed services	0	0	69,058	0	69,058
Distributions	0	0	0	(79,533)	(79,533)
Balance at December 31, 1996	71,273	760	134,662	26,847	162,269
Contributed services for the six months ended June 30, 1997	0	0	36,346	36,346	
Distribution to shareholders through June 30, 1997	0	0	0	(96,851)	(96,851)
Effects of conversion to C Corporation	0	0	216,283	(216,283)	0
Purchase of warrants by founding shareholders	0	0	100	0	100
Conversion of convertible subordinated notes to common stock at a conversion price of $6.00 share, net of unamortized costs	500,000	0	2,751,187	0	

2,751,187					
Effects of initial public offering (IPO) of 1,015,000 shares of common stock at $6.00 per share, net of costs	1,015,000	0	5,417,578	0	5,417,578
Effect of interest expense on convertible notes paid in common stock at $6.00 per share	34,241	0	205,446	0	205,446
Purchase of warrants by underwriters of IPO	102	0	102		
Net loss for the year ended December 31, 1997	0	0	0	(1,168,821)	(1,168,821)
Balance at December 31, 1997	1,620,514	$ 760	$ 8,761,704	$ (1,455,108)	$ 7,307,356

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

COMMONWEALTH BIOTECHNOLOGIES, INC.
STATEMENTS OF CASH FLOWS

Years Ended December 31,	1997	1996
Cash flows from operating activities		
Net income (loss)	$ (1,168,821)	$ 110,088
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	283,471	54,382
Issuance of common stock for interest on convertible notes	205,446	0
Contributed services	36,346	69,058
Changes in:		
Accounts receivable	(36,653)	(37,422)
Interest receivable	(137)	0
Prepaid expenses	(55,094)	(1,080)
Inventory	(6,799)	0
Accounts payable	230,626	15,940
Deferred revenue	(200,000)	198,170
Total adjustments	457,206	299,048
Net cash provided by (used in) operating activities	(711,615)	409,136
Cash flows from investing activities		
Purchases of property and equipment	(1,348,400)	(194,798)
Deposits	4,525	(9,125)
Net cash used in investing activities	(1,343,875)	(203,923)
Cash flows from financing activities		
Proceeds from issuance of long-term debt	488,161	231,000
Principal payments on long-term debt	(366,461)	(33,578)
Principal payments on capital lease obligations	0	(63,860)
Shareholder distributions	(96,851)	(79,533)
Proceeds from IPO of common stock, net of costs	5,417,578	0
Purchase of warrants by founding shareholders	100	0
Purchase of warrants by underwriter	102	0
Proceeds from issuance of convertible subordinated notes, net of deferred loan costs	2,626,269	0
Net cash provided by financing activities	8,068,898	54,029
Net increase in cash and cash equivalents	6,013,408	259,242
Cash and cash equivalents, beginning of year	260,357	1,115
Cash and cash equivalents, end of year	$ 6,273,765	$ 260,357
Supplemental disclosure of cash flow information		
Cash paid during the year for interest	$ 27,069	$ 10,102

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

COMMONWEALTH BIOTECHNOLOGIES, INC.
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 1997

NOTE 1 -- ORGANIZATION

Commonwealth Biotechnologies, Inc., (the "Company"), was formed on September 30, 1992 as a Virginia Subchapter S Corporation, for the purpose of providing specialized analytical laboratory services for the life scientist. The Company provides basic research services in the general areas of protein/peptide and DNA/RNA chemistries. Such services include synthesis, sequence analysis, composition analysis, protein purification and biophysical characterization of biologically relevant materials. The Company also pursues its own research and development leading to intellectual properties. In June 1997, the company altered its taxable status to a corporation governed by Subchapter C of the Internal Revenue Code.

NOTE 2 -- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Revenue Recognition

The Company recognizes revenue and related profit upon the completion of laboratory service projects, or upon the delivery and acceptance of biologically relevant materials that have been synthesized in accordance with project terms. Laboratory service projects are generally administered under fee-for-service contracts or purchase orders. Any revenues from research and development arrangements, including corporate contracts and research grants, are recognized pursuant to the terms of the related agreements as work is performed, or as scientific milestones, if any, are achieved. Amounts received in advance of services to be performed, or acceptance of milestones, are recorded as deferred revenue.

