

PAION Q2#2005

Interim Report of the Second Quarter 2005
And the First Half-Year 2005

Content

Management Report for the First Half-Year 2005	3
Overview	3
IPO and share price development	3
Research and development overview	4
Net assets, financial position and results of operations	6
Personnel development	9
Changes in Supervisory Board Composition	9
Significant events occurring after the balance sheet date	10
Outlook	11
Consolidated balance sheet	12
Consolidated profit and loss statement	14
Consolidated cash flow statement	15
Consolidated statement of changes in equity	16
Selected notes to the interim financial statements as of 30 June 2005	17
Report of the Supervisory Board	18

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Important Events of the First Half-Year 2005

- Successful IPO resulting in an inflow of funds of EUR 46m leads to sustainable improvement of equity ratio
- Publication of the positive outcome of the DEDAS clinical Phase II study at International Stroke Conference, New Orleans, USA
- Start of Phase III clinical study for Desmoteplase in acute ischaemic stroke together with Forest
- Presentation of the combined analysis of DIAS and DEDAS Phase II results at the European Stroke Conference in Bologna, Italy
- Start of clinical interaction and safety studies for Enecadin (neuroprotectant)

Key figures

(all figures in EUR k unless otherwise noted)	Q2 2005 (unaudited)	Q2 2004* (unaudited)	1. half-year '05 (unaudited)	1. half-year '04* (unaudited)
Revenues	338	16,296	701	16,296
Research and development expenses	-2,610	-1,757	-5,616	-3,069
General and administrative expenses	-1,102	-2,423	-1,987	-2,885
Selling and marketing expenses	-548	-250	-774	-349
Net result for the period	-3,932	10,796	-7,740	8,971
Earnings per share in EUR for the period (undiluted)	-0.25	1.21	-0.54	1.00
Earnings per share in EUR for the period (diluted)		1.21		1.00
Net cash from operating activities			-6,850	-9,452
Net cash used in investing activities			-201	-754
Net cash from financing activities			40,343	10,033
Average number of group employees			59	44

	06/30/2005 (unaudited)	12/31/2004 (audited)
Intangible assets	1,904	1,939
Cash and cash equivalents	54,180	20,889
Equity	49,243	15,312
Non-current liabilities	4,341	4,076
Balance sheet total	59,000	25,670
Equity ratio	83.5%	59.6%

* The comparative figures for the period 1/1/2004 to 6/30/2004 relate to PAION Deutschland GmbH.

Management report for the first half-year 2005

Overview

In February, PAION was the first German company in 2005 that successfully conducted an IPO, the proceeds of which amounted to EUR 46 million. The second quarter was characterised by intensive negotiations with a number of potential cooperation partners regarding the out-licensing of Desmoteplase for Europe, Asia and all other territories except North America, where Forest Laboratories Inc. (Forest) holds the marketing and development rights. In early July 2005, this process came to a successful end by the signing of a licensing agreement between PAION and H. Lundbeck A/S, Valby-Copenhagen, Denmark (Lundbeck). Under the terms of the agreement, PAION will receive milestone payments of up to EUR 65 million, development costs funding plus revenue-based license fees or 50% profit split, respectively. By this agreement, PAION has achieved to further improve its risk structure and liquidity in a sustainable way.

Research and development activities in the first half-year 2005 were advanced according to plan. In early February, the results of the successful Phase II clinical study DEDAS for Desmoteplase in acute ischaemic stroke were published. Shortly afterwards, the joint Phase III clinical study with our collaboration partner Forest was initiated. Drug interaction and safety studies for Enecadin were started in the second quarter 2005, too. These studies shall provide additional data to Enecadin's safety profile.

