

# PAION Q3#2008

Consolidated Financial Interim Report for the Third Quarter 2008  
and the Nine Month Period Ending 30 September 2008

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## Key Figures

(all figures in EUR k unless otherwise noted)	Q3 2008 (unaudited)	Q3 2007 (unaudited)	Q1–Q3 2008 (unaudited)	Q1–Q3 2007 (unaudited)
Revenues	483	2,145	2,697	4,430
Research and development expenses	-1,670	2,865	-6,064	-6,767
General and administrative expenses	-1,407	-765	-6,161	-3,217
Selling and marketing expenses	-18	-21	-84	-487
Net result for the period	-2,284	4,240	-9,320	-6,692
Earnings per share in EUR for the period (basic)	-0.07	0.25	-0.49	-0.40
Earnings per share in EUR for the period (diluted)	-0.07	0.25	-0.49	-0.40

	Q1–Q3 2008 (unaudited)	Q1–Q3 2007 (unaudited)
Net cash from operating activities	-2,144	-10,638
Net cash from investing activities	-467	-155
Net cash from financing activities	-1,471	-477
Average number of group employees	50	82

	30 Sept. 08 (unaudited)	31 Dec. 07 (audited)
Intangible assets	18,454	462
Cash and cash equivalents	38,820	42,901
Equity	36,866	35,664
Non-current liabilities	18,694	6,746
Balance sheet total	60,033	45,542
Equity ratio	61.4 %	78.3 %

# Interim Group Management Report for the Nine Month Period Ending 30 September 2008

## Overview

At the end of June 2008, PAION successfully completed the acquisition of UK-based CeNeS, a group focusing on the development of drugs for the treatment of central nervous system disorders. The acquisition strengthened PAION's development pipeline by three more compounds plus an early-stage discovery program. Previously in April 2008, PAION broadened its pipeline in the field of thrombotic diseases by purchasing the rights to the thrombin inhibitor, Flovagratan. Also in April, PAION decided to terminate the development of the drug candidate Enecadin.

The acquisition of CeNeS Pharmaceuticals plc was effected by means of an exchange of shares. To this end, PAION has issued 7.8 million new shares in total and thus increased the number of outstanding shares to 24.6 million. The integration of the acquired group is nearly completed.

The loss in the first nine months of 2008 amounts to EUR 9,320k and is EUR 2,628k higher than in the corresponding prior year's period. The main reasons for this are significantly higher general and administrative expenses, which are mainly due to transaction and restructuring costs. The research and development expenses amount to EUR 6,064k and are EUR 703k lower than in the first nine months of 2007, which is primarily attributable to the new license agreement with Lundbeck, according to which Lundbeck will bear all development expenses of the Desmoteplase program. Moreover the research and development expenses for Enecadin are much lower than in the corresponding prior year's period because of the cutback of the project in 2007 and finally the termination in the beginning of 2008. This decline was partly compensated by the research and development expenses incurred in the PAION UK group since acquisition, which reflects the broader product pipeline of the PAION group compared to the prior year.

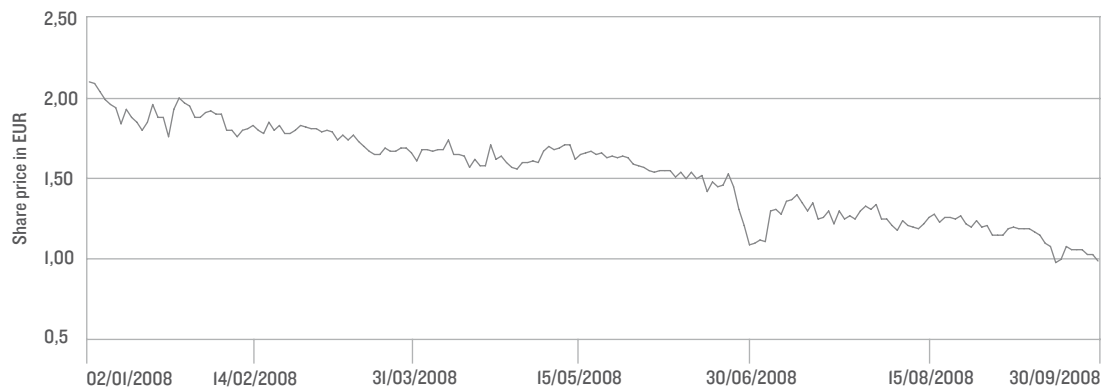
At the end of the reporting period, 30 September 2008, cash and cash equivalents amounted to EUR 38,820k. These were significantly strengthened by the non-refundable upfront payment of EUR 8 million paid by Lundbeck in the beginning of 2008. This payment was made under the license agreement between PAION and Lundbeck which was signed at the end of 2007 and which grants Lundbeck the exclusive global rights to develop and market Desmoteplase.

## Share Performance

The beginning of the third quarter of 2008 initially marked a strong increase in the PAION share price on Xetra, peaking in mid-July with an increase of 30 percent. Subsequently there was a decline although the share price remained above the closing level of the prior quarter until mid-September. At the end of September and reflecting the general market weakness caused by the financial crisis, the PAION share price dropped below this line and closed at EUR 0.99 on 30 September 2008 (AIM: GBP 0.77, corresponding to EUR 0.97). On a quarterly basis, the PAION share lost 10 percent (AIM: minus 5.5 percent).

The average daily trading volume (Xetra and Frankfurt Floor) during the first nine months of 2008 amounted to 45,187 shares. Since the first day of trading on AIM, on average 42,056 shares per day (represented by depository interests) have been traded.

### Development of the PAION Share Price (FSE: Xetra) in the First Nine Months of 2008:



## Overview of Research and Development Activities

Through the acquisition of the PAION UK group, PAION was able to significantly broaden its portfolio which now comprises six candidates in clinical development. This includes CeNeS' morphine-6-glucuronide (M6G), CNS 5161 and CNS 7056 programs. Together with Flovagatran, which was purchased by PAION in April 2008, these substances add to PAION's development portfolio which previously consisted of Desmoteplase and Solulin.

