

**THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION.**

**PART 2 OF THIS DOCUMENT COMPRISES AN EXPLANATORY STATEMENT IN COMPLIANCE WITH SECTION 897 OF THE COMPANIES ACT 2006.**

**If you are in any doubt as to the action you should take, you should seek your own financial advice immediately from your stockbroker, bank manager, solicitor, accountant or other independent financial adviser authorised under the Financial Services and Markets Act 2000 if you are in the United Kingdom, or, if not, from another appropriately authorised independent financial adviser.**

If you have sold or otherwise transferred all your CeNeS Shares, please forward this document, and the accompanying documents, at once to the purchaser or transferee or to the stockbroker, bank or other agent through whom the sale or transfer was effected, for delivery to the purchaser or transferee. However, such documents should not be forwarded or transmitted in or into any jurisdiction in which such act would constitute a violation of the relevant laws in such jurisdiction. If you have sold or transferred part of your holding of CeNeS Shares, please consult the bank, stockbroker or other agent through whom the sale or transfer was effected.

Application will be made for the New Paion Shares to be admitted to trading on the Regulated Market (Regulierter Markt) of the Frankfurt Stock Exchange (with simultaneous admission to the sub-segment of the Regulated Market with additional post admission obligations (Prime Standard)) and for all Paion Shares, including the New Paion Shares, to be admitted to trading on AIM.

It is expected that admission to trading of the New Paion Shares on the Regulated Market of the Frankfurt Stock Exchange will become effective on the first Business Day following the Effective Date. It is expected that admission of Paion Shares to trading on AIM will become effective within two dealing days after the Effective Date.

**The distribution of this document in jurisdictions other than the United Kingdom may be restricted by the laws of those jurisdictions and therefore persons into whose possession this document comes should inform themselves about and observe any such restrictions. Failure to comply with any such restrictions may constitute a violation of the securities laws of any such jurisdiction.**

The availability of the New Paion Shares to persons who are not resident in the United Kingdom may be affected by the laws of the relevant jurisdictions in which they are located. Persons who are not resident in the United Kingdom should inform themselves of and observe any applicable requirements.

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**Recommended acquisition of all the  
issued and to be issued share capital of**

**CeNeS Pharmaceuticals plc**

*(incorporated in Scotland with registered number SC166791)*

**by**

**PAION AG**

**to be effected by a**

**Scheme of Arrangement**

**under Part 26 of the Companies Act 2006**

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**Your attention is drawn to the letter from the Chairman of CeNeS on behalf of the CeNeS Directors in Part 1 of this document, which contains the unanimous recommendation of the CeNeS Directors that you vote in favour of the Scheme at the Court Meeting and in favour of the special resolution relating to the Acquisition to be proposed at the General Meeting. A letter from Nomura Code explaining the Scheme appears in Part 2 of this document.**

Notices convening the Court Meeting and the General Meeting, both of which will be held at the offices of Morrison & Foerster, 7th Floor, CityPoint, One Ropemaker Street, London EC2Y 9AW on 28 May 2008, are set out in Appendix I and Appendix J to this document respectively. The Court Meeting will start at 11:00 a.m. and the General Meeting will start at 11:30 a.m. (or as soon thereafter as the Court Meeting has been concluded or adjourned).

**The action to be taken by CeNeS Shareholders in respect of the Meetings is set out on page 3. Subject to the next following paragraph, whether or not you plan to attend both or either of the Meetings, please complete the enclosed Forms of Proxy and return them in accordance with the instructions printed thereon, which apply whether or not your CeNeS Shares are in uncertificated form (i.e. in CREST). Such Forms of Proxy should be returned by post or, during normal business hours, by hand to Equiniti, Aspect House, Spencer Road, Lancing, BN99 6ZR as soon as possible and in any event so as to be received no later than 11:00 a.m. on 26 May 2008 in the case of the Court Meeting and no later than 11:30 a.m. on 26 May 2008 in the case of the General Meeting or in the case of any adjournment, not later than 48 hours before the time fixed for the holding of the adjourned meeting. If the blue Form of Proxy for use at the Court Meeting is not received by 11:00 a.m. on 26 May 2008, it may be handed to the Registrars on behalf of the chairman of the Court Meeting before the taking of the poll. However, in the case of the General Meeting, unless the pink Form of Proxy is received by 11:30 a.m. on 26 May 2008 (or, in the case of any adjournment, not later than 48 hours before the time fixed for the holding of the adjourned meeting), it will be invalid. The completion and return of a Form of Proxy will not prevent you from attending and voting at either of the Meetings, or any adjournment thereof, in person should you wish to do so.**

If you hold your CeNeS Shares in uncertificated form you may instead vote using the CREST Proxy Voting Service in accordance with the procedures set out in the CREST Manual (please also refer to the notice of the Court Meeting and the notes to the notice of the General Meeting set out in Appendix I and Appendix J to this document respectively). Proxies submitted via CREST (under CREST participant 7RA01) must be received by the Registrars not later than 11:00 a.m. on 26 May 2008 in the case of the Court Meeting and no later than 11:30 a.m. on 26 May 2008 in the case of the General Meeting or in the case of any adjournment, not later than 48 hours before the time fixed for the holding of the adjourned meeting.

Nomura Code, which is authorised and regulated in the UK by the Financial Services Authority, is acting for CeNeS and no-one else in connection with the Acquisition and will not be responsible to anyone other than CeNeS for providing the protections afforded to clients of Nomura Code or for giving advice in relation to the Acquisition nor any other matter referred to in this document.

Landsbanki, which is authorised and regulated in the UK by the Financial Services Authority, is (in its function as financial adviser) acting for Paion and no-one else in connection with the Acquisition and will not be responsible to anyone other than Paion for providing the protections afforded to clients of Landsbanki or for giving advice in relation to the Acquisition nor any other matter referred to in this document.

Some words and terms used in this document are defined in Appendix H to this document. All times referred to are London times unless otherwise stated.

## **IMPORTANT NOTICE**

In this notice, any reference to a New Paion Share includes any interest in a New Paion Share represented by a Paion DI.

### **Overseas jurisdictions**

This document does not constitute an offer or invitation to acquire or exchange securities in Paion or CeNeS or the solicitation of any vote or approval in any jurisdiction in which such offer, invitation or solicitation is unlawful. This document does not constitute a prospectus or a prospectus equivalent document.

The implications of the Scheme for overseas CeNeS Shareholders may be affected by the laws of the relevant jurisdictions. Such overseas CeNeS Shareholders should inform themselves about and observe any applicable legal requirements. It is the responsibility of each overseas CeNeS Shareholder to satisfy himself as to the full observance of the laws of the relevant jurisdiction in connection therewith, including the obtaining of any governmental, exchange control or other consents which may be required to be observed and the payment of any issue, transfer or other taxes in such jurisdictions. The distribution of this document in jurisdictions other than the United Kingdom may be restricted by law and therefore persons in such jurisdictions into whose possession this document comes should inform themselves about and observe such restrictions. Any failure to comply with these restrictions may constitute a violation of the securities laws of any such jurisdiction. Further details in relation to Overseas Shareholders are contained in paragraph 19 of Part 2 of this document. All CeNeS Shareholders or other persons (including nominees, trustees and custodians) who would otherwise intend to, or may have a contractual or legal obligation to, forward this document and the accompanying Forms of Proxy to a jurisdiction outside the United Kingdom should refrain from doing so and seek appropriate professional advice before taking any action.

The New Paion Shares have not been, and neither will they be, registered in or the subject of a prospectus prepared according to the laws of any of the Restricted Overseas Jurisdictions and dealings therein may be subject to restrictions under the laws of such jurisdictions.