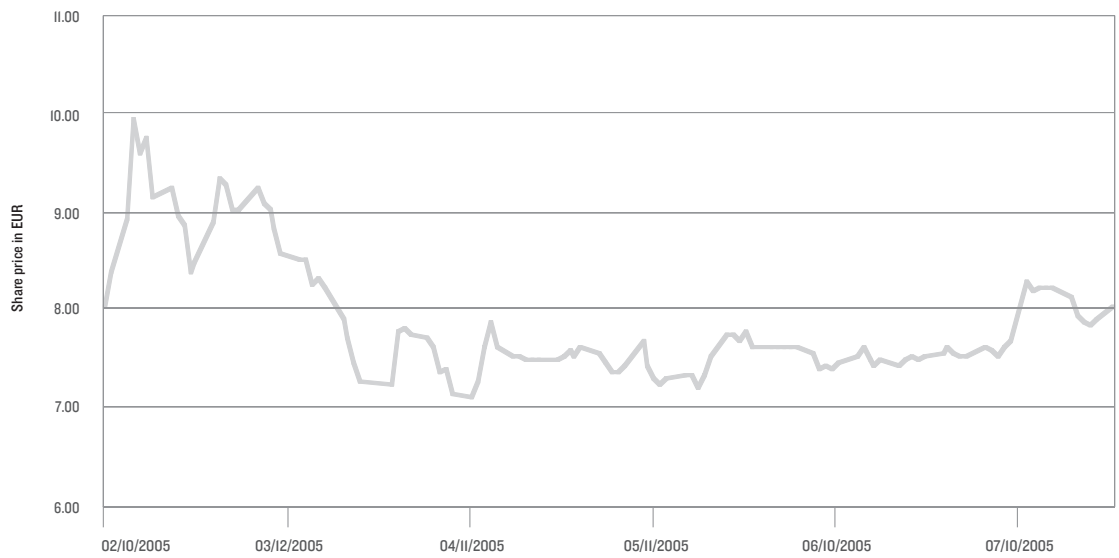
IPO and share price development

PAION shares were first traded at the Frankfurt Stock Exchange on 11 February 2005. At the first trading day, the stock, which is listed at the Prime Standard segment of the official market, closed at EUR 8.35 (Xetra) which was well above the issuing price of EUR 8.00.

After the initial placement of 5,000,000 shares, additional 750,000 shares were allocated by fully exercising the over-allotment option (greenshoe). The total proceeds of the IPO amounted to EUR 46 million. Currently, the freefloat amounts to 36.5%. The Management Board Members Mariola and Wolfgang Söhngen have agreed to a voluntary lock-up period of 12 months, while a six-months lock-up period applies for all other pre-IPO shareholders.

In the first days of trading, the trading volume in PAION shares was very high and the share price increased by up to 24.1% but declined afterwards. On 30 June 2005 the Xetra closing price was EUR 7.50. Initially after the publication of the Lundbeck Agreement on 11 July 2005, the PAION share gained significantly and, on 25 July 2005 a Xetra closing price of EUR 8.00 was recorded. The average daily trading volume at that date was 56,336 shares. Adjusted by the very high trading volume within the first four days totalling 3,506,358 shares, the average daily trading volume amounted to 27,042 shares.

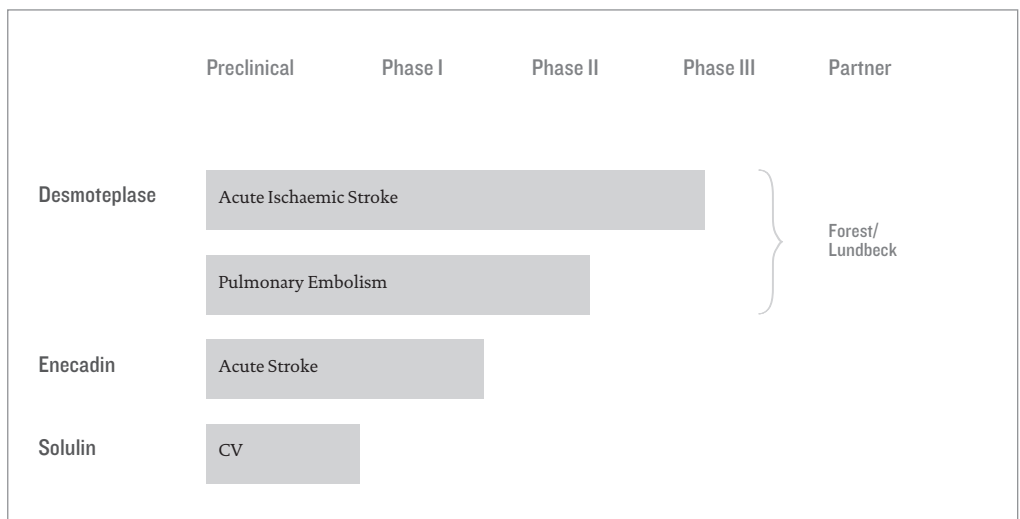
PAION share price development



Research and development overview

PAION focuses its research and development activities on the three drugs Desmoteplase, Enecadin and Solulin.