In July 2008, PAION started a clinical Phase I study with CNS 7056, a new short-acting sedative and anesthetic for intravenous administration. Among other indications, such compounds are used in endoscopic procedures such as colonoscopies. In pre-clinical studies, a fast on/fast off action was shown with respect to sedation. Therefore, PAION believes that the substance has a high potential for controllable sedation, especially in the field of outpatient procedures. PAION expects that the current study will yield proof-of-concept for the target profile. To achieve this, the study includes the comparatively large number of up to 91 healthy volunteers. A comparison group with midazolam is included. Midazolam is the current therapeutic standard for procedural sedation in minor but painful procedures, e.g. endoscopies. The volunteers have

been divided in cohorts receiving ascending doses. At the end of September, PAION announced that the study has progressed to dose levels that induced pronounced sedation. So far no safety concerns have been raised by the Drug Safety Monitoring Board. In addition, the first group including a comparison with midazolam has been completed. In Japan, CNS 7056 is partnered with Ono Pharmaceuticals.

For the anticoagulant **Solulin**, proof-of-concept has already been obtained within the scope of a Phase I study with healthy volunteers. The study focused on safety, tolerability, pharmacokinetics, and as far as can be concluded from laboratory results, also on the pharmacological effects following single and multiple dosing of the substance. The study revealed that in blood samples taken from the study participants, Solulin was able to exert its anticoagulant effect with only a very low impact on hemostasis. Following the completion of the Phase I study, PAION has now initiated the partnering process for the further development of Solulin.

CNS 5161 is a so-called NMDA receptor antagonist which may prove beneficial for the treatment of neuropathic pain, i.e. pain caused by irritation or damage of the nervous system. A second potential indication is the treatment of cancer pain. Currently, an open-label dose escalation clinical Phase IIa study is being conducted which will enroll up to 36 cancer patients. The study primarily focuses on assessing multiple-dose safety of the compound. In addition, efficacy signs will be monitored. Results from this study are expected to be available in the fourth quarter of 2008. Based on the data available at that time, PAION will then decide on the further development of CNS 5161.

In April 2008 PAION purchased all rights to the anticoagulant **Flovagatran** for a one-off payment amounting to EUR 265k plus a further milestone payment which will only be due in the event of receiving market authorization, out-licensing or re-sale. This substance is characterized by a very fast onset of anticoagulation but also very rapid deactivation once intravenous administration is stopped. This is a complementary mode of action to Solulin's fast onset but longer lasting effect. Thus Flovagatran could prove useful as an acute anticoagulant during major surgery such as coronary artery bypass grafting. The substance was previously tested by its originator in two smaller Phase II studies, although in other indications. Therefore, PAION plans to conduct additional preclinical studies in preparation for clinical assessment in this new target indication.

Morphine-6-glucuronide (**M6G**) is the most advanced project of the PAION UK portfolio. In clinical Phase II and Phase III studies this morphine metabolite demonstrated an analgesic effect comparable to morphine, the "gold standard" for severe, post-operative pain, while the common side effects of morphine administration such as nausea and vomiting were markedly reduced. In total, more than 1,000 patients have been treated with M6G. However, M6G narrowly failed to demonstrate statistical significance with respect to the reduction of nausea (p-value of 0.052 against a target of <0.050). Under the assumption that the positioning and partnering potential of M6G for post-operative pain can be optimized, PAION has started a more in-depth analysis of available clinical data. A combined data analysis based on 769 patients from two Phase II studies and two Phase III studies has now been completed. The results confirm the analgesic effect of M6G and also reveal significant reduction in both vomiting and nausea. In parallel, modelling analyses were conducted to simulate dose-response relationships and pharmacodynamic effects. The results support the product profile of M6G, both in terms of analgesic properties and side-effect profile, and in addition reproduce the previously observed longer duration of action of M6G compared to morphine. Based on this model, PAION believes that even at increased doses M6G will be better tolerated than equi-analgesic doses of morphine. In

summary, these new analyses support PAION's view that M6G has a wider therapeutic margin than morphine, with lower incidence of post-operative nausea and vomiting at equi-analgesic levels. PAION believes that the findings will facilitate a data-driven design of a future Phase III program and will thus increase the probability of success. Based on these results, PAION will now re-start the partnering process which was originally initiated by CeNeS.

A thorough analysis was also the basis to secure the future development of **Desmoteplase** after the Phase III study DIAS-2 missed its endpoint back in 2007. The substance is now exclusively outlicensed to H. Lundbeck A/S of Denmark who anticipates starting a new Phase III study towards the end of 2008. The licensing contract was signed in late 2007 and PAION received an upfront payment of EUR 8 million when the contract came into effect in early 2008. In the future, PAION will be eligible for up to EUR 63 million of milestone payments as well as significant royalties following successful completion of the development. In addition, PAION was able to secure options to co-promote Desmoteplase in Germany, Austria and Switzerland, together with Lundbeck. Desmoteplase is targeted towards the treatment of acute ischemic stroke, where its role consists of dissolving blood clots which block brain arteries. Results from earlier Phase II studies suggested that the treatment window may be widened from currently three to up to nine hours after the first stroke symptoms.

## Net Assets, Financial Position, and Results of Operations

### Results of Operations

The loss in the first nine months of 2008 increased by EUR 2,628k to EUR 9,320k. The main reason for this increase are significantly higher general and administrative expenses (EUR 6,161k; prior year's period: EUR 3,217k) due to the acquisition of the CeNeS group (in the following: PAION UK group) as well as one off expenses for restructuring measures. The research and development expenses amounted to EUR 6,064k and decreased by EUR 703k compared to the first nine months of 2007 because the research and development expenses for Desmoteplase are completely borne by Lundbeck and the development of Enecadin was terminated. This decrease was compensated by the research and development costs incurred by the PAION UK group since acquisition, which reflects the broader product pipeline of the PAION group. The gross profit amounted to EUR 1,979k and was in line with the prior year's period (EUR 1,831k).