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

Property and Equipment

Property and equipment are recorded at cost. Depreciation and amortization expense is recorded over the estimated useful lives of the assets. The straight-line method is used by the Company in providing depreciation and amortization for financial reporting purposes. The cost of repairs and maintenance is expensed as incurred. The estimated useful lives of assets are as follows:

Laboratory and computer equipment	30 months to 5 years
Furniture and fixtures and office equipment	7 years
Automobile	5 years

Other Assets

Other assets consist of the organizational costs associated with the formation of the Company and are amortized over five years.

Inventory

Inventory is stated at the lower of cost (first-in, first-out method), or market.

Income Taxes

The Company elected Subchapter S Corporation status effective January 1, 1993. Accordingly, the taxable income of the Company has been "passed-through" to its shareholders, and they have been subject to the tax on any income earned by the Company.

As more fully described in Note 13, the Company organized a private placement offering of convertible subordinated notes, which caused the income tax status of the Company to change. Management believes that the Company is no longer eligible for S Corporation status effective June 25, 1997. Therefore, at June 25, 1997, the undistributed earnings were treated as a constructive distribution to the original shareholders and as a contribution to additional paid-in capital. As a C Corporation, the Company will be responsible for income taxes payable resulting from earnings subsequent to June 25, 1997. Additionally, under the provisions of Financial Accounting Standards Board ("FASB") Statement No. 109, Accounting for Income Taxes, deferred tax assets and liabilities are computed based on the

difference between the financial statement and tax bases of assets and liabilities using currently enacted tax rates.

At December 31, 1997, the Company's deferred taxes consist of differences attributable to the cash basis of accounting and accelerated methods of depreciation used for income tax purposes. The Company also has loss carryforwards for tax return purposes.

Research & Development

Costs incurred in connection with research and development activities are expensed as incurred. These consist of direct and indirect costs associated with specific research and development projects.

Advertising Costs

The Company expenses all advertising costs as incurred. Total advertising expense for the years ended December 31, 1997 and 1996 was $61,248 and $25,008, respectively.

Earnings (Loss) Per Common Share

The Company adopted FASB Statement No. 128, Earnings Per Share, on December 31, 1997. This statement establishes standards for computing and presenting earnings per share (EPS). This statement supersedes standards previously set in APB Opinion No. 15, Earnings Per Share. The statement requires dual presentation of basic and diluted EPS on the face of the income statement, and it requires a reconciliation of the numerator and denominator of the basic EPS with the numerator and denominator of the basic EPS with the numerator and denominator of the diluted EPS computation.

Basic EPS excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

In computing diluted EPS, only potential common shares that are dilutive -- those that reduce earnings per share -- are included. The exercise of options and warrants or conversion of convertible securities is not assumed if the result would be antidilutive, such as when a loss from continuing operations is reported. Consequently, the effect of options, warrants and convertible notes is not considered in computing diluted EPS and, therefore, basic and diluted EPS are the same.

Credit Risk

The Company provides laboratory services primarily to researchers in North America (United States, Canada). Other major clients are located in South America (Brazil, Colombia), in the far east (Japan, Korea), and in Europe (Norway, Sweden, Germany, Italy, France, Greece). For projects exceeding $5,000, the Company mitigates its credit risk by requiring a deposit of 50% of total anticipated billings. The Company performs ongoing credit evaluations of its customers and generally does not require additional collateral on its laboratory services. However, the Company provides a charge to bad debts when, in the opinion of management, such balances are not deemed to be collectible.