PAION's Development Pipeline



PAION's most advanced drug is Desmoteplase, an intravenously administered therapeutic, which is being developed primarily for the causal treatment of acute ischaemic stroke. Desmoteplase belongs to a group of substances that are able to dissolve blot clots, the so-called plasminogen activators. To date, two Phase II clinical studies have been successfully conducted regarding the treatment of acute ischaemic stroke with Desmoteplase. These studies were dubbed Desmoteplase In Acute ischaemic Stroke (DIAS) and Dose Escalation study of Desmoteplase In Acute ischaemic Stroke (DEDAS). In January 2005, the results of the DIAS study were published in the *STROKE* journal while the DEDAS results were presented in February 2005 at the International Stroke Conference in New Orleans, USA. A combined analysis of both DIAS and DEDAS was presented on 28 May 2005 at the European Stroke Conference in Bologna, Italy. The DEDAS results confirm the positive results for the best dosage of the DIAS study. In spring 2004, Desmoteplase was assigned fast-track status by the US Food and Drug Administration (FDA) for the indication acute ischaemic stroke.

Based on a study protocol that was discussed with the FDA, a clinical Phase III study of Desmoteplase in acute ischaemic stroke was started as planned in February 2005 together with PAION's collaboration partner and licensee Forest. For this study, MRI (magnetic resonance imaging) as well as perfusion computer tomography (PCT) can be used for inclusion of patients and diagnostics. Perfusion CT is a diagnostic technique that allows to visualise blood flow in the brain using a contrast agent. Thus, potentially salvageable brain tissue (penumbra) can be detected by using computer tomographs which are more widely available and less expensive than MRI. Due to regulatory reasons, PAION plans to conduct a security study to broaden the safety profile of Desmoteplase in the fiscal year 2005. The respective study protocol has already been filed with the FDA.

In 2004, apart from the clinical studies regarding the efficacy of Desmoteplase in stroke, PAION initiated the DEPTH study (DEsmoteplase in Pulmonary THromboembolism). This Phase II study is currently being conducted in Germany, Hungary and Russia and aims at evaluating the safety and efficacy of intravenously administered Desmoteplase in patients with acute pulmonary embolism. Preliminary data suggest a dose-dependant improvement of lung function by Desmoteplase. Completion of this study is anticipated within the current fiscal year.

Enecadin is also part of PAION's pipeline. The substance was inlicensed from Nippon Shinyaku Co., Ltd., Kyoto, Japan, during the fiscal year 2004. Enecadin is a so-called neuroprotectant which improves the chance of survival for brain cells which have no adequate blood supply. It will thus be tested for treatment of secondary effects within acute ischaemic stroke and is also planned to be developed in combination with Desmoteplase. PAION has already conducted pre-clinical studies with Enecadin. In the second quarter of 2005, drug interaction and safety studies were started in order to provide additional data to Enecadin's safety profile. In the second half of 2005, the entry into clinical Phase II is planned.

PAION's portfolio is further enhanced by Solulin, an anti-inflammatory thrombin modulator, or "intelligent anticoagulant", which could prove useful for the prevention of restroke in the acute time window of ischaemic stroke or for the treatment of other thrombotic diseases. Currently, PAION is conducting animal trials with Solulin. In the second half of 2005, the start of a Phase I clinical study is anticipated.

Net assets, financial position and results of operations

Results of operations

The comparability of the current reporting periods, the second quarter 2005 and the first half-year 2005, with the prior year's reporting periods is limited because the prior year's reporting periods were significantly influenced by the income and expenses resulting from the license agreement with Forest dated 30 June 2004. The impact on the results of operations from the license agreement with Lundbeck will be considered in the interim financial statements on the third quarter of 2005 as this agreement was signed in July 2005.