This document and the accompanying documents have been prepared in connection with a scheme of arrangement pursuant to and for the purpose of complying with English law and, where applicable in relation to the Scheme, Scots law, the Code and the AIM Rules for Companies and information disclosed may not be the same as that which would have been prepared in accordance with the laws of jurisdictions outside the United Kingdom. Nothing in this document or the accompanying documents should be relied on for any other purpose.

### **Notice to US shareholders of CeNeS**

For US securities law purposes, the exchange offer set out in this document will be made for the securities of a foreign company by means of a scheme of arrangement under Part 26 of the United Kingdom Companies Act 2006. The New Paion Shares will not be registered under the US Securities Act in reliance on the exemption from registration contained in Section 3(a)(10) of the US Securities Act. The offer is subject to disclosure and procedural requirements of a foreign country that are different from those which would apply to a public offering of securities in the US. Financial statements relating to CeNeS and Paion included or incorporated in this document have been prepared in accordance with foreign accounting standards that may not be comparable to the financial statements of US companies.

It may be difficult for you to enforce your rights and any claim you may have arising under United States federal securities laws, since CeNeS is located in a foreign country, and some or all of its officers and directors may be residents of a foreign country. You may not be able to sue CeNeS or its officers or directors in a foreign court for violations of the US securities laws. It may be difficult to compel CeNeS and its affiliates to subject themselves to a US court's judgment.

This document has not been reviewed by any federal or state securities commission or regulatory authority in the United States, nor has any such commission or authority passed upon the accuracy or adequacy of this document. Any representation to the contrary is unlawful and may be a criminal offence.

### **Unauthorised statements**

No person has been authorised to make any representations on behalf of CeNeS or Paion concerning the Acquisition or the Scheme which are inconsistent with the statements contained herein and any such representations, if made, may not be relied upon as having been so authorised.

### **Provisions of the Scheme**

The summary of the principal provisions of the Scheme contained in this document is qualified in its entirety by reference to the Scheme itself, the full text of which is set out in Part 3 of this document. Each CeNeS Shareholder is advised to read and consider carefully the text of the Scheme itself. This is because this document, and in particular, the Chairman's Letter (Part 1) and Explanatory Statement (Part 2) have been prepared solely to assist CeNeS Shareholders in respect of their decisions as to how to vote on the Scheme.

### **No legal, tax or financial advice**

CeNeS Shareholders should not construe the contents of this document as legal, tax or financial advice, and should consult with their own advisers as to the matters described herein.

### **Statements are made as at the date of this document**

The statements contained herein are made as at the date of this document, unless some other time is specified in relation to them, and service of this document shall not give rise to any implication that there has been no change in the facts set forth herein since such date. Nothing contained herein shall be deemed to be a forecast, projection or estimate of the future financial performance of Paion or CeNeS or the Enlarged Group except where otherwise stated.

### **Paion Prospectus**

Paion is expected to publish the Paion Prospectus in connection with the listing of the New Paion Shares on the Regulated Market of the Frankfurt Stock Exchange on or about 16 May 2008. Copies of the Paion Prospectus will be sent to CeNeS Shareholders prior to the Court Meeting and the General Meeting. The Paion Prospectus will be published in English, with a summary in German.

### **Forward-looking statements**

This document includes forward-looking statements with respect to the financial condition, results of operations and businesses of Paion and CeNeS and certain plans and objectives of the Paion Directors and the CeNeS Directors with respect to them. These forward-looking statements can be identified by the fact that they do not relate only to historical or current facts. Forward-looking statements often use words such as "anticipate", "expect", "estimate", "intend", "plan", "goal", "believe", "will", "may", "should", "would", "could", or other words of similar meaning. These statements are based on assumptions and assessments made by the Paion Directors and the CeNeS Directors in light of their experience and their perception of historical trends, current conditions, expected future developments and other factors they believe appropriate. By their nature, forward-looking statements involve risk and uncertainty, because they relate to events and depend on circumstances that will occur in the future and the factors described in the context of such forward-looking statements in this document could cause actual results and developments to differ materially from those expressed in or implied by such forward-looking statements.

These risks and uncertainties include, among others, the risk that (1) neither Paion nor CeNeS have been profitable to date and may together as the Enlarged Group never achieve profitability; (2) the Enlarged Group will to a large extent rely on collaborations with third parties

to progress the development of its drug candidates; (3) the Enlarged Group might not succeed in entering into collaborative agreements with third parties for the further clinical development and marketing for its drug candidates, including M6G, and thus might not be able to complete the clinical development of these drug candidates in a timely manner or at all; (4) M6G, the CeNeS Group's most advanced drug candidate, is subject to limited intellectual property protection and is developed for a price-sensitive market segment; (5) the Enlarged Group may have difficulty integrating its two constituent businesses and/or may have to incur significant expenses in doing so and any expected synergies or other benefits may fail to materialise or be less pronounced than expected; and (6) the Scheme may not be completed or completion may be delayed, including the risk that required shareholder and other approvals for the Scheme may not be obtained.

Should one or more of these risks or uncertainties materialise, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein. CeNeS and Paion assume no obligation to update or correct the information contained in this document.

### **Capita**

Neither Capita IRG Trustees Limited nor Capita Trust Company Limited make any representations or recommendations whatsoever regarding this document and accept no responsibility or liability for any information contained herein. Capita IRG Trustees Limited and Capita Trust Company Limited owe no duty to any holder of CeNeS Shares.

### **Dealing disclosure requirements**

Under the provisions of Rule 8.3 of the Code, if any person is, or becomes, "interested" (directly or indirectly) in 1 per cent. or more of any class of "relevant securities" of CeNeS or Paion, all "dealings" in any "relevant securities" of that company (including by means of an option in respect of, or a derivative referenced to, any such "relevant securities") must be publicly disclosed by no later than 3:30 pm (London time) on the London business day following the date of the relevant transaction. This requirement will continue until the date on which the Scheme becomes effective or the Acquisition lapses or is otherwise withdrawn or on which the "offer period" otherwise ends. If two or more persons act together pursuant to an agreement or understanding, whether formal or informal, to acquire an "interest" in "relevant securities" of CeNeS or Paion, they will be deemed to be a single person for the purpose of Rule 8.3.

Under the provisions of Rule 8.1 of the Code, all "dealings" in "relevant securities" of CeNeS or of Paion by CeNeS or Paion, or by any of their respective "associates", must be disclosed by no later than 12:00 noon (London time) on the London business day following the date of the relevant transaction.

A disclosure table, giving details of the companies in whose "relevant securities" "dealings" should be disclosed, and the number of such securities in issue, can be found on the Panel's website at [www.thetakeoverpanel.org.uk](http://www.thetakeoverpanel.org.uk).

"Interests in securities" arise, in summary, when a person has long economic exposure, whether conditional or absolute, to changes in the price of securities. In particular, a person will be treated as having an "interest" by virtue of the ownership or control of securities, or by virtue of any option in respect of, or derivative referenced to, securities.

Terms in quotation marks are defined in the Code, which can also be found on the Panel's website. If you are in any doubt as to whether or not you are required to disclose a "dealing" under Rule 8, you should consult the Panel.

As at the date of this document Paion has 16,755,552 ordinary no-par value bearer shares representing a notional value equal to €1.00 per share in issue and admitted to trading on the Frankfurt Stock Exchange under the ISIN code DE 000A0B65S3. As at the date of this document CeNeS has 21,920,192 ordinary shares of 30 pence each in issue and admitted to trading on AIM under the ISIN GB 00B23MNL84.