The Company invests its excess cash in high quality commercial paper, U.S. Government Agency discount notes and certificates of deposits which are administered by an institutional investment firm. Their balances are insured up to $500,000 (with a limit of $100,000 for cash) by the Securities Investor Protection Corporation (SIPC). The institutional firm has private insurance in addition to the SIPC, which provides additional protection to the Company. In addition, excess bank account balances are invested in overnight deposits managed by a financial institution. At times these deposits may exceed the federally insured limits of the financial institution.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

NOTE 3 -- PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at December 31:

	1997	1996
Laboratory and computer equipment	$ 1,662,346	$ 359,476
Furniture and fixtures	3,754	1,925
Office equipment	30,971	11,908
Automobile	24,637	--
Leasehold improvements	5,075	5,075
	1,726,783	378,384
Less accumulated depreciation and amortization	(290,971)	(134,773)
Property and equipment, net	$ 1,435,812	$ 243,611

Depreciation expense for the years ended December 31, 1997 and 1996, amounted to $156,198 and $51,936, respectively.

NOTE 4 -- DEMAND NOTE

On November 4, 1997, the Company consolidated it's debt through a demand note payable with Crestar Bank in the amount of approximately $320,000, which bears interest payable at the bank's prime rate plus 1%. The note is collateralized by a security interest in the Company's accounts receivable, chattel paper, equipment and intangibles. As of December 31, 1997, the balance due was $314,680.

NOTE 5 -- LONG-TERM DEBT

Long-term debt at December 31, 1997 and 1996, consists of:

	1997	1996
Term note payable at an interest rate of 8.75% to Crestar Bank, collateralized by a security interest in the Company's accounts receivable, chattel paper, equipment and intangibles, and due in equal monthly payments of principal and interest of $4,150 through October 2001. This noted was incorporated in the consolidation financing noted above.	$ --	$ 19,298
Enterprise Zone incentive loan payable to the City of Richmond, collateralized by equipment and due in ten annual installments of $3,000 plus interest at 3% beginning in September 1997. Enterprise Zone incentive loans provide for an alternative means of		

repayment in lieu of cash. Each year, any increase over 1996 in real estate, machinery and tools, and business licenses taxes will directly curtail, on a dollar for dollar basis, the interest and then principal payments on the loan.	30,000	30,000
	30,000	222,980
Less -- current portion of long-term debt	(30,000)	(37,293)
	$ --	$ 185,687

NOTE 6 -- CAPITAL LEASE OBLIGATIONS

The Company acquired, in January 1994, certain computer equipment for its laboratory from Hewlett Packard Company under a capital lease in the amount of $104,500. The lease terms called for monthly lease payments of $2,049 to be made through December 1998 at an implicit lease rate of 8.44%. The lease was paid off during 1996. Accumulated depreciation and depreciation expense on the assets subject to capital lease amounted to $83,600 and $20,900, at December 31, 1997 and 1996, respectively.

NOTE 7 -- COMMITMENTS AND CONTINGENCIES

Leases

During 1997 and 1996, the Company was engaged in a noncancellable operating lease for its laboratory and office space from the Virginia Biotechnology Research Park in Richmond, Virginia as a sub-landlord for the City of Richmond. The monthly rental payment through the culmination of the lease, at June 30, 1997, was $691.

Beginning July 1, 1997, the Company leased its current laboratory and office space directly from the City of Richmond. The monthly rental payment will increase to $3,222. The initial term of the lease will extend through June 30, 2000, however, either party may cancel the lease with nine months notice.

As of January 1, 1998, the Company began leasing two suites from the Virginia Biotechnology Research Park located in the Biotech One building. The monthly rental payment is $6,069. The term of the lease is through May 31, 1998, at which time, it may be renewed for additional ninety day increments.

The Company also leases certain of its office equipment under a noncancellable lease agreement which expires in February 2001.

Future minimum payments under these noncancellable operating leases are as follows:

1998	$ 73,140
1999	42,794
2000	23,460
2001	688
2002	--
	$ 140,082

Total rent expense for all operating leases for each of the years ended December 31, 1997 and 1996, was $69,141 and $8,291, respectively.

Sales Commitments

In December 1996, the Company entered into a contract with one customer to perform structural studies on a proprietary protein product totaling approximately $200,000, which was recorded as deferred revenue at year-end.