After the development activities have proceeded as planned in the second quarter 2005, the net loss for the period amounts to EUR 3,932k and in the first half-year to EUR 7,740k. Thus, the development of the net result is still within plan.

EUR k	Q2 2005	Q2 2004	1. half-year '05	1. half-year '04
Revenues	338	16,296	701	16,296
Cost of Revenues	-323	-1,273	-688	-1,273
Gross profit	15	15,023	13	15,023
Research and development expenses	-2,610	-1,757	-5,616	-3,069
General and administrative expenses	-1,102	-2,423	-1,987	-2,885
Selling and marketing expenses	-548	-250	-774	-349
Other income (expenses)	40	-221	159	-210
Operating expenses	-4,220	-4,651	-8,218	-6,513
Operating result	-4,205	10,372	-8,205	8,510
Financial result	273	32	465	69
Taxes on income	0	392	0	392
Net result for the period	-3,932	10,796	-7,740	8,971

All **revenues** of the first half-year 2005 result exclusively from the reimbursement of development expenses by Forest. In the prior year's reporting period, the revenues stem also exclusively from the license agreement with Forest. These revenues were generated from the transfer of know-how (EUR 15,592k) and from proportionate realisation of a signing fee (EUR 704k).

Cost of revenues stem from the development expenses allocated to Forest. In the prior year's reporting period, cost of revenues comprised 50% of the license fees paid until 30 June 2004 for the worldwide development and marketing rights for Desmoteplase as it is assumed that the territories licensed to Forest make up 50% of the global market.

As in the prior year's period, **research and development expenses** mainly relate in the first half-year 2005 to clinical studies for Desmoteplase and the further production development for Desmoteplase. Additional expenses in the first half-year 2005 incurred mainly in relation to the preparation and execution of clinical interaction and safety studies for Enecadin as well as costs for the production development for Solulin. Research and development expenses were set off against subsidies amounting to EUR 1,513k.

The **general and administrative expenses** are lower than the corresponding expenses of the first half-year 2004. This is largely due to the fact that the expenses of the prior year's period contained a remuneration in the amount of EUR 1,668k paid to an external consultant in connection with the conclusion of the license agreement with Forest. Furthermore, the prior year's expenses include legal and consulting fees in connection with the capital increase performed during the second quarter of 2004 and the preparatory measures for the IPO. In the first-half year of 2005, the higher involvement of personnel and management resources to the IPO process and the installation respectively expansion of the investor relations and finance departments lead to increased general and administrative expenses.

Net assets and financial position

Due to the IPO, the balance sheet structure improved significantly throughout the first half-year 2005. At the cut-off date of the reporting period, 30 June 2005, the balance sheet total as well as the shareholders' equity increased significantly in comparison to the figures as of 31 December 2004. With the balance sheet total increasing by EUR 33,330k to EUR 59,000k and equity increasing by EUR 33,931k to EUR 49,243k the equity ratio improved from 59.6% to 83.5%.

EUR k	06/30/2005	12/31/2004	Change
Non-current assets	2,900	2,945	-45
Current assets	56,100	22,725	33,375
Assets	59,000	25,670	33,330
Equity	49,243	15,312	33,931
Non-current liabilities	4,341	4,076	265
Current liabilities	5,416	6,282	-866
Equity and liabilities	59,000	25,670	33,330

In the first half-year 2005, cash and cash equivalents increased by EUR 33,292k to EUR 54,180k. The cash flows stem from the following areas:

EUR k	1. half-year '05	1. half-year '04
Cash flow from operating activities	-6,850	-9,452
Cash flow from investing activities	-201	-754
Cash flow from financing activities	40,343	10,033
Change in cash and cash equivalents	33,292	-173

In the first half-year 2005, the negative cash flow from operating activities in the amount of EUR 6,850k mainly stems from research and development expenses and general and administrative expenses. Due to low investing activities within the first six months of the fiscal year 2005, the corresponding negative cash flow only amounted to EUR 201k.