Dated 2 May 2008

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## EXPECTED TIMETABLE OF EVENTS

All times shown in this document are London times unless otherwise stated

<i>Event</i>	<i>Time and/or date</i>
Date of publication of Paion Prospectus	16 May 2008 <sup>(1)</sup>
<b>Latest time for lodging blue Forms of Proxy for the Court Meeting</b>	<b>11:00 a.m. on 26 May 2008<sup>(2)</sup></b>
<b>Latest time for lodging pink Forms of Proxy for the General Meeting</b>	<b>11:30 a.m. on 26 May 2008<sup>(3)</sup></b>
Voting Record Time for the Court Meeting and the General Meeting	6:00 p.m. on 27 May 2008 <sup>(4)</sup>
<b>Court Meeting</b>	<b>11:00 a.m. on 28 May 2008</b>
<b>General Meeting</b>	<b>11:30 a.m. on 28 May 2008<sup>(5)</sup></b>
Last day of dealings in CeNeS Shares	19 June 2008 <sup>(6)</sup>
Court Hearing	20 June 2008 <sup>(6)</sup>
<b>Effective Date</b>	<b>23 June 2008<sup>(6)</sup></b>
Cancellation of trading of CeNeS Shares on AIM	23 June 2008 <sup>(6)</sup>
Registration of the capital increase for the issue of the New Paion Shares with the Commercial Register	23 June 2008 <sup>(6)</sup>
Issue on trust/delivery of New Paion Shares to the Trustee for onward distribution to CeNeS Shareholders	23 June 2008 <sup>(6)</sup>
Commencement of dealings in New Paion Shares on the Frankfurt Stock Exchange	24 June 2008 <sup>(6)</sup>
Commencement of dealings in New Paion Shares on AIM	25 June 2008 <sup>(6)</sup>
Latest date for settlement of consideration	7 July 2008 <sup>(6)</sup>

(1) The date of publication of the Paion Prospectus is dependent, *inter alia*, on the approval of the Paion Prospectus by the BaFin.

(2) The blue Form of Proxy for the Court Meeting if not lodged by this deadline may be handed to the Registrars on behalf of the chairman of the Court Meeting at any time before the taking of the poll.

(3) The pink Form of Proxy for the General Meeting must be lodged no later than 11:30 a.m. on 26 May 2008 in order to be valid or, if the General Meeting is adjourned, not later than 48 hours before the time fixed for the holding of the adjourned meeting.

(4) If either the Court Meeting or the General Meeting is adjourned, the time fixed for determining the entitlement of CeNeS Shareholders to vote at the adjourned meeting(s) will be 48 hours before the time fixed for the adjourned meeting.

(5) The General Meeting will commence at 11:30 a.m. on 28 May 2008 or as soon thereafter as the Court Meeting has been concluded or adjourned.

(6) These dates are indicative only and will depend, *inter alia*, on the date upon which the Conditions are either satisfied or waived and the dates upon which the Court sanctions the Scheme and confirms the Reduction and the Court Order(s) are delivered to the Registrar of Companies and, in respect of the Reduction, registered by the Registrar of Companies.

**The Court Meeting and the General Meeting will be held at the offices of Morrison & Foerster, 7th Floor, CityPoint, One Ropemaker Street, London EC2Y 9AW, on 28 May 2008.**

**The dates given are based on CeNeS's current expectations and may be subject to change. If the expected dates of the Court Meeting, the General Meeting and/or the Court Hearing change, or there is any other change to the expected timetable of events, CeNeS will give adequate notice of the change by issuing an announcement through a Regulatory Information Service.**

## **EXCHANGE RATE**

The exchange rate used in this document is €1.26558 = £1 (being the Euro foreign exchange reference rate as at 30 April 2008 (the latest practicable date prior to publication of this document) as quoted by the European Central Bank on <http://www.ecb.int/stats/exchange/eurofxref/html/index.en.html>), save that for the purpose of stating the value of the cash and cash equivalents of the Enlarged Group on a pro-forma basis as at 31 December 2007 in this document, the exchange rate used is €1.36361 = £1 (being the Euro foreign exchange reference rate as at 31 December 2007 as quoted by the European Central Bank on <http://www.ecb.int/stats/exchange/eurofxref/html/index.en.html>).



## ACTION TO BE TAKEN

The Court Meeting and the General Meeting will be held at the offices of Morrison & Forester, 7th Floor, CityPoint, One Ropemaker Street, London EC2Y 9AW on 28 May 2008 at 11:00 a.m. and 11:30 a.m., respectively (or, in the case of the General Meeting, as soon thereafter as the Court Meeting has been concluded or adjourned). The Scheme requires approval of the resolutions to be proposed at both of these Meetings.

### **Please check you have received the following with this document:**

- a blue Form of Proxy for use in respect of the Court Meeting on 28 May 2008; and
- a pink Form of Proxy for use in respect of the General Meeting on 28 May 2008.

### **Paion Prospectus**

Paion is expected to publish the Paion Prospectus in connection with the listing of the New Paion Shares on the Regulated Market of the Frankfurt Stock Exchange on or about 16 May 2008. Copies of the Paion Prospectus will be sent to CeNeS Shareholders prior to the Court Meeting and the General Meeting. The Paion Prospectus will be published in English, with a summary in German.

### **To vote on the Acquisition**

**It is important that, for the Court Meeting, as many votes as possible are cast so that the Court may be satisfied that there is a fair and reasonable representation of the opinion of Scheme Shareholders. You are therefore strongly urged to sign and return your Forms of Proxy as soon as possible.**

**Therefore, subject to the next following paragraph, whether or not you plan to attend both or either of the Meetings, please complete the enclosed Forms of Proxy and return them in accordance with the instructions printed thereon, which apply whether or not your CeNeS Shares are in uncertificated form (i.e. in CREST). Such Forms of Proxy should be returned by post (or, during normal business hours, by hand) to Equiniti, Aspect House, Spencer Road, Lancing, BN99 6ZR as soon as possible and in any event so as to be received no later than 11:00 am on 26 May 2008 in the case of the Court Meeting (blue form) and no later than 11:30 am on 26 May 2008 in the case of the General Meeting (pink form) or in the case of any adjournment, not later than 48 hours before the time fixed for the holding of the adjourned meeting.** This will enable your votes to be counted at the Meetings in the event of your absence. If the blue Form of Proxy for use at the Court Meeting is not received by 11:00 a.m. on 26 May 2008, it may be handed to the Registrars on behalf of the chairman of the Court Meeting before the taking of the poll. However, in the case of the General Meeting, unless the pink Form of Proxy is received by 11:30 a.m. on 26 May 2008 (or, in the case of any adjournment, not later than 48 hours before the time fixed for the holding of the adjourned meeting), it will be invalid.

If you hold your Scheme Shares in uncertificated form (i.e. in CREST), you may instead vote using the CREST Proxy Voting Service in accordance with the procedures set out in the CREST Manual (please also refer to the notice of the Court Meeting and the notes to the notice of the General Meeting set out in Appendix I and Appendix J to this document respectively). Proxies submitted via CREST (under CREST participant 7RA01) must be received by the Registrars not later than 11:00 a.m. on 26 May 2008 in the case of the Court Meeting and no later than 11:30 a.m. on 26 May 2008 in the case of the General Meeting (or, in the case of an adjourned meeting, not less than 48 hours prior to the time and date set for the adjourned meeting).

The completion and return of a Form of Proxy will not prevent you from attending and voting at the Court Meeting or the General Meeting, or any adjournment thereof, in person should you wish to do so.