	Q3 2008 EUR k	Q3 2007 EUR k	Q1-Q3 2008 EUR k	Q1-Q3 2007 EUR k
Revenues	483	2,145	2,697	4,430
Cost of revenues	-93	-431	-717	-2,599
<b>Gross profit</b>	<b>390</b>	<b>1,714</b>	<b>1,980</b>	<b>1,831</b>
Research and development	-1,670	2,865	-6,064	-6,767
General and administrative	-1,407	-765	-6,161	-3,217
Selling and marketing	-18	-21	-84	-487
Other income (expenses)	37	112	86	170
<b>Operating expenses</b>	<b>-3,058</b>	<b>2,191</b>	<b>-12,223</b>	<b>-10,301</b>
<b>Operating result</b>	<b>-2,668</b>	<b>3,905</b>	<b>-10,243</b>	<b>-8,470</b>
Financial result	295	335	834	1,778
Taxes on income	89	0	89	0
<b>Net result for the period</b>	<b>-2,284</b>	<b>4,240</b>	<b>-9,320</b>	<b>-6,692</b>

**Revenues** of EUR 2,697k in the first nine months of 2008 primarily include the refund of development expenses by Lundbeck (EUR 1,599k; prior year's period: EUR 1,608k) and the systematic release of deferred income in connection with the license agreement concluded with Lundbeck (EUR 1,091k). As part of the outlicensing agreement between PAION and Lundbeck, Lundbeck reimbursed substantial prior production development costs and made a non-refundable upfront payment of EUR 8 million, which is recognized as a deferred income item and is being released over the anticipated development period for Desmoteplase. The higher revenues in 2007 include refunds from Forest in the amount of EUR 1,148k as well as the release of an upfront payment in the amount of EUR 1,669k.

The **cost of revenues** of EUR 717k incurred in the first nine months of 2008 related to the development expenses incurred in this period, which were refunded by Lundbeck. In the prior year's period, this cost also related exclusively to development expenses reimbursed by Forest and Lundbeck.

**Research and development** expenses in the first nine months of 2008 decreased by EUR 703k to EUR 6,084k compared with the corresponding prior year's period. The expenses in the German PAION group decreased whereas additional research and development costs came along with the acquisition of the PAION UK group. The decrease in the German PAION group is primarily attributable to the new license agreement with Lundbeck, according to which Lundbeck will bear all development expenses for Desmoteplase. Furthermore, in the first nine months 2008, significantly lower expenses arose for the development of Enecadin compared to the prior year's period as the development program with Enecadin was reduced in the middle of 2007 and finally terminated in April 2008. These cost savings were compensated by the takeover of the PAION UK compounds in connection with the acquisition of the PAION UK group for which research and development expenses have been incurred since the acquisition date, 20 June 2008. Moreover in the prior years' period EUR 2,668k income out of the reversal of repayment obligations to Forest and the de-recognition of refund claims against Lundbeck were offset against the research and development expenses.

Compared to the prior year's period, the **general and administrative** expenses increased significantly because of transaction and consulting fees in connection with the acquisition of the PAION UK group in June as well as one-off expenses for restructuring measures and amounted to EUR 6,161k (prior year's period: EUR 3,217k). The general and administrative expenses include EUR 1,510k severance payments as well as one-off expenses of EUR 800k which relate to the technical settlement of the exchange of the shares and from the admission of all PAION shares on AIM.

The **financial result** for the first nine months of 2008 decreased by EUR 944k to EUR 835k compared to the prior year's period. This reduction is mainly due to a special effect in the prior year's period. As a result of the DIAS-2 outcome, present value adjustments of the long-term refund claims and the long-term repayment obligation were made and resulted to a financial income of EUR 633k, which was recorded in the second quarter 2007.

The **income taxes** relate to the change of deferred tax liabilities which were recognized in connection with the first time consolidation of the PAION UK group. These liabilities are being released against tax income corresponding to the amortization of the capitalized development projects.

### Net Assets and Financial Position

The balance sheet as of 30 September 2008 contains the assets and liabilities acquired within the business combination of the PAION UK group. Compared to 31 December 2007, the balance sheet total increased by EUR 14,491k to EUR 60,033k which was primarily due to the capitalization of the development projects (EUR 18.6 million) within the first-time consolidation of the PAION UK group and to the non-refundable upfront payment by Lundbeck of EUR 8 million under the outlicensing agreement on the exclusive right to develop and market Desmoteplase. As of 30 September 2008, the equity ratio fell to 61.4% from 78.3% on 31 December 2007. Accounting for the subordinated loan and the release of the deferred upfront payment of Lundbeck as economic equity would increase the equity ratio by 23 percentage points to 84.4%.

	30 Sept. 08	31 Dec. 07	Change
	EUR k	EUR k	EUR k
Non-current assets	18,916	1,365	17,551
Current assets	41,117	44,177	-3,060
<b>Assets</b>	<b>60,033</b>	<b>45,542</b>	<b>14,491</b>
Equity	36,866	35,664	1,202
Non-current liabilities	18,694	6,746	11,948
Current liabilities	4,473	3,132	1,341
<b>Equity and liabilities</b>	<b>60,033</b>	<b>45,542</b>	<b>14,491</b>

The increase in **non-current assets** is principally due to the business combination with the PAION UK group. Within the allocation of the purchase price the acquired development projects were capitalized with their fair values of EUR 18,580k in accordance with IFRS 3. As of 30 September 2008, the book value of these projects amounts to EUR 18,146k. Furthermore, the substance Flovagatran was acquired for EUR 265k in April 2008. These additions were partly off-set by the disposal of license rights to develop Desmoteplase in connection with the license agreement concluded with Lundbeck on the exclusive right to develop and market Desmoteplase as well as the disposal of the license rights for Enecadin.