The proceeds from the IPO that was conducted in February 2005 amounted to EUR 46,000k. This inflow of funds has to be set off against cash disbursements amounting to EUR 4,649k due to costs directly related to the IPO. In addition, obligations regarding a pre-IPO stock option plan of PAION Deutschland GmbH amounting to EUR 967k were settled. The overall cash flow from financing activities was positive and amounted to EUR 40,343k. In previous

year's period, the cash flow from financing activities had mainly stemmed from the cash inflow of unpaid contributions on premiums as of 31 December 2003, amounting to EUR 511k and from cash inflows of the capital increase performed during the second quarter of 2004 (EUR 9,777k).

The increase of **non-current liabilities** by EUR 265k is primarily due to the increase of the provision for the refund obligation to Forest by EUR 1,514k to EUR 2,250k. The refund obligation will arise on Desmoteplase being approved in Europe and/or Japan and relates to 50% of the costs borne directly and indirectly by Forest plus a premium of 20% of this amount. This was contrasted by the reclassification to current liabilities of a provision for the third instalment of the cash settlement (EUR 1,200k) in connection with the termination of the pre-IPO stock option plan. In addition, the non-current liabilities comprise a non-repayable signing fee totalling EUR 1,758k which was already paid by Forest and which will be recognised in profit and loss in relation to the milestones achieved as well as finance lease liabilities (EUR 245k) and government grants (EUR 88k).

The decrease of **current liabilities** in the amount of EUR 866k is mainly due to the payment of consulting fees resulting from the IPO and wage taxes and social security contributions which arose from the termination of a pre-IPO stock option plan of PAION Deutschland GmbH.

Personnel development

Following the planned expansion of development activities regarding Desmoteplase, Enecadin and Solulin, the number of PAION's employees was again increased in the second quarter 2005. On average for the first half-year, 59 employees have been working for PAION. In comparison to 2004's 12 months average figure, this marks an increase by 10. Of these 59 employees, 39 worked in research and development and 20 employees in administration and sales. It is planned to further increase the number of employees in the remaining fiscal year 2005.

Changes in Supervisory Board composition

Effective as of 25 May 2005, Prof. Dr. Erich Schlick, director and Head of the Healthcare Sector Germany with PAION's investor 3i Deutschland GmbH, has declared to resign from his Supervisory Board position at PAION in accordance with internal guidelines of 3i. As of that date, the Aachen local court (Amtsgericht) has appointed Prof. Dr. Wolfgang Blättchen to his successor and new Member of the Supervisory Board of PAION AG, thus following a unanimous nomination by the company's Supervisory Board and Management Board. Professor Blättchen is Member of the Management Board of the financial advisory firm BLÄTTCHEN & PARTNER, Leonberg-Munich, specialised in capital market transactions. Prof. Dr. Blättchen holds positions in the following boards: Marc O'Polo AG (Chairman of the Supervisory Board), tec2b AG (Chairman of the Supervisory Board), Haubrok AG (Deputy Chairman of the Supervisory Board), Horváth AG (Deputy Chairman of the Supervisory Board), Aixtron AG, Apcoa Parking AG, Gardena AG.

Significant events occurring after the balance sheet date

On 11 July 2005, PAION Deutschland GmbH signed a licensing agreement with H. Lundbeck A/S, Valby-Copenhagen, Denmark. Under the terms of the agreement, Lundbeck is granted an exclusive license for the development and marketing of Desmoteplase in the European and Japanese markets as well as for all other countries except the USA and Canada, the territories which have been already out-licensed to Forest Laboratories. Within the scope of the contract, Lundbeck has agreed to make a payment amounting to EUR 15 million which is due immediately after signing as well as additional milestone payments of up to EUR 50 million for the development of Desmoteplase in the indication of acute ischaemic stroke. The total milestone amount depends on the number of co-promotion options in major European markets that PAION chooses to exercise. Furthermore, Lundbeck has agreed to take over development costs which, among others, include PAION's repayment obligation towards Forest. These repayment obligations refer to direct and indirect costs originally borne by Forest and would be due if approval was granted in Europe and/or Japan. In addition, PAION will receive double-digit net royalties, i.e. after deduction of its own royalty obligation towards Schering, based on sales in the countries with exclusivity for Lundbeck. In countries with co-promotion, PAION will gain a 50% profit share in exchange for covering a proportional share of development which could amount to up to approximately 18% of total development costs. Thus, Lundbeck and Forest are funding the majority of the development cost for Desmoteplase which results in a further effective improvement of PAION's risk structure.