**If you have any questions relating to this document or the completion and return of your Forms of Proxy, please call Equiniti on 0871 384 2998 (or, if calling from outside the United Kingdom, +44 121 415 0281) between 8:30 a.m. and 5:30 p.m. Monday to Friday (excluding public bank holidays in England). Please note that calls to these numbers may be monitored or recorded and no advice in relation to the Acquisition can be given to you.**

## PART 1

### Letter from the Chairman of CeNeS

*Directors:*

Alan Goodman (*Chairman*)

Neil Clark (*Chief Executive*)

Tony Osborne (*Finance Director and Company Secretary*)

Ronald Irwin (*Non-Executive Director*)

Dr Peter Johnson (*Non-Executive Director*)

Alan Smith (*Non-Executive Director*)

*Registered office*

Riverside Way

Riverside Business Park

Irvine KA11 5DJ

Scotland

2 May 2008

To: CeNeS Shareholders and, for information only, to participants in the CeNeS Share Schemes

Dear Shareholder,

### **Recommended Acquisition of CeNeS Pharmaceuticals plc by PAION AG**

#### **1. Introduction**

On 10 April 2008, the management board of Paion and the board of directors of CeNeS announced that they had agreed the terms for the recommended acquisition of all the issued and to be issued share capital of CeNeS by Paion (the "**Acquisition**").

This letter sets out the background to the Acquisition and the reasons why the CeNeS Directors are recommending that CeNeS Shareholders vote in favour of the Scheme at the Court Meeting and the special resolution relating to the Acquisition to be proposed at the General Meeting.

This document contains details of the Acquisition and notices of the Meetings at which they will be put to CeNeS Shareholders.

Your attention is drawn to (i) the Explanatory Statement set out in Part 2 of this document which gives details about the Acquisition, (ii) the terms of the Scheme set out in Part 3 of this document and (iii) the additional information set out in the Appendices to this document.

If the Scheme becomes Effective, it will be binding on all CeNeS Shareholders irrespective of whether or not they attended or voted at the Court Meeting or the General Meeting.

#### **2. Summary of the terms of the Acquisition**

The Acquisition will be effected by means of a scheme of arrangement between CeNeS and the Scheme Shareholders under Part 26 of the Companies Act 2006 (involving a reduction of capital under sections 135 to 138 of the Companies Act 1985).

If the Scheme becomes Effective, each Scheme Shareholder on the register of members of CeNeS at the Scheme Record Time will be entitled to:

**for each CeNeS Share**

**0.3521 New Paion Shares**

Based on the Closing Price of a Paion Share on 30 April 2008 of €1.60 and an exchange rate of €1.26558 =£1, the terms of the Acquisition value each CeNeS Share at 44.5 pence and the ordinary share capital of CeNeS on a fully diluted basis at approximately £9.9 million.

The terms of the Acquisition represent: (i) a premium of 39.1 per cent. to the Closing Price of 32 pence per CeNeS Share on 4 February 2008, the last Business Day before CeNeS announced that it was in discussions which may or may not lead to an offer; and (ii) a premium of 37.0 per cent. to the Closing Price of 32.5 pence per CeNeS Share on 30 April 2008, the last Business Day prior to the date of this document.

The Acquisition is expected to result in the issue to CeNeS Shareholders of approximately 7,850,000 New Paion Shares, representing approximately 31.9 per cent. of the issued share capital of Paion as enlarged by the Acquisition.

Fractions of New Paion Shares will not be allotted or issued pursuant to the Scheme.

Details of the settlement arrangements are set out in paragraph 21 of the Explanatory Statement set out in Part 2 of this document.

The New Paion Shares shall rank *pari passu* with all other Paion Shares in issue on the date on which the New Paion Shares are issued and shall have the right to receive all dividends, distributions and other entitlements made or paid on Paion Shares in respect of the period from 1 January 2008 onwards (but not otherwise).

### **3. Paion Prospectus**

Paion is expected to publish the Paion Prospectus in connection with the listing of the New Paion Shares on the Regulated Market of the Frankfurt Stock Exchange on or about 16 May 2008. Copies of the Paion Prospectus will be sent to CeNeS Shareholders prior to the Court Meeting and the General Meeting. The Paion Prospectus will be published in English, with a summary in German.

### **4. Background to and reasons for the recommendation by the CeNeS Directors**

The CeNeS Directors believe that the Acquisition would benefit CeNeS Shareholders in a number of ways. First, the Enlarged Group should benefit from a greater visibility in the market, a stronger position vis-à-vis potential collaborative partners and a larger investor base. In addition, the Acquisition would allow CeNeS to combine its portfolio of drug candidates, which is focused on compounds for CNS-related interventions, with promising drug candidates for the treatment of thrombotic diseases and thereby achieve a better diversification of the risks inherent in its drug pipeline. A further benefit is that, like CeNeS's own portfolio of drug candidates, Paion's portfolio is focused on the hospital sector. The CeNeS Directors believe that this commonality in the two companies' strategic focus positions the Enlarged Group well to achieve synergies by (1) leveraging the companies' combined know-how to develop innovative therapeutics for the treatment of thrombotic diseases and CNS-related interventions and to conduct clinical trials and interact with regulators in this area and (2) potentially building a single organisation to co-commercialise these drugs once they achieve regulatory approval. The portfolio of clinical projects of the Enlarged Group would consist of two Phase III, one Phase II and one Phase I project with another compound scheduled to enter Phase I in the near future.

The CeNeS Directors therefore believe, and have been so advised by Nomura Code, that for the reasons expressed above, the interests of CeNeS Shareholders are best served by the Acquisition.

### **5. Irrevocable Undertakings and Letter of Intent**

Paion has received irrevocable undertakings and a letter of intent in respect of, in aggregate, 8,136,106 CeNeS Shares, representing approximately 37.1 per cent. of CeNeS's existing issued share capital. Further details of these irrevocable undertakings and the letter of intent are set out in paragraph 11 of the Explanatory Statement set out in Part 2 of this document.

### **6. Management and Employees**

Paion and CeNeS have agreed that, on completion of the Acquisition, Gavin Kilpatrick (currently Chief Scientific Officer of CeNeS) will be appointed to the management board of Paion.

It is also intended that, following completion of the Acquisition, Alan Goodman (currently Chairman of CeNeS) will become a member of the supervisory board of Paion.

Each of Ron Irwin, Peter Johnson and Alan Smith (currently non-executive directors of CeNeS), Alan Goodman, Neil Clark (currently Chief Executive of CeNeS) and Tony Osborne (currently Finance Director of CeNeS) has agreed to resign as a CeNeS Director on the Scheme becoming Effective.

Paion and CeNeS both benefit from strong management teams and staff experienced in the drug development process. Paion intends to maintain the expertise that exists within CeNeS through the retention of the majority of CeNeS staff within the Enlarged Group and does not intend to make any material change in the conditions of employment of CeNeS staff.

Paion intends to maintain CeNeS's and Paion's facilities in Cambridge, UK and Aachen, Germany, respectively.

Further information relating to the effect of the Acquisition on management and employees of Paion is set out in paragraphs 13 and 14 of the Explanatory Statement set out in Part 2 of this document.

## **7. CeNeS Share Schemes**

Participants in the CeNeS Share Schemes are being contacted regarding the effect of the Scheme on their rights and appropriate proposals are being made to participants. Information relating to the effect of the Scheme on participants is set out in paragraph 15 of the Explanatory Statement in Part 2 of this document.

## **8. Cancellation of trading of CeNeS Shares on AIM**

Your attention is drawn to paragraph 17 of the Explanatory Statement set out in Part 2 of this document in relation to Paion's intentions with regard to the cancellation of trading in CeNeS Shares on AIM.