At December 31, 1997 and 1996, the Company is performing services under contract with several companies. These companies include Insmed Pharmaceuticals (Richmond, Virginia), Bayer Corporation (Clayton, North Carolina, Raleigh, North Carolina, West Haven, Connecticut and Berkeley, California), Breastek, Inc. (Charleston, South Carolina) and Somatix Therapeutics Corporation (Alameda, California). The company is the major biochemistry subcontractor to a

grant issued by the University of New Mexico, Department of Chemical and Nuclear Engineering at Albuquerque, New Mexico.

Sponsored Research Contract and Consulting Agreement

The Company entered into a sponsored research agreement (the "Agreement") with Virginia Commonwealth University (the "University") on November 15, 1992. Unless canceled by written notification by either party, the Agreement automatically renews annually. The Agreement allows CBI personnel access to equipment located within the academic laboratories of certain professors, who are also officers of the Company. The laboratories are located on the campus of the Medical College of Virginia (an affiliate of the University). The Agreement carries a fee for service schedule, which allows for payment to the University for use of the equipment. The Company has since purchased its own equipment and reduced its dependence on the University's equipment to a level that total payments made to the University are approximately $1,200 per calendar quarter. This contract and consulting agreement ended on August 1, 1997.

NOTE 8 -- RETIREMENT PLAN

Effective October 1, 1996, the Company adopted an employee 401(k) retirement plan. Qualified employees may contribute up to 15% of their gross pay to the plan. Employee contributions are limited to amounts established

by law. The Company may make matching contributions to the plan as determined by the Board of Directors subject to the limitations under the Internal Revenue Code. The Company made no contributions to the Plan in 1996 or 1997.

NOTE 9 -- MAJOR CUSTOMERS

During 1997 and 1996, the Company had the following revenue concentrations that exceeded 10% of total revenue:

	1997	1996
Bayer Pharmaceuticals, AG	$ 377,932	$
Small Business Technology Transfer Research Grant Phase II	226,239	63,773
Small Business Technology Transfer Research 2 Grant Phase I	--	90,766
Small Business Technology Transfer Research 3 Grant Phase I	--	26,025
University of New Mexico Grant	--	124,423

These contracts represented 40.91% and 30.81% of total revenue in 1997 and 1996, respectively.

NOTE 10 -- COMPENSATION AND BENEFIT COSTS

Compensation and benefit costs are included in the statements of operations as follows:

	1997	1996
Cost of services	$ 338,994	$ 104,703
Selling, general and administrative expenses	620,721	112,983
Research and development costs	361,925	170,415
- ----------	----------	---------
	$ 1,321,640	$ 388,101

NOTE 11 -- INCOME TAXES

The difference between expected income tax expense (benefit) and income tax expense recorded in the financial statement is explained below.

	1997
Income taxes computed at 34% statutory rate	$ (397,399)

Statutory limitations of loss carryovers	381,472
Contributed services	12,358
Other	3,569
Income tax expense	$ --

The significant components of deferred income tax assets and liabilities as of December 31 consist of the following:

	1997
Deferred tax assets:	
Effect of net operating loss	$ 463,329
Accrual basis to cash basis conversion	41,629
	504,958
Deferred tax liabilities:	
Tax depreciation in excess of book depreciation	(75,860)
Net deferred tax asset before valuation allowance	429,098
Less -- valuation allowance	(429,098)
Net deferred tax asset	$ --

Tax return operating loss carryforwards were approximately $1,122,000 at December 31, 1997.

NOTE 12 -- FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company has determined, based on available market information and appropriate valuation methodologies, that the fair value of its financial instruments approximates carrying value. The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term maturity of the instruments. The carrying amounts of debt approximates fair value because the interest rates under the credit agreement are predominantly variable, based on current market conditions.

NOTE 13 -- PRIVATE PLACEMENT AND INITIAL PUBLIC OFFERING ("IPO")

On June 24, 1997, the Company declared a 93.78-for-1 stock split which has been retroactively reflected in the accompanying financial statements.