Outlook

The inflow of funds from the IPO as well as from the licensing partners Forest and Lundbeck secures the implementation of the development plan for Desmoteplase, Enecadin and Solulin far beyond the fiscal year 2005.

In total for the fiscal year 2005, PAION is going to achieve significantly higher revenues than originally planned. This is particularly due to the already received Lundbeck payment of EUR 15 million following the signing of the contract and future cost reimbursements. As from the second half-year of 2005, these cost reimbursements will lead to higher cost of revenues and thus to an appropriate reduction of development expenses. Overall, the anticipated annual net loss will be significantly reduced compared to the previous planning.

For the fiscal year 2005, PAION expects revenues of approx. EUR 21 million and research and development costs of approx. EUR 16 million leading to a negative EBIT of up to EUR 12 million. Total liquidity at the end of the year is expected to amount to approx. EUR 52 million.

Aachen, 28 July 2005

PAION AG

The Management Board

Consolidated Balance Sheet as of 30 June 2005

ASSETS	06/30/2005	12/31/2004
EUR		
Non-current assets		
Intangible assets	1,904,301.59	1,939,469.04
Equipment	995,364.60	1,005,539.22
	2,899,666.19	2,945,008.26
Current assets		
Trade receivables	488,656.40	449,968.18
Prepaid expenses and other assets	1,431,516.88	1,386,487.80
Marketable securities	35,254,802.40	0.00
Cash	18,925,376.12	20,888,829.59
	56,100,351.80	22,725,285.57
Total assets	59,000,017.99	25,670,293.83

EQUITY AND LIABILITIES	06/30/2005	12/31/2004
EUR		
Equity		
Share capital	15,755,552.00	10,005,552.00
Capital reserve	75,401,825.52	39,480,795.29
Loss carryforward	-34,174,373.72	-34,350,454.31
Net profit (loss) for the period	-7,740,464.51	176,080.59
	49,242,539.29	15,311,973.57
Non-current liabilities		
Finance lease liabilities	244,780.00	281,331.00
Provisions	2,249,850.55	1,935,702.38
Deferred income	1,846,662.45	1,858,869.05
	4,341,293.00	4,075,902.43
Current liabilities		
Current portion of finance lease liabilities	72,375.00	70,930.00
Trade payables	2,526,390.28	2,706,036.38
Provisions	2,308,862.04	2,311,330.95
Accrued liabilities	252,955.96	110,530.00
Other current liabilities	231,169.22	1,059,147.30
Current portion of deferred income	24,433.20	24,443.20
	5,416,185.70	6,282,417.83
Total equity and liabilities	59,000,017.99	25,670,293.83

Consolidated Income Statement

EUR	1 April — 30 June 2005	1 April — 30 June 2004*	1 January — 30 June 2005	1 January — 30 June 2004*
Revenues	337,795.85	16,295,778.45	700,683.65	16,295,778.45
Cost of revenues	-323,008.15	-1,272,846.50	-688,523.62	-1,272,846.50
Gross profit	14,787.70	15,022,931.95	12,160.03	15,022,931.95
Operating expenses				
Research and development expenses	-2,609,865.01	-1,757,133.51	-5,615,507.53	-3,068,951.88
General and administrative expenses	-1,101,647.19	-2,422,520.88	-1,986,867.50	-2,884,709.44
Selling and marketing expenses	-547,740.46	-250,468.58	-774,108.13	-348,781.01
Other income (expenses). net	39,343.55	-220,692.82	158,369.21	-209,951.80
	-4,219,909.11	-4,650,815.79	-8,218,113.95	-6,512,394.13
Operating result	-4,205,121.41	10,372,116.16	-8,205,953.92	8,510,537.82
Financial result	272,648.01	32,689.67	465,489.41	68,622.19
Profit/Loss for the period before taxes	-3,932,473.40	10,404,805.83	-7,740,464.51	8,579,160.01
Income taxes	0.00	391,600.00	0.00	391,600.00
Net result for the period	-3,932,473.40	10,796,405.83	-7,740,464.51	8,970,760.01
Earnings per share (undiluted)	-0.25	1.21	-0.54	1.00
Earnings per share (diluted)	-	1.21	-	1.00

* The comparative figures for the period from 1 April to 30 June 2004 and from 1 January to 30 June 2004 relate to PAION Deutschland GmbH.