## **9. United Kingdom Taxation**

Your attention is drawn to Appendix F to this document. If you are in any doubt as to your tax position, you should consult an independent professional adviser.

## **10. Action to be Taken**

Your attention is drawn to paragraph 22 of the Explanatory Statement in Part 2 of this document, which explains the action you should take in relation to the Acquisition.

Please read carefully the remainder of this document, including the letter from the Nomura Code set out in Part 2 of this document (being the Explanatory Statement made in compliance with section 897 of the Companies Act 2006). Please note that the information contained in this letter is not a substitute for reading the remainder of this document.

Overseas Shareholders should refer to paragraph 19 of the Explanatory Statement set out in Part 2 of this document. Details relating to settlement are included in paragraph 21 of the Explanatory Statement.

## **11. Recommendation**

**The CeNeS Directors, who have been so advised by Nomura Code, consider the terms of the Acquisition to be fair and reasonable. In providing its advice to the CeNeS Directors, Nomura Code has taken into account the commercial assessments of the CeNeS Directors.**

**Accordingly, the CeNeS Directors unanimously recommend that CeNeS Shareholders vote in favour of the Scheme at the Court Meeting and the special resolution relating to the Acquisition to be proposed at the General Meeting to give effect to the Acquisition (or, in the event that the Acquisition is implemented by way of a Takeover Offer, accept or procure acceptance of such offer), as those CeNeS Directors who own CeNeS Shares have irrevocably undertaken to do in respect of their beneficial holdings of 371,415 CeNeS Shares representing (as at the date of this document) approximately 1.7 per cent. of the existing issued ordinary share capital of CeNeS.**

Yours faithfully

Alan Goodman  
*Chairman*

**PART 2**  
**Explanatory Statement**  
**(in compliance with section 897 of the Companies Act 2006)**

**NOMURA**



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Date: 2 May 2008

*To: CeNeS Shareholders and, for information only, to participants in the CeNeS Share Schemes*

Dear Shareholder,

**Recommended Acquisition of CeNeS Pharmaceuticals plc by PAION AG**

**1. Introduction**

On 10 April 2008, the management board of Paion and the board of directors of CeNeS announced that agreement had been reached on terms for the Acquisition.

The Acquisition is to be implemented by means of a scheme of arrangement under Part 26 of the Companies Act 2006 (involving a reduction of capital under sections 135 to 138 of the Companies Act 1985).

The CeNeS Directors have been advised by Nomura Code in connection with the Acquisition. Nomura Code has been authorised by the CeNeS Directors to write to you to explain the Acquisition and to provide you with other relevant information. Statements made in this letter which refer to the reasons for the Acquisition, the background to the recommendation, information concerning the business of CeNeS and intentions and expectations regarding CeNeS reflect the views of the CeNeS Directors.

In giving its advice, Nomura Code is advising the CeNeS Directors in relation to the Acquisition and is not acting for any CeNeS Shareholders in relation to the Acquisition. Nomura Code will not be responsible to any such person for providing the protections afforded to its clients or for advising any such person in relation to the Acquisition.

This letter sets out and explains the provisions of the Scheme. The Scheme is set out in full in Part 3 of this document. Your attention is also drawn to the conditions to the Acquisition and the implementation of the Scheme set out in Appendix A to this document and the additional information set out in Appendix E to this document.

**2. Recommendation of the Acquisition**

**Your attention is drawn to the letter from the Chairman of CeNeS on behalf of the CeNeS Directors set out in Part 1 of this document, which forms part of this Explanatory Statement and which contains, among other things, the unanimous recommendation by the CeNeS Directors to CeNeS Shareholders to vote in favour of the Scheme at the Court Meeting and the special resolution relating to the Acquisition to be proposed at the General Meeting to give effect to the Acquisition and the background to and reasons for such recommendation.**

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A member of the Nomura group of companies.

### 3. The Acquisition

The Acquisition will be effected by means of a scheme of arrangement under Part 26 of the Companies Act 2006 (involving a reduction of capital under sections 135 to 138 of the Companies Act 1985) between CeNeS and the Scheme Shareholders.

In accordance with the terms of the Scheme, if the Scheme becomes Effective, each Scheme Shareholder on the register at the Scheme Record Time will be entitled to:

**for each CeNeS Share**

**0.3521 New Paion Shares**

Based on the Closing Price of a Paion Share on 30 April 2008 of €1.60 and an exchange rate of €1.26558 =£1, the terms of the Acquisition value each CeNeS Share at 44.5 pence and the ordinary share capital of CeNeS on a fully diluted basis at approximately £9.9 million.

The terms of the Acquisition represent: (i) a premium of 39.1 per cent. to the Closing Price of 32 pence per CeNeS Share on 4 February 2008, the last Business Day before CeNeS announced that it was in discussions which may or may not lead to an offer; and (ii) a premium of 37.0 per cent. to the Closing Price of 32.5 pence per CeNeS Share on 30 April 2008, the last Business Day prior to the date of this document.

The Acquisition is expected to result in the issue to CeNeS Shareholders of approximately 7,850,000 New Paion Shares, representing approximately 31.9 per cent. of the issued share capital of Paion as enlarged by the Acquisition.

Details of the rights attaching to the New Paion Shares are set out in Appendix B.

The New Paion Shares shall rank pari passu with all other Paion Shares in issue on the date on which the New Paion Shares are issued and shall have the right to receive all dividends, distributions and other entitlements made or paid on Paion Shares in respect of the period from 1 January 2008 onwards (but not otherwise).

Fractions of New Paion Shares will not be allotted or issued pursuant to the Scheme.

Details of the settlement arrangements are set out in paragraph 21 below.

**Once Effective, the Scheme will be binding on all Scheme Shareholders, including those Scheme Shareholders who did not vote, or who voted against it, at the Meetings or who could not be traced.**

Your decision as to whether to vote in favour of the Scheme and the Acquisition will depend on your individual circumstances, including your tax position. If you are in any doubt as to the action you should take, you are urged to seek your own independent financial advice.

### 4. Information on CeNeS

CeNeS is a biopharmaceutical company specialising in the development and commercialisation of drugs for CNS disorders, which are a major cause of mortality and disability. The CeNeS Group is focused on the development and commercialisation of novel drugs for use by hospital-based anaesthetists, pain specialists and neurologists. Its portfolio of drug candidates is targeted at postoperative pain, neuropathic pain, sedation, anaesthesia and Parkinson's disease.

In 2007, the CeNeS Group had revenues of £0.5 million and generated a net loss of £6.6 million. As at 31 December 2007, the CeNeS Group had shareholders' equity of £9.2 million, total assets of £11.9 million and 15 full-time equivalent employees.

Further financial information in relation to CeNeS for the three years ended 31 December 2005, 2006 and 2007 and for the three months ended 31 March 2008 is set out in Appendix C to this document.

### 5. Information on Paion

Paion is a biopharmaceutical company specialising in developing and commercialising innovative drugs for the treatment of thrombotic diseases, that is, diseases caused by the



obstruction of a blood vessel by a blood clot. Currently, Paion's focus is on the causal treatment of acute ischaemic stroke. Paion intends to build and expand its portfolio of drug candidates using a "search-and-development" approach. Accordingly, Paion seeks to identify promising new compounds, license or otherwise acquire them and advance them through the clinical development and regulatory approval process. Where appropriate, particularly during the late stages of the clinical development and approval process and the commercialisation phase, Paion seeks to collaborate with experienced partners.

From its inception in July 2000 to 31 December 2007, Paion accumulated a net loss of €66.8 million. In 2007, Paion had revenues of €4.8 million and generated a net loss of €10.5 million. At 31 December 2007, Paion had total assets of €45.5 million, cash and cash equivalents of €42.9 million and 53 full-time equivalent employees.