On June 25, 1997, the Company sold 60 convertible subordinated notes ("notes"), with a principal amount of $50,000, in a private placement offering at an offering price of $50,000 per note. Each note bears interest at the rate of 20% and is payable upon the conversion of the note into shares of the Company's common stock. Interest was paid through the date of the conversion in the form of additional shares of common stock, which were issued based on a conversion price of $6.00 for each share of common stock. Each note was automatically converted into a minimum of 8,333.33 shares of the Company's common stock, upon the earlier of the closing of the Company's proposed IPO, or on June 25, 1998, the maturity date. Upon conversion, the actual number of shares issued equaled the principal amount of the notes

plus accrued interest divided by the stated conversion price of $6.00. The Company received net proceeds of $2,626,269, after underwriting and other offering costs of $373,731.

Upon the closing of the private placement offering, the Company issued warrants to members of Management for the purchase of 100,000 shares of common stock. The warrants were issued to the management team at $.001 per share, and will be exercisable for a period of ten years at an exercise price of $9.90 per share.

On July 21, 1997, the Company filed a Form SB-2 Registration Statement with the Securities and Exchange Commission for the sale of 1,015,000 shares of common stock. The proceeds are expected to be used to acquire laboratory equipment, additional personnel, expand existing facilities, expand marketing and advertising and fund working capital. On October 25, 1997, the Company closed the IPO and received net proceeds of $5,417,578, after underwriting and other offering costs of $672,422. On October 29, 1997, the Company began trading on the NASDAQ exchange using the symbol "CBTE".

On November 13, 1997, Anderson & Strudwick (the "Underwriters") purchased warrants for 101,500 shares of common stock. The warrants were issued to the Underwriter at $.001 per share, and will be exercisable for a period of five years at an exercise price of $9.90 per share.

NOTE 14 -- STOCK COMPENSATION

The Company adopted its Incentive Plan (the "Plan") on June 24, 1997. The Incentive Plan provides for the granting to employees, officers, directors, consultants and certain non-employees of the Company of options to purchase shares of common stock. The maximum number of shares of common stock that may be issued pursuant to options under the Plan is 410,000. This amount is subject to adjustment in the event of a stock split, stock dividend or other change in the common stock or capital structure of the Company. Of the maximum number of shares to be issued under the Plan, 270,000 will be reserved for incentive awards to be granted to the four founders of the Company, and 140,000 shares will be reserved for incentive awards to be granted to other persons.

Incentive awards may be in the form of stock options, restricted stock, incentive stock or tax offset rights. In the case of incentive stock options or non-qualified stock options, the exercise price will not be less than 100% of the fair market value of shares covered at the time of the grant. Options granted under the Plan generally vest over a five year period from the date of grant and are exercisable for ten years, except that the term may not exceed five years for incentive stock options granted to persons who own more than 10% of the Company's outstanding common stock.

The Company applies APB Opinion No. 25 and related accounting interpretations in accounting for its Plan and, accordingly, no compensation cost has been recognized. Had compensation cost for the Company's Plan been determined based on the fair value at the grant dates for awards under the Plan consistent with the method prescribed by FASB No. 123, Accounting for Stock-Based Compensation, the Company's net income and earnings per share would have been reduced to the proforma amounts indicated below as if the Plan had been in effect for the periods presented:

	December 31, 1997
Net income (loss)	
As reported, historically	$ (1,168,821)
Proforma	$ (1,330,841)
Earnings (loss) per common share	
As previously reported, historically	$ (3.55)
Proforma	$ (4.04)

Under FASB No. 123, the fair value of each management warrant is estimated on the date of grant using the Black-Scholes option pricing model. The following assumptions were used for grants made during 1997: No dividend yield, expected volatility of 34%, risk free interest rate of 5.5%, and expected lives of 5 years.