The EUR 3,060k decrease in **current assets** is mainly attributable to the decrease in cash and cash equivalents by EUR 4,082k to EUR 38,820k. In the opposite direction the prepaid expenses and the other assets increased by EUR 858k to EUR 1,357k. The increase primarily relates to the acquired assets of the PAION UK group (EUR 819k), of which EUR 642k represent tax refund claims. The change in cash and cash equivalents stems from the following areas:

	Q1–Q3 2008	Q1–Q3 2007
	EUR k	EUR k
Cash flows from operating activities	-2,144	-10,638
Cash flows from investing activities	-467	-155
Cash flows from financing activities	-1,471	-477
Change in cash and cash equivalents	-4,082	-11,270

The cash flows from operating activities improved from EUR -10,638k in the prior year's period to EUR -2,144k. The main reason for this enhancement was the non-refundable upfront payment of EUR 8 million by Lundbeck in the beginning of 2008. The cash flows from operating activities for the third quarter of EUR -6.7 million were related besides the operating business also mainly to the payment of transaction and restructuring costs.

The negative cash flows from investing activities in the first nine months of 2008 primarily resulted from additions and disposals of license rights and the net cash effect of the business combination with the PAION UK group.

The increase in negative cash flows from financing activities relates to payments in connection with the issuing of new shares in connection with the acquisition of the PAION UK group (EUR 981k).

The increase of EUR 11,948k in **non-current liabilities** is attributable to the recognition of deferred taxes (EUR 5,081k) as a result of the valuation of the development projects of the PAION UK group at fair value and to a provision in the amount of EUR 1,249k for unused premises which are rented on a long-term basis. Furthermore, the rise in non-current liabilities is based on the long-term portion of the deferred payment of the non-refundable amount of EUR 8 million relating to the license agreement concluded with Lundbeck (EUR 5,541k).

Compared to 31 December 2007, the **current liabilities** increased by EUR 1,341k to EUR 4,473k. This increase is mainly due to the current portion of the deferred payment from Lundbeck. Compared to 30 June 2008, the current liabilities decreased from EUR 9,704k to EUR 5,231k, which is mainly due to payments of transaction and restructuring costs in the third quarter 2008.

## Personnel Development

In the course of the acquisition of the PAION UK group, PAION decided to adjust the number of staff to the organizational requirements of the new business group. Therefore, the number of employees was reduced by 23, 19 from the PAION group in Germany and 4 from the PAION group in the UK. As of 30 September 2008, PAION employed 35 employees in total, of which 9 are from the PAION UK group. In comparison to this, the headcount as of 31 December 2007 amounted to 53 employees (solely the German PAION group).

## Changes in the Management and Supervisory Board

At the end of June 2008, following the successful acquisition of the PAION UK group, Dr Gavin Kilpatrick, formerly Chief Scientific Officer of CeNeS, was appointed Chief Scientific Officer on the Managing Board of PAION. The former CeNeS Pharmaceuticals plc and CeNeS Limited have been renamed PAION Holdings UK Limited and PAION UK Limited respectively in the reporting period. Dr. Gavin Kilpatrick and Dr. Mariola Söhngen along with Bernhard Hofer serve as Managing Directors of the UK companies.

Effective as of 30 July 2008, Prof Dr Schlick, due to his responsibilities as a General Partner at a venture capital company with a growing portfolio, has resigned from his position on the Supervisory Board of PAION. The Court of Aachen appointed Alan Goodman as his successor to the Supervisory Board until the next General Meeting and effective as of 31 July 2008. The Court followed a unanimous proposal by the Supervisory Board and Management Board of PAION. Alan Goodman was a Chartered Management Accountant for many years and is the founder of a number of biotech companies including CeNeS Pharmaceuticals plc. He is also the founder of a venture capital fund that invests in early stage life science companies. Through this fund (Avlar BioVentures) he was invested in CeNeS Pharmaceuticals plc, as was his private investment vehicle ATM Investments Ltd. In addition, he was also a private investor in CeNeS Pharmaceuticals plc. As a consequence, he is a direct and indirect investor in PAION, too. At the time of the acquisition, Alan Goodman was Chairman of CeNeS Pharmaceuticals plc.

## Risks and Opportunities

Through the acquisition of the PAION UK group, PAION was able to further broaden its development pipeline and was able to add such products to its portfolio which in comparison to PAION's previous drug candidates belong to better established drug classes. By broadening the development pipeline, a diversification of the risk inherent to drug development can be achieved.

As PAION UK, like PAION Germany, focuses on the development and commercialization of drugs and as yet, has no drug approved, the risks and opportunities regarding the future development remain the same as described in detail in the group management report for fiscal year 2007 as well as in the prospectus dated 16 May 2008 and are also valid for the enlarged group. These risks and opportunities did not materially change since then.

Due to the size of the two individual entities and the flexible structures, no material risks are expected to result from the integration of the formerly independent groups.

## Significant Events Occurring After the Balance Sheet Date

In the time period between the balance sheet day, 30 September 2008, and the day of finalization of this report, no significant events occurred.

## Outlook

The acquisition of CeNeS Pharmaceuticals plc (now PAION Holdings UK Limited) marks the expansion of PAION's pipeline beyond its former focus on thrombotic diseases towards drugs for the treatment of central nervous system (CNS) disorders. As a result of the out-licensing of global rights for Desmoteplase to Lundbeck within the scope of an expanded contract, PAION still retains a financially strong partner for conducting and financing the future development and marketing of Desmoteplase.