Further financial information in relation to Paion for the three years ended 31 December 2005, 2006 and 2007 and for the three months ended 31 March 2008 is set out in Appendix D to this document.

## **6. Background to, and reasons for, the Acquisition**

### ***Strategy and strategic fit***

The Enlarged Group's vision is to develop, partner and, potentially, commercialise innovative drugs for the treatment of thrombotic diseases and CNS-related interventions in the hospital setting. Consistent with this vision, the Enlarged Group's primary strategic goal for the next several years will be to use its existing cash balances and any payments it may receive from its collaborative partners to achieve significant milestones for one or more of its current drug candidates. Beyond that, the Enlarged Group plans to exploit the expertise of its two constituent companies in identifying compounds with potential in the treatment of thrombotic diseases and CNS-related interventions, licensing or otherwise acquiring these compounds and advancing them through the clinical development and regulatory approval process. Notwithstanding the foregoing, the Enlarged Group may decide to pursue its goals in collaboration with experienced partners or by obtaining additional external financing where it believes that doing so is economically attractive.

Consistent with this overall goal, the key elements of the strategy of the Enlarged Group will be as follows:

- support Lundbeck in finalising the development of Desmoteplase for the indication acute ischaemic stroke and extending the therapeutic profile of this drug candidate to other indications;
- seek to establish economically attractive collaborations with experienced partners for the late-stage development and commercialisation of M6G and, potentially, other drug candidates;
- streamline its drug pipeline and optimise its clinical development and partnering decisions in light of its existing cash balances and any payments it may receive from its collaborative partners, including seeking to outlicense Solulin and discontinuing the clinical development of Enecadin;
- evaluate new drug candidates and potential mergers and acquisitions on an opportunistic basis; and
- in the medium term, consider complementing collaborations with the creation of a specialty sales and marketing organisation in certain parts of Europe.

### ***Financial strength and investment proposition***

As at 31 December 2007, Paion and CeNeS had approximately €49 million in cash and cash equivalents. The Enlarged Group will expect to benefit from milestone and royalty payments from existing licences and the Paion Directors believe that the Enlarged Group will be sufficiently well financed following the Acquisition to continue development of the combined

pipeline and achieve significant pre-clinical, clinical and commercial milestones. Cost savings will be made after the combination has been effected by the removal of duplicated administration costs and a reduction in the use of external contractors.

The Paion Directors believe that the Acquisition will create a significant and attractive international investment opportunity in the field of CNS product development.

### ***Product pipeline***

The combination of CeNeS and Paion will allow the Enlarged Group to focus on the development of a balanced drug pipeline. The Enlarged Group will have a strong cash position which will allow for the exploitation of the broader pipeline to create significant value and will help to reduce the portfolio risk profile. The Enlarged Group will have two Phase III, one Phase II and one Phase I project with another compound (CNS 7056) scheduled to enter Phase I in the near future.

<i>Programme</i>	<i>Indication</i>	<i>Stage of development</i>
Desmoteplase	Acute ischaemic stroke	Phase III
M6G	Post-operative pain	Phase III
CNS 5161	Neuropathic/cancer pain	Phase II
Solulin	Stroke, cardiovascular disorders	Phase I
CNS 7056	Short-acting sedative	Pre-Clinical
COMT inhibitor	Parkinson's disease/schizophrenia	Lead optimisation

#### *Desmoteplase – for the causal treatment of acute ischaemic stroke*

Desmoteplase is being developed for the causal treatment of acute ischaemic stroke. Paion licensed Desmoteplase from Bayer Schering Pharma AG in 2001. Since 29 January 2008, Lundbeck is solely responsible for the clinical development of Desmoteplase and bears all Desmoteplase-related development, registration and marketing costs.

Desmoteplase belongs to a group of blood clot-dissolving compounds known as plasminogen activators. Plasminogen activators convert plasminogen, an inactive enzyme circulating in the blood, into plasmin, a fibrin-digesting substance. By attacking fibrin, the protein that keeps blood clots together, plasmin dissolves blood clots and restores blood flow. Desmoteplase is a genetically engineered version of a plasminogen activator found in the saliva of the vampire bat *desmodus rotundus*.

Paion completed a Phase II clinical trial for Desmoteplase for the indication acute ischaemic stroke in Europe, Singapore and Australia in 2003 and another Phase II clinical trial in the United States in 2004. The DIAS-2 trial, which was a Phase III clinical trial Paion conducted in the United States, Australasia and Europe in collaboration with Paion's former collaborative partner Forest Laboratories Holdings Limited, was concluded in February 2007 and results for this trial were published in May 2007. Lundbeck has informed Paion that it plans to initiate a further Phase III clinical trial of Desmoteplase in acute ischaemic stroke in the second half of 2008.

In a Phase III clinical trial, Desmoteplase failed to show a statistically significant clinical improvement over placebo. Nonetheless, Paion continues to believe that Desmoteplase offers substantial benefits in the causal treatment of acute ischaemic stroke in the three- to nine-hour time window after the occurrence of a stroke, for which no pharmaceutical treatment is currently approved. This belief is based on Paion's evaluation of the results of a Phase III clinical trial which showed that, compared to the previous Phase II clinical trials conducted by Paion, a greater number of patients suffered from relatively light stroke symptoms and did not have a visible vessel occlusion in the most important brain arteries. These patients thus had a better chance of spontaneous recovery and were less likely to benefit from treatment with Desmoteplase. This difference may explain why patients treated with placebo showed similar recovery to patients treated with Desmoteplase. A sub-group analysis carried out as part of the evaluation further suggested that patients who had a visible vessel occlusion or a particularly large penumbra may benefit from Desmoteplase, although the number of patients in which this

effect had been observed was not large enough for the result to be statistically significant. The penumbra is an at-risk area of cells in the brains of stroke patients that surrounds the core infarct and is characterised by reduced blood supply.

#### *M6G – for the treatment of post-operative pain*

The CeNeS Group's most advanced drug candidate is M6G, a drug candidate that is being developed for the intravenous treatment of post-operative pain. M6G has been under development since 1997. In 2000, additional clinical data and know-how was licensed from Nycomed.

M6G is a metabolite of morphine, that is, a substance produced by the body while processing morphine. Morphine is currently considered the "gold standard" in the treatment of post-operative pain. Morphine is one of the most effective painkillers available and is widely used for the management of moderate to severe pain, including the pain experienced by patients following a wide range of surgical operations. However, it is also associated with a number of adverse drug reactions, including nausea and vomiting. In addition, at higher dosages, morphine carries an increased risk of respiratory depression, a potentially fatal condition. M6G is developed with a view to mitigating these adverse reactions.

In total, 11 Phase II and 2 Phase III clinical trials have been conducted with respect to M6G. Overall, these clinical trials suggest that M6G may achieve a similar painkilling effect to morphine and at the same time has an improved side effect profile, particularly with respect to nausea and vomiting and, possibly, respiratory depression. However, in the most recent Phase III clinical trial, which was completed in 2007, M6G achieved only one of the two primary clinical endpoints but narrowly missed the other, preventing the filing of a registration application. Specifically, M6G failed to show a statistically significant improvement in post-operative nausea compared to morphine. At the same time, the Phase III clinical trial demonstrated that M6G was non-inferior to morphine in achieving pain relief in patients undergoing major abdominal surgery. Pain relief was assessed by a standardised rating scale over the 24-hour post-operative period. With respect to the secondary clinical endpoints, M6G showed a reduction in the severity of post-operative nausea and vomiting in the 6 to 24 hours after treatment and a reduction in the incidence of dry retching and vomiting in the 24 hours after treatment. Further clinical development of M6G is currently on hold pending the successful conclusion of a collaborative agreement with a third party.