Consolidated Cash Flow Statement

EUR	1 January — 30 June 2005	1 January — 30 June 2004*
Cash flows from operating activities:		
Net result for the period	-7,740,464.51	8,970,760.01
Reconciliation of net profit (loss) for the period to cash flows from operating activities:		
Amortization/depreciation	246,565.33	150,617.08
Loss/Profits from the disposal of non-current assets	210.99	-2,483.96
Deferred tax assets	0.00	-391,600.00
Interest paid on finance leases	6,662.00	740.00
Release of investment grants	-12,216.60	0.00
Expenses from stock option plans	319,895.01	0.00
Change in assets and liabilities which are not attributable to investing or financing activities:		
Trade receivables	-38,688.22	-17,827,793.74
Prepaid expenses and other assets	-745,029.08	-5,979,538.74
Trade payables	-179,646.10	3,828,761.49
Provisions	1,685,274.03	137,113.11
Other current liabilities	-392,368.19	-96,670.78
Deferred income	0.00	1,758,458.18
Net cash from operating activities	-6,849,805.34	-9,451,637.35
Cash flows from investing activities:		
Cash paid for investments in intangible assets and equipment	-202,634.25	-1,029,391.42
Cash received from the sale of intangible assets and equipment	1,200.00	275,615.09
Net cash used in investing activities	-201,434.25	-753,776.33
Cash flows from financing activities:		
Capital increase	5,750,000.00	23,150.00
Contributions to the capital reserve	40,250,000.00	10,288,564.74
Payments in connection with the raising of capital	-4,648,864.78	-275,000.00
Capital repayment due to the settlement of options	-966,778.70	0.00
Payment of finance lease liabilities	-41,768.00	-4,057.00
Net cash used in financing activities	40,342,588.52	10,032,657.74
Change in cash and cash equivalents	33,291,348.93	-172,755.94
Cash and cash equivalents at beginning of the period	20,888,829.59	8,453,517.89
Cash and cash equivalents at end of the period	54,180,178.52	8,280,761.95
Composition of cash and cash equivalents at the end of the period:		
Cash	18,925,376.12	8,280,761.95
Marketable Securities	35,254,802.40	0.00
Cash and cash equivalents at end of the period	54,180,178.52	8,280,761.95

* The comparative figures for the period from January 1 to June 30, 2004 relate to PAION Deutschland GmbH.

Statement of Changes in Consolidated Equity

EUR	Share capital	Capital reserve	Loss carryforward	Equity
31 December 2003*	155,350.00	41,774,355.23	-34,350,454.31	7,579,250.92
Issue of shares	23,150.00	0.00	0.00	23,150.00
Contribution to the capital reserve	0.00	10,288,564.74	0.00	10,288,564.74
Cost of raising capital	0.00	-275,000.00	0.00	-275,000.00
Net profit for the period	0.00	0.00	8,970,760.01	8,970,760.01
30 June 2004*	178,500.00	51,787,919.97	-25,379,694.30	26,586,725.67
Effect from the business combination of PAION AG and PAION Deutschland GmbH	9,827,052.00	-9,778,079.85	0.00	48,972.15
Additional contribution to the capital reserve due to the issue of options	0.00	803,000.00	0.00	803,000.00
Decrease in the capital reserve due to the settlement of options	0.00	-3,332,044.83	0.00	-3,332,044.83
Net loss for the period (7/1 - 12/31/2004)	0.00	0.00	-8,794,679.42	-8,794,679.42
31 December 2004	10,005,552.00	39,480,795.29	-34,174,373.72	15,311,973.57
Issue of shares	5,750,000.00	0.00	0.00	5,750,000.00
Contribution to the capital reserve	0.00	40,250,000.00	0.00	40,250,000.00
Cost of raising capital	0.00	-4,648,864.78	0.00	-4,648,864.78
Additional contribution to the capital reserve due to the issue of options	0.00	319,895.01	0.00	319,895.01
Net loss for the period	0.00	0.00	-7,740,464.51	-7,740,464.51
30 June 2005	15,755,552.00	75,401,825.52	-41,914,838.23	49,242,539.29

* The comparative figures for 31 December 2003 and 30 June 2004 relate to PAION Deutschland GmbH.