Once value-generating steps such as proof of concept have been achieved as a result of Phase I or Phase II studies, PAION intends to consistently pursue out-licensing for their other projects, too. The cash and cash equivalents amounting to EUR 39 million provide PAION with the necessary flexibility to achieve such value-generating steps while securing a sufficient cash-reach until the end of 2010. This does not account for future upfront and milestone payments which would expand the cash reach but may also be used fully or in part for financing additional development activities.

# Consolidated Interim Financial Statements

PAION AG

## Consolidated Balance Sheet

ASSETS	30 Sept. 2008 EUR	31 Dec. 2007 EUR
<b>Non-current assets</b>		
Intangible assets	18,453,745.99	462,349.84
Equipment	462,506.55	902,786.33
Other assets	2.52	0.00
	<b>18,916,255.06</b>	<b>1,365,136.17</b>
<b>Current assets</b>		
Trade receivables	938,999.66	776,806.33
Prepaid expenses and other assets	1,357,427.22	498,934.20
Cash and cash equivalents	38,820,342.60	42,901,123.18
	<b>41,116,769.48</b>	<b>44,176,863.71</b>
<b>Total assets</b>	<b>60,033,024.54</b>	<b>45,541,999.88</b>

EQUITY AND LIABILITIES	30 Sept. 2008 EUR	31 Dec. 2007 EUR
<b>Equity</b>		
Share capital	24,602,919.00	16,755,552.00
Capital reserve	88,484,215.79	85,737,273.03
Expense and income recognised directly in equity	-72,552.33	0.00
Loss carryforward	-66,828,608.63	-56,316,554.35
Loss for the period	-9,319,547.84	-10,512,054.28
	<b>36,866,425.99</b>	<b>35,664,216.40</b>
<b>Non-current liabilities</b>		
Financial liabilities	6,816,803.94	6,657,137.24
Deferred taxes	5,081,005.10	0.00
Provisions	1,249,352.88	0.00
Finance lease liabilities	6,264.00	61,761.00
Deferred income	5,540,656.58	27,121.27
	<b>18,694,082.50</b>	<b>6,746,019.51</b>
<b>Current liabilities</b>		
Trade payables	1,704,355.16	2,294,817.61
Provisions	980,671.92	421,417.51
Current portion of finance lease liabilities	73,644.00	71,559.00
Other current liabilities	248,188.41	319,536.65
Current portion of deferred income	1,465,656.56	24,433.20
	<b>4,472,516.05</b>	<b>3,131,763.97</b>
<b>Total equity and liabilities</b>	<b>60,033,024.54</b>	<b>45,541,999.88</b>

## Consolidated Income Statement

EUR	1 July – 30 Sept. 2008	1 July – 30 Sept. 2007	1 January – 30 Sept. 2008	1 January – 30 Sept. 2007
Revenues	483,098.04	2,144,807.20	2,696,736.47	4,430,004.70
Cost of revenues	-93,530.75	-431,060.96	-717,440.29	-2,599,216.24
<b>Gross profit</b>	<b>389,567.29</b>	<b>1,713,746.24</b>	<b>1,979,296.18</b>	<b>1,830,788.46</b>
Research and development expenses	-1,670,010.04	2,865,141.12	-6,064,087.33	-6,766,607.49
General and administrative expenses	-1,407,041.24	-765,306.07	-6,160,610.76	-3,217,135.21
Selling and marketing expenses	-18,480.00	-20,677.48	-83,701.20	-487,250.37
Other income (expenses), net	37,449.37	112,335.51	85,759.35	170,152.72
<b>Operating expenses</b>	<b>-3,058,081.91</b>	<b>2,191,493.08</b>	<b>-12,222,639.94</b>	<b>-10,300,840.35</b>
<b>Operating result</b>	<b>-2,668,514.62</b>	<b>3,905,239.32</b>	<b>-10,243,343.76</b>	<b>-8,470,051.89</b>
Financial income	452,630.58	488,756.61	1,430,211.85	4,061,776.37
Financial expenses	-157,272.92	-153,899.90	-595,664.06	-2,283,579.45
<b>Financial result</b>	<b>295,357.66</b>	<b>334,856.71</b>	<b>834,547.79</b>	<b>1,778,196.92</b>
<b>Loss for the period before taxes</b>	<b>-2,373,156.96</b>	<b>4,240,096.03</b>	<b>-9,408,795.97</b>	<b>-6,691,854.97</b>
<b>Income taxes</b>	<b>89,248.13</b>	<b>0.00</b>	<b>89,248.13</b>	<b>0.00</b>
<b>Loss for the period</b>	<b>-2,283,908.83</b>	<b>4,240,096.03</b>	<b>-9,319,547.84</b>	<b>-6,691,854.97</b>
Earnings per share (basic)	-0.07	0.25	-0.49	-0.40
Earnings per share (diluted)	-0.07	0.25	-0.49	-0.40