As a well-known derivative of morphine, M6G itself is not eligible for patent protection. The CeNeS Group licensed the patent with respect to the M6G manufacturing process from Nycomed. Nycomed's patent will expire in 2016. To broaden its rights with respect to M6G, the CeNeS Group has obtained patents and other rights regarding various manufacturing processes with respect to M6G and a composition of matter patent with respect to a novel salt form of M6G. However, the protection afforded by these patents and rights is more narrow than that offered by a substance patent and would not prevent generics companies from developing and marketing other chemical forms of M6G, including chemical forms that could potentially be developed with a relatively limited investment. The CeNeS Group expects that a certain amount of protection will be available to it under the patent extension provisions of the Hatch-Waxman Act in the United States and supplementary protection certificates under EU Regulation 1768/92 in Europe. These additional protections may extend up to ten years following the first approval of a drug in Europe and up to five years following the first approval of a drug in the United States.

#### *CNS 5161 – for the treatment of neuropathic pain.*

CNS 5161 is a drug candidate that is being developed for the treatment of neuropathic pain from conditions such as diabetes, post-traumatic pain and cancer. Neuropathy describes diseases of the peripheral nerves. The most common form of neuropathic pain is pain affecting the feet and legs. The CeNeS Group acquired the rights to CNS 5161 through the acquisition of another biotechnology company in 2000.

While the CeNeS Group believes that CNS 5161 may be a potent painkiller without causing significant adverse drug reactions, the drug candidate is still at an early stage, and its exact profile is hard to predict. The Phase II clinical trial currently being conducted is an open-label study aimed primarily at showing tolerability of the drug candidate in cancer pain patients.

#### *Solulin*

Solulin is a thrombin modulator with anti-inflammatory potential that Paion has historically developed for the treatment of thrombotic diseases and to reduce the likelihood of a stroke following the occurrence of transitory ischaemic attack (TIAs) or a minor stroke. TIAs are temporary conditions with symptoms similar to those of a stroke. Thrombin modulators reduce the formation of thrombin, which, in excess, can contribute to the formation of blood clots. Solulin is an “intelligent anticoagulant” because it acts only from the moment thrombin is formed, which should significantly reduce the risk of bleeding compared with the anticoagulants currently available. Paion acquired the rights to Solulin from Bayer Schering Pharma AG in 2001.

#### *CNS 7056 – for use as a general anaesthetic and short-acting sedative*

CNS 7056 is a short-acting sedative that is being developed primarily as a sedative for short non-surgical and surgical procedures, which could fulfil a substantial unmet need by materially shortening the time during which patients require supervision following an operation. Possible applications include diagnostic procedures such as gastroscopies and colonic endoscopies and certain applications in the area of intensive care. The most commonly used sedative today is Midazolam, which has various drawbacks, including a risk of causing respiratory depression, potential interactions with other drugs and a prolonged and variable duration of action. Ongoing pre-clinical studies suggest that, compared with Midazolam, CNS 7056 may have a faster onset and, in particular a shorter duration of sedation, potentially leading to a shorter recovery period, and may carry a lower risk of causing respiratory depression and interact less with other drugs. The CeNeS Group acquired the rights to CNS 7056 from GlaxoSmithKline plc in 2003. In 2007, the rights to CNS 7056 for Japan were out-licensed to Ono Pharmaceutical Co., Ltd. for the indication of anaesthesia in consideration for an initial payment of US\$1 million. The CeNeS Group may receive further payments, subject to certain milestones.

#### *COMT inhibitor programme – for the treatment of Parkinson’s disease and schizophrenia*

In addition, CeNeS operates a drug exploration programme managing third-party contractors, called the COMT inhibitor programme, which is aimed at finding drug candidates for the treatment of Parkinson’s disease. COMT inhibitors are believed to provide extended functional time in patients suffering from this disease. The programme is currently at an early stage.

#### **Staff and facilities**

Paion and CeNeS both benefit from strong management teams and staff experienced in the drug development process. Paion intends to maintain the expertise that exists within CeNeS through the retention of the majority of CeNeS staff within the Enlarged Group, and Paion does not intend to make any material change in the conditions of employment of CeNeS staff. Paion intends to maintain CeNeS and Paion’s facilities in Cambridge, UK and Aachen, Germany, respectively. This will provide a means to expand the operational capabilities and form the basis of an international biopharmaceutical company.

## **7. Current trading and prospects**

### **Paion**

Following the New Lundbeck Agreement, which has allowed Paion to secure the future clinical development of Desmoteplase, Paion has turned to reviewing its company strategy and the strategic focus of its drug pipeline. In doing so, its goal is to diversify the risks associated with the development of new innovative therapeutics, not just by entering into collaborative agreements with third parties but also by adding new drug candidates to its portfolio, including compounds for thrombotic diseases and CNS-related interventions other than stroke. Paion has evaluated a number of compounds and companies in the past and intends to continue to do so in 2008.

The future clinical development of Desmoteplase will be led by Lundbeck. Since Lundbeck will bear all Desmoteplase-related development costs going forward, Paion expects that the level of

its research and development expenses will decline compared with past periods.

Paion expects to publish complete results of its ongoing Phase I clinical trial of Solulin in the course of 2008. Going forward, Paion will be open to expanding the profile of Solulin to include a broader range of cardiovascular indications.

In addition, Paion has decided to discontinue the clinical development of Enecadin, a neuroprotectant that it had previously developed for use in connection with Desmoteplase. Paion took this decision in light of scientific data that has called into question the viability of this substance class.

On 23 April 2008, Paion announced that it has acquired the worldwide rights to Flovagatran, a direct thrombin inhibitor, from Trigen Limited for an upfront payment of approximately €0.3 million. Paion will be required to make a milestone payment in the event Flovagatran receives regulatory approval or is licensed or sold in a major market but will not be required to pay ongoing royalties. The substance has been tested in two small Phase IIa clinical trials for dialysis and percutaneous transluminal coronary angioplasty (PTCA), which is one of the most common procedures for opening damaged or obstructed coronary arteries. Paion believes Flovagatran has potential as an anti-coagulant for use in a variety of hospital-based interventions. As an initial step, it intends to conduct additional preclinical studies, on the basis of which it will formulate a clinical development strategy for Flovagatran.

Given that Lundbeck has assumed sole responsibility for the future development of Desmoteplase, which has significantly reduced Paion's role in the development of this drug candidate, the fact that Paion has decided to discontinue the clinical development of Enecadin, and in light of the proposed Acquisition, Paion has decided to reduce its headcount by approximately 20 employees over the course of 2008. If the Acquisition is completed, this reduction will be part of the overall headcount reduction that the Enlarged Group plans to implement. See "Enlarged Group" below for more information on the planned headcount reduction and the underlying reasons.

### **CeNeS**

Following the completion of the M6G Phase III study in February 2007 CeNeS is continuing to pursue partnering arrangements for M6G. The combination with Paion will strengthen CeNeS's negotiation position and its flexibility in partnering negotiations.

CeNeS is currently undertaking a Phase II cancer pain trial with CNS 5161 and that is expected to report Phase II data later in 2008. CeNeS is also planning to file an IND for its short acting sedative CNS 7056 later in 2008 and thereafter to complete a proof of concept Phase I trial. CeNeS is also continuing to progress its COMT discovery programme and seeking to identify a lead candidate from the current lead series.