Stock option transactions are summarized as follows:

	1997	Weighted Average Exercise Price Per Share
Options outstanding -- beginning of year	--	$ --
Granted	314,400	8.80
Exercised	--	--
Lapsed	--	--
Options outstanding -- end of year	314,400	$ 8.80
Options exercisable -- end of year	77,564	$ 6.69

The following table summarizes information about stock options outstanding at December 31, 1997:

<TABLE>
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Options Outstanding				Options Exercisable	
Exercise Prices Per Share	Number Outstanding	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price Per Share	Number Exercisable	Weighted Average Exercise Price Per Share
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$ 6.00	107,400	10	$ 6.00	70,109	$ 6.00
$ 8.25	7,000	10	$ 8.25	--	$ 8.25
$ 9.90	200,000	8	$ 9.90	7,455	$ 9.90
$ 6.00-9.90	314,400	9	$ 8.80	77,564	$ 6.37

</TABLE>

NOTE 15 -- EMPLOYMENT AGREEMENTS

On June 24, 1997, the Company entered into employment agreements with its four founders. Each of the agreements has a term of five years with specified base salaries and provide for successive one-year terms. In addition, except for 1997, the employment agreements provide the Company's executive officers with annual bonuses equal to, in the aggregate, 15% of the Company's pre-tax net income for the preceding fiscal year. For the fiscal year ending December 31, 1997, the bonuses for the Company's executive officers were $150,000.

In connection with the aforementioned employment agreements, the Company has recognized the fair value for services rendered by its founders in its financial statements. The financial statement recognition is achieved by reflecting a charge against income for contributed services and a contribution to additional paid-in capital for all of the periods presented. The fair value of the charges have been established based on the approximate number of hours worked by the Company's founders annually, and application of a base hourly rate that increases approximately 5% annually to the approximate hourly rate reflected in the agreement applied at June 24, 1997.

The contributed services charged against income amounted to $36,346 and $69,058 for the years ended December 1997 and 1996, respectively. Of these amounts, the charges allocated to sales, general and administrative expenses the years ended December 31, 1997 and 1996, were $33,173 and $63,029, respectively. The contributed services allocated to research and development costs for the years ended December 31, 1997 and 1996, were $3,173 and $6,029, respectively.

NOTE 16 -- SUBSEQUENT EVENT

During January 1998, the Company announced that they will be locating to a new 30,000 square foot state-of-the-art laboratory facility located in Chesterfield County, Virginia. The Company has already received approval from the Industrial Development Authority and the Board of Supervisors of Chesterfield County, Virginia to issue $4,000,000 of Industrial Revenue Bonds. An inducement resolution has been approved by the Virginia Small Business Financing Authority. Final approval to issue the Bonds is expected in mid-February. The Company anticipates ground breaking in mid-March, 1998, with occupancy expected to occur in mid to late third quarter of 1998.

* * * * *

The Executive Officers and Board of Directors

Executive Officers

Richard J. Freer, Ph.D.
Chairman of the Board

Robert B. Harris, Ph.D.
President

Gregory A. Buck, Ph.D.
Senior Vice President and
Chief Scientific Officer

Thomas R. Reynolds,
Senior Vice President

Directors

Richard J. Freer, Ph.D.
Chairman of the Board

Robert B. Harris, Ph.D.
President

Gregory A. Buck, Ph.D.
Vice President, Chief Scientific Officer, and Secretary

Thomas R. Reynolds
Vice President

Charles A. Mills
Director and CEO, Anderson & Strudwick, Inc.

Peter Einselen
Director and Senior Vice President, Anderson & Strudwick, Inc.

Corporate Information

[Company photo -- employees]

The Company owes its success to the loyalty, dedication, and commitment of its employees.

Corporate Office:

Commonwealth Biotechnologies, Inc.
911 East Leigh St., Suite G-19
Richmond, VA 23219
phone: 800-735-9224; 804-648-3820
fax: 804-648-2641
email: cbi@i2020.net
web site: www.cbi-biotech.com

General Counsel

LeClair Ryan,
A Professional Corporation
707 East Main St, 11th Floor
Richmond, VA 23219

Transfer Agent and Registrar

American Securities Transfer and Trust, Inc.,
938 Quail St., Suite 101
Denver, CO

Independent Auditors

Goodman and Company, LLP
7301 Forest Ave.
Richmond, VA 23226

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THE FINANCIAL DATA SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION
EXTRACTED FROM THE COMPANY'S BALANCE SHEET AND STATEMENT OF OPERATIONS
FOR DECEMBER 31, 1997 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO
SUCH FINANCIAL STATEMENTS.
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