## Consolidated Cash Flow Statement

EUR	1 January – 30 Sept. 2008	1 January – 30 Sept. 2007
<b>Cash flows from operating activities:</b>		
Net result for the period	-9,319,547.84	-6,691,854.97
<b>Reconciliation of net profit (loss) for the period to cash flows from operating activities:</b>		
Amortization/depreciation	937,725.55	356,082.44
Loss/Profits from the disposal of non-current assets	63,834.68	4,359.86
Interest expenses and interest income	-834,547.79	-1,778,196.92
Tax expenses and income	-89,248.13	0.00
Release of deferred income	-1,145,241.33	-1,687,400.51
Expenses from stock option plans	196,992.01	567,270.10
<b>Change in assets and liabilities which are not attributable to investing or financing activities:</b>		
Long-term refund claims resulting from the assumption of development costs	0.00	6,065,907.88
Trade receivables	-162,193.33	1,641,856.81
Prepaid expenses and other assets	1,130,934.36	633,107.09
Trade payables	-2,377,027.34	-2,812,086.17
Provisions	315,322.81	-8,218,043.67
Other current liabilities	-199,362.76	1,068.43
Deferred income	8,100,000.00	0.00
	-3,382,359.11	-11,917,929.63
Interest received	1,238,807.13	1,279,763.84
<b>Net cash used in operating activities</b>	<b>-2,143,551.98</b>	<b>-10,638,165.79</b>
<b>Cash flows from investing activities:</b>		
Cash paid for investments in intangible assets and equipment	-311,765.36	-155,157.63
Cash received from the sale of intangible assets and equipment	320,529.05	300.00
Net cash paid for/received from business combinations	-476,249.61	0.00
<b>Net cash used in investing activities</b>	<b>-467,485.92</b>	<b>-154,857.63</b>
<b>Cash flows from financing activities:</b>		
Payments in connection with the issuing of new shares	-981,364.40	0.00
Interest paid	-432,841.36	-415,341.45
Payment of finance lease liabilities	-56,568.00	-61,976.00
<b>Net cash used in financing activities</b>	<b>-1,470,773.76</b>	<b>-477,317.45</b>
Change in cash and cash equivalents	-4,081,811.66	-11,270,340.87
Effect of exchange rate changes on cash	1,031.08	0.00
Cash and cash equivalents at beginning of the period	42,901,123.18	57,188,779.78
<b>Cash and cash equivalents at end of the period</b>	<b>38,820,342.60</b>	<b>45,918,438.91</b>
<b>Composition of cash and cash equivalents at the end of the period:</b>		
Cash	38,820,342.60	30,491,708.19
Marketable securities	0.00	15,426,730.72
	<b>38,820,342.60</b>	<b>45,918,438.91</b>

## Consolidated Statement of Changes in Equity

	Share capital	Capital reserve	Expense and income recog- nised directly in equity	Loss carry- forward	Equity
	EUR	EUR	EUR	EUR	EUR
<b>31 December 2006</b>	<b>16,755,552.00</b>	<b>85,032,116.76</b>	<b>0.00</b>	<b>-56,316,554.35</b>	<b>45,471,114.41</b>
Additional contribution to the capital reserve due to the issue of options	0.00	567,270.10	0.00	0.00	567,270.10
Loss for the period	0.00	0.00	0.00	-6,691,854.97	-6,691,854.97
<b>30 September 2007</b>	<b>16,755,552.00</b>	<b>85,599,386.86</b>	<b>0.00</b>	<b>-63,008,409.32</b>	<b>39,346,529.54</b>
Additional contribution to the capital reserve due to the issue of options	0.00	137,886.17	0.00	0.00	137,886.17
Profit for the period	0.00	0.00	0.00	-3,820,199.31	-3,820,199.31
<b>31 December 2007</b>	<b>16,755,552.00</b>	<b>85,737,273.03</b>	<b>0.00</b>	<b>-66,828,608.63</b>	<b>35,664,216.40</b>
Issue of shares	7,847,367.00	0.00	0.00	0.00	7,847,367.00
Contribution to the capital reserve	0.00	3,531,315.15	0.00	0.00	3,531,315.15
Payments in connection with the issuing of new shares	0.00	-981,364.40	0.00	0.00	-981,364.40
Additional contribution to the capital reserve due to the issue of options	0.00	196,992.01	0.00	0.00	196,992.01
Currency conversion of foreign subsidiaries	0.00	0.00	-72,552.33	0.00	-72,552.33
Loss for the period	0.00	0.00	0.00	-9,319,547.84	-9,319,547.84
<b>30 September 2008</b>	<b>24,602,919.00</b>	<b>88,484,215.79</b>	<b>-72,552.33</b>	<b>-76,148,156.47</b>	<b>36,866,425.99</b>

## Selected Explanatory Notes to the Consolidated Interim Financial Statements as of 30 September 2008

### General

The half-year financial report of PAION AG includes interim consolidated financial statements and an interim group management report in accordance with the provisions of Secs. 37x (3) and 37w (2) to (4) WpHG [“Wertpapierhandelsgesetz”: German Securities Trading Act] in conjunction with Sec. 37y WpHG. The interim consolidated financial statements have been prepared pursuant to the International Financial Reporting Standards (IFRSs) for interim financial reporting. The interim group management report was prepared in accordance with the relevant provisions of the German Securities Trading Act.

The interim consolidated financial statements comprise PAION AG as the parent company, registered at Martinstrasse 10-12, 52062 Aachen, Germany, and the wholly-owned subsidiary PAION Deutschland GmbH, Aachen, Germany, which is fully consolidated. Additionally, the interim consolidated financial statements include PAION Holdings UK Ltd (until July 2008: CeNeS Pharmaceuticals plc), Irvine, Scotland, and its subsidiaries, which were acquired in June 2008 and which are fully consolidated. More details on this acquisition are provided under “Changes in the Scope of Consolidation” in these interim consolidated financial statements.

### Basis of Accounting

The interim consolidated financial statements have been prepared in accordance with Sec. 315a HGB [“Handelsgesetzbuch”: German Commercial Code] and IFRSs, as adopted by the EU, and the interpretations of the International Financial Reporting Interpretations Committee (IFRIC). All IFRSs issued by the International Accounting Standards Board (IASB), London, UK, which were effective as of the balance sheet date of 30 September 2008 and applied by PAION, were adopted by the European Commission for application in the EU. The following standards adopted by the European Commission came into effect during the reporting period for the interim consolidated financial statements:

- IFRIC 11: In November 2006, the IFRIC published IFRIC 11, “IFRS 2 – Group and Treasury Share Transactions”. IFRIC 11 answers the question as to how IFRS 2, “Share-Based Payment”, applies to share-based payment arrangements involving an entity granting rights to its own equity instruments or equity instruments of another group entity. IFRIC 11 is effective for reporting periods beginning on or after 1 March 2007. Application of this new interpretation may in some cases lead to additional disclosures in the next set of consolidated financial statements and does currently not have any effect on the Group’s net assets, financial position and results of operations.
- IAS 39 and IFRS 7: On 13 October 2008, the IASB published amendments to IAS 39 “Financial Instruments: Recognition and Measurement” and IFRS 7 “Financial Instruments: Disclosures” to allow reclassifications of certain financial instruments held for trading to either the held to maturity, loans and receivables or available for sale categories. The amendment also allows the transfer of certain instruments from available for sale to loans and receivables. The amendments were endorsed by the European Union on 15 October 2008. The effective date is 1 July 2008. Since PAION does not have any affected financial instruments, these amendments do not have any effects on the Group’s net assets, financial position and results of operations.