Selected Explanatory Notes to the Interim Financial Statements as of 30 June 2005

General Information on the Parent Company and the PAION Group

PAION AG is the parent company and has its registered office at Martinstrasse 10–12, 52062 Aachen, Germany. In addition to PAION AG, the consolidated financial statements also include the parent company's sole subsidiary, PAION Deutschland GmbH, Aachen, on the basis of full consolidation.

PAION AG was founded on 2 June 2004. The former shareholders of PAION Deutschland GmbH transferred all their shares in PAION Deutschland GmbH to PAION AG in return for shares in the latter as a contribution in kind. Accordingly, the information of the comparative prior reporting period as of 30 June 2004 is on PAION Deutschland GmbH as the business combination of PAION AG and PAION Deutschland GmbH qualifies as a reverse acquisition under International Financial Reporting Standard (IFRS) 3.21, **Business Combinations**.

Basis of Accounting

The unaudited, condensed interim financial statements have been prepared in compliance with IFRSS. The regulations of International Accounting Standard (IAS) 34 **Interim Financial Reporting** have been adopted. The interim financial statements as of 30 June 2005 have to be read in connection with the consolidated financial statements as of 31 December 2004.

The preparation of interim financial statements in accordance with IFRSS requires management to make estimates and assumptions that affect the carrying amounts of assets and liabilities, income and expenses and contingent liabilities. Actual amounts may differ from the estimates.

The interim financial statements do not contain any segment information as no reportable business or geographical segments could be identified.

Consolidation Policies

In comparison to the consolidated financial statements as of 31 December 2004, the consolidation policies adopted in the interim financial statements as of 30 June 2005 are unchanged.

Accounting Policies

In comparison to the consolidated financial statements as of 31 December 2004, the accounting policies adopted in the interim financial statements as of 30 June 2005 are unchanged.

Other Notes to the Interim Financial Statements

Increase of Share Capital

On 9 February 2005, the PAION AG shares were admitted to trading on the Official Market Segment of the Frankfurt Stock Exchange and to the Prime Standard, the sub-segment of the Official Market Segment with additional post-admission obligations. Trading commenced on 11 February 2005. In the course of the initial public offering a capital increase of 5,000,000 shares was initially accomplished. As a result of the complete Greenshoe option being exercised on 21 February 2005, the number of shares of PAION AG increased by further 750,000 shares to 15,755,552 shares in total. Under consideration of the complete exercised Greenshoe option, PAION AG generated proceeds of EUR 46 million from the issue. Thereof an amount of EUR 5,750,000 was transferred to share capital and the remaining amount of EUR 40,250,000 to capital reserve.

In accordance with IAS 32.37 **Financial Instruments**, cost directly related to the issuing of the new shares amounting to EUR 4,648,864.78 were not considered as expense in the profit and loss statement but were directly deducted from the new equity. The deduction was made against the capital reserve.

Stock Option Programme 2005

As of 10 March 2005, 949,305 stock options were granted to the members of the management board and employees of the PAION group from the stock option programme 2005. Half of the stock options granted can be exercised after 2 year at the earliest. A quarter of the stock options granted can be exercised after 3 and 4 years, respectively. The accounting of the stock options granted are in accordance with IFRS 2 **Share-based Payment**. The fair value of the stock options at the grant date was computed using the Black/Scholes option pricing model. During the vesting period of 2 to 4 years, the fair value will be recognised as personnel expenses. In the reporting period, an amount of EUR 320k has been considered as expense and as an increase in capital reserve.

Aachen, 28 July 2005

PAION AG

The Management Board

Report of the Supervisory Board

The interim report of the first half-year of 2005 was submitted to the Supervisory Board and explained by the Management Board. The Supervisory Board approved the interim report of the first half-year of 2005.

Aachen, 28 July 2005

Chairman of the Supervisory Board

Dr. Walter Wenninger

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