The provisions of IAS 34, “Interim Financial Reporting”, have been applied. The interim consolidated financial statements as of 30 September 2008 should be read in conjunction with the consolidated financial statements as of 31 December 2007.

The preparation of interim consolidated financial statements in accordance with IFRSs requires management to make estimates and assumptions which have an effect on the amount of recognised assets and liabilities, income and expenses and contingent liabilities. Actual amounts may differ from these estimates.

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

## Consolidation Principles

The consolidation principles used in the interim consolidated financial statements as of 30 September 2008 were the same as those used in the consolidated financial statements as of 31 December 2007.

## Changes in the Scope of Consolidation

On 20 June 2008, PAION AG gained control over CeNeS Pharmaceuticals plc (in the meantime changed in PAION Holdings UK Ltd) by acquiring 100% of the shares of this company and its subsidiaries. PAION Holdings UK Ltd is a biopharmaceutical company, which together with its subsidiaries specialised in the development of drugs for CNS disorders. Before the acquisition, PAION Holdings UK Ltd was listed on the Alternative Investment Market of the London stock exchange (AIM). The acquisition was effected by means of an exchange of shares. The management of PAION AG with approval of the supervisory board has decided to increase the company's share capital by 7,847,367 new shares against contribution in kind based on the authorisation at the Annual General Meeting on 10 May 2006. The new shares were registered on 23 June 2008.

The acquisition of the PAION UK group was accounted for by applying the purchase method. The net result of the PAION UK group during the time period from the acquisition date, 20 June 2008 to the closing date was recognized in these interim consolidated financial statements. The acquisition costs of EUR 12,318k consist of the fair value of the newly issued shares amounting to EUR 11,379k and costs of EUR 939k directly attributable to the business combination. The fair value of the newly issued shares is the result of the number of new shares (7,847,367 pieces) and the share price at the acquisition date of EUR 1.45. The amount exceeding the nominal amount of the share capital was recognized as increase of the capital reserve (EUR 3,531k). In connection with the takeover of the PAION UK group, also cash and cash equivalents of EUR 463k were acquired. Deduction of the directly attributable costs results in a cash outflow of EUR 476k.

The fair values of PAION UK assets, liabilities and contingent liabilities and their book values immediately before the business combination are shown in the following table.

	Fair Values at Date of Acquisition	Book Values Immediately Before Business Combination
	EUR k	EUR k
Goodwill	0	7,239
Intangible assets	18,664	84
Tangible assets	13	13
Non-current assets	18,677	7,336
Other current assets	1,808	1,808
Cash and cash equivalents	463	463
Current assets	2,271	2,271
Provisions	1,305	1,305
Deferred taxes	5,202	0
Non-current liabilities	6,507	1,305
Trade payables	1,796	1,796
Provisions	198	198
Other current liabilities	129	129
Current Liabilities	2,123	2,123
<b>Net Assets</b>	<b>12,318</b>	<b>6,179</b>

The allocated purchase price includes development projects with a fair value of EUR 18,580k in total, which were capitalised as intangible assets. Also deferred tax liabilities of EUR 5,202k were determined in the course of this fair value adjustment. The goodwill formerly balanced by CeNeS Pharmaceuticals plc resulted from previous transactions is no longer recognised, as it is included in the project values.

The net loss of EUR 3,331k incurred by the PAION UK group after the acquisition date is recognized in the net loss of the Group. A material part of that loss is related to transaction and restructuring costs. Had the transaction taken place at the beginning of the year, the net loss for the period of EUR 9,320k would have increased by EUR 4,409k to EUR 13,729k. The revenue would have remained unchanged as the PAION UK group did not generate any revenues in the first half of 2008.

## Foreign Currency Translation

The consolidated financial statements are shown in EURO, being the Group's functional and reporting currency. Each company within the Group defines its own functional currency. All items of the financial statements of each company are converted to the functional currency by using the exchange rate on the day of each accounting transaction. Monetary assets and liabilities in a foreign currency are converted to the functional currency with the period-end exchange rate. All currency differences immediately effect the net loss.

Goodwill resulting from an acquisition of a foreign company and all fair value adjustments made to the book values of assets and liabilities of the foreign company are accounted for as assets and liabilities of the foreign company and are converted to EURO with the period-end exchange rate. Expenses and income are converted with the weighted average exchange rate of the financial year. The resulting currency differences are accounted for separately within equity.

## Accounting Policies

The accounting policies used in the interim consolidated financial statements as of 30 September 2008 remained the same as those used in the consolidated financial statements as of 31 December 2007.

## Licence Agreement between PAION and Lundbeck

Pursuant to a new licence agreement concluded on 21 December 2007 between PAION and Lundbeck, Lundbeck has been granted the exclusive global rights for the development and marketing of Desmoteplase. The agreement was contingent on the successful completion of a patent review in progress at the time of conclusion. On 29 January 2008, Lundbeck announced that the patent review was completed and that the new licence agreement was in effect without condition as of that day. Under the agreement, Lundbeck has agreed to make the following payments:

- Payment of non-refundable upfront and milestone payments amounting up to EUR 71 million in total, of which a non-refundable payment of EUR 8 million in advance was made on the date the agreement became effective.
- Assumption of all future costs, especially for clinical development, production development, approval and marketing.

The payment of the non-refundable amount of EUR 8 million was made on 31 January 2008. The non-refundable amount of EUR 8 million in connection with the global outlicensing agreement is recognised as deferred income and is being released over the anticipated development period for Desmoteplase.

## Restructuring

### a) Discontinuation of Enecadin

PAION decided in 2008 to discontinue the clinical development of the neuroprotectant Enecadin and to return all rights to the Japanese licensor Nippon Shinyaku Co., Ltd. Enecadin is a neuroprotectant that was originally intended to be used in connection with Desmoteplase. PAION took this decision in light of scientific data which called into question the viability of this substance class.

### b) Staff reduction in Germany and England and close-down of Berlin laboratories

In the course of the CeNeS acquisition, PAION decided to reduce its staff and to adjust its infrastructure to the new organisational requirements. Therefore, the number of employees was reduced by 23, thereof 19 former employees of the PAION Germany group and 4 former employees of the PAION UK group. Severance payments of about EUR 1,510k were expensed.

The research laboratories in Berlin were closed at 30 June 2008. A complete value adjustment was made on all previously used equipment due to lack of future benefits. An accrual was made for the existing removal obligations of the rented premises in Berlin. The close-down of the Berlin laboratories effects the net loss for the period by EUR 373k.

## Stock Option Program 2008

On 5 May 2008, the Annual General Meeting approved a Stock Option Plan for the granting of options for the purchase of stocks of PAION AG to board members and employees. The program allows for the granting of a total of 815,000 options, thereof 366,750 to board members and 448,250 to employees. One option qualifies for the acquisition of one share out of the "Authorised Capital 2008", which was set up for this purpose. The options have a maturity of ten years and can be exercised only after a vesting period. The vesting period for beneficiaries

receiving options for the first time starts with the grant date and ends for 50% of the options two years after the grant date; for 25% of the options the vesting period ends after three respectively four years after the grant date. For all other beneficiaries the vesting period ends two years after the grant date. An exercise requires furthermore a cumulated increase of the share price of 5% p.a. since granting. As of 30 September 2008, 378,140 options were granted with an exercise price of EUR 1.26, of which 183,740 options were granted to board members and 194,400 options were granted to employees. Accounting for the stock option program is done in accordance with IFRS 2 Share-based Payments.

## Reimbursement of Research and Development Costs through British Tax Authorities

Research and Development is being subsidized in England upon existence of certain conditions. The subsidy envisages the refund of part of the research and development expenses from the tax authorities. PAION UK Ltd has in the past qualified for these tax credits and will probably do so in the future as well. The corresponding income is netted off against the research and development expenses.

## Related Parties

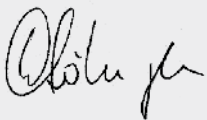
The relationships with related parties have not changed in comparison to those applied in the consolidated financial statements as of 31 December 2007 except through the changes in the Management and Supervisory Board outlined in the Management Report.

## Significant Events Occurring After the Balance Sheet Date

No significant events occurred in the time period between the balance sheet date, 30 September 2008, and the finalisation date of this report.

Aachen, 5 November 2008

PAION AG



Dr. Wolfgang Söhngen



Alexander Vos



Bernhard Hofer



Dr. Mariola Söhngen



Dr. Gavin Kilpatrick

# Review Report

## To PAION AG, Aachen:

We have reviewed the condensed consolidated interim financial statements – comprising the balance sheet, income statement, cash flow statement, statement of changes in equity and selected explanatory notes – together with the interim group management report of PAION AG, Aachen, for the period from January 1 to September 30, 2008 which are components of the interim financial report pursuant to § (Article) 37x Abs. (paragraph) 3 WpHG ("Wertpapierhandelsgesetz": German Securities Trading Act). The preparation of the condensed consolidated interim financial statements in accordance with the IFRS applicable to interim financial reporting as adopted by the EU and of the interim group management report in accordance with the provisions of the German Securities Trading Act applicable to interim group management reports is the responsibility of the parent Company's Board of Managing Directors. Our responsibility is to issue a review report on the condensed consolidated interim financial statements and on the interim group management report based on our review.

We conducted our review of the condensed consolidated interim financial statements and the interim group management report in accordance with German generally accepted standards for the review of financial statements promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany) (IDW) and additionally in accordance with the International Standard on Review Engagements "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" (ISRE 2410). Those standard require that we plan and perform the review so that we can preclude through critical evaluation, with moderate assurance, that the condensed consolidated interim financial

statements have not been prepared, in all material respects, in accordance with the IFRS applicable to interim financial reporting as adopted by the EU and that the interim group management report has not been prepared, in all material respects, in accordance with the provisions of the German Securities Trading Act applicable to interim group management reports. A review is limited primarily to inquiries of company personnel and analytical procedures and thus provides less assurance than an audit. Since, in accordance with our engagement, we have not performed a financial statement audit, we cannot express an audit opinion.

Based on our review, no matters have come to our attention that cause us to presume that the condensed consolidated interim financial statements have not been prepared, in all material respects, in accordance with the IFRS applicable to interim financial reporting as adopted by the EU nor that the interim group management report has not been prepared, in all material respects, in accordance with the provisions of the German Securities Trading Act applicable to interim group management reports.

Cologne, Germany, November 5, 2008

Ernst & Young AG  
Wirtschaftsprüfungsgesellschaft  
Steuerberatungsgesellschaft

(signed) Gockel  
Wirtschaftsprüfer  
[German Public Auditor]

(signed) Schlöder  
Wirtschaftsprüfer  
[German Public Auditor]

PAION AG

Martinstraße 10 – 12

52062 Aachen Germany

Phone +49 241 4453-0

Fax +49 241 4453-100

info@paion.com www.paion.com