The transaction with Paion will give CeNeS greater in-house resource and financial strength in progressing all its development programmes through to significant pre-clinical, clinical and commercial milestones.

During the year ended 31 December 2007, CeNeS has a loss after tax of £6.6 million (2006: £8.6 million) and cash at period end of £4.3 million (2006: £6.3 million) and made significant progress in developing its business and progressing the clinical development of its pipeline. Since 31 December 2007, CeNeS has continued to operate in line with the CeNeS Directors' expectations.

### **Enlarged Group**

The Paion Directors believe that the combination of Paion and CeNeS will create an international biopharmaceutical company focused on thrombotic diseases and CNS related interventions in the hospital setting.

The Enlarged Group will support Lundbeck in obtaining regulatory approval of Desmoteplase and marketing the drug as an innovative therapeutic for the causal treatment of acute ischaemic stroke. Paion has been informed by Lundbeck that it intends to submit data to the regulatory authorities with a view to obtaining their approval of a new Phase III clinical trial of Desmoteplase. Lundbeck has informed Paion that it expects to initiate this clinical trial in the second half of 2008.



In addition, the Enlarged Group will seek to outlicense M6G on economically attractive terms. Similarly, outlicensing of Solulin is envisaged following the completion of Phase I clinical trials, in which it expects to demonstrate this drug candidate's mechanism of action in humans, and to discontinue the clinical development of Enecadin in light of scientific data that has called into question the viability of this substance class. A decision regarding the further clinical development of CNS 5161 will be made based on the results of the ongoing Phase II clinical trial. With respect to CNS 7056, an innovative sedative which in preclinical studies has shown a superior onset of action and clearance profile compared with the sedatives currently on the market, the Enlarged Group plans to conduct a Phase I clinical trial in 2008.

On 23 April 2008, the Enlarged Group announced that it had acquired the worldwide rights to Flovagatran, a direct thrombin inhibitor, from Trigen Limited for an upfront payment of approximately €0.3 million. The Enlarged Group will be required to make a milestone payment in the event Flovagatran receives regulatory approval or is licensed or sold in a major market but will not be required to pay ongoing royalties. The substance has been tested in two small Phase IIa clinical trials for dialysis and percutaneous transluminal coronary angioplasty (PTCA), which is one of the most common procedures for opening damaged or obstructed coronary arteries. The Enlarged Group believes Flovagatran has potential as an anti-coagulant for use in a variety of hospital-based interventions. As an initial step, it intends to conduct additional preclinical studies, on the basis of which it will formulate a clinical development strategy for Flovagatran.

As of 31 December 2007, the Enlarged Group had cash and cash equivalents of approximately €49 million on a pro forma basis. The upfront payment of €8 million Paion received under the New Lundbeck Agreement in February 2008 further strengthened its cash balance.

Given that Lundbeck has assumed sole responsibility for the future development of Desmoteplase, which has significantly reduced the Enlarged Group's role in the development of this drug candidate, the fact that Paion and CeNeS have decided to discontinue the clinical development of Enecadin and in light of the proposed Acquisition, the Enlarged Group has decided to reduce its headcount by approximately 24 employees over the course of 2008. This decision reflects, among other things, the Paion Directors' expectation that the Acquisition will allow the Enlarged Group to benefit from CeNeS's technical expertise as well as the fact that the drug pipeline of the Enlarged Group will require a significantly less complex organisational structure than the one the constituent companies had historically. Based on the new structure and the broadened pipeline, the Paion Directors believe the Enlarged Group to be able to achieve significant pre-clinical, clinical and commercial milestones and to have sufficient funding until 2010.

## 8. Financial effects of the Acquisition

The following table shows, for illustrative purposes only and on the bases and assumptions set out in the notes below, the financial effects of the Acquisition on the capital value and income for a holder of 10,000 CeNeS Shares if the Scheme becomes Effective. The table below compares the value of the consideration for the Acquisition on 30 April 2008 (the last Business Day prior to the date of this document) with the Closing Price of 32 pence for each CeNeS Ordinary Share on 4 February 2008 (the last Business Day before CeNeS announced that it was in discussions which may or may not lead to an offer).

### Increase in capital value<sup>(1)</sup>

Consideration received on sale of 10,000 CeNeS Shares:	3,521 Paion Shares
Market value of 3,521 Paion Shares <sup>(2)</sup>	£4,451.40
Market value of 10,000 CeNeS Shares <sup>(3)</sup>	£3,200
Increase in capital value <sup>(1)</sup>	£1,251.40
Representing an increase of <sup>(1)</sup>	39.1%

(1) No account has been taken of any potential liability to taxation.

(2) The market value of Paion Shares is based on the Closing Price of €1.60 per share as at 30 April 2008 (the last Business Day prior to the date of this document) and an exchange rate of €1.26558 = £1.

(3) The market value of CeNeS Shares is based on the Closing Price for each CeNeS Share of 32p on 4 February 2008 (the last Business Day before CeNeS announced that it was in discussions which may or may not lead to an offer).

No dividends have ever been paid on CeNeS Shares or Paion Shares.



Currently, Paion does not expect to generate net income for the foreseeable future. As long as Paion does not generate distributable net income, it is not permitted to make dividend payments. If Paion generates net income in the future, it plans to allocate it to profit reserves and to use it to finance business development and organic growth. Therefore, Paion does not expect to pay dividends for the foreseeable future.

## **9. Structure of the Acquisition**

The Acquisition will be effected by way of the Scheme. The Scheme is an arrangement made between CeNeS and the Scheme Shareholders under Part 26 of the Companies Act 2006 subject to the approval of the Court. The Acquisition involves an application by CeNeS to the Court to sanction the Scheme and confirm the related Reduction, in consideration for which Scheme Shareholders on the register of members of CeNeS at the Scheme Record Time will be entitled to New Paion Shares on the basis set out in paragraph 3 of this Part 2. The cancellation of the Scheme Shares and the subsequent issue of new CeNeS Shares to Paion provided for in the Scheme will result in CeNeS becoming a wholly-owned subsidiary of Paion.

After the Court Hearing, but prior to the time at which the Scheme becomes Effective, Paion shall subscribe at nominal value for, and (subject to receipt of such subscription monies) CeNeS shall allot and issue to Paion as fully paid, one CeNeS Share (ranking *pari passu* with each other CeNeS Share then in issue), which CeNeS Share shall thereafter be held by Paion such that Paion is a member of CeNeS as at the time at which the Scheme becomes Effective and accordingly no valuation of the new CeNeS Shares being issued to Paion shall be required under section 103 of the Companies Act 1985. The Panel has consented to the acquisition of such CeNeS Share by Paion and the waiver of Rule 11 of the Code in respect of such acquisition.

Prior to the Scheme Record Time, CeNeS will allot and issue CeNeS Shares pursuant to the exercise or vesting of options or awards outstanding under the Executive Plan. Save for the issue of the new CeNeS Shares to Paion pursuant to the Scheme, CeNeS will not issue any shares after the Scheme Record Time until the Scheme has become Effective. It is intended that CeNeS Shares (if any) issued after the Scheme has become Effective will be subject to the provision of new article 146 proposed to be adopted by CeNeS and incorporated in its articles of association at the General Meeting and as set out in Appendix J.

## **10. Meetings and the Court Hearing**

Before the Court's approval can be sought, the Scheme will require approval by Scheme Shareholders at the Court Meeting and the passing of a special resolution relating to the Acquisition by CeNeS Shareholders at the General Meeting. Notices of the Meetings are set out in Appendix I and Appendix J to this document respectively. CeNeS Shareholders' entitlement to attend and vote at the Meetings and the number of votes which may be cast at them will be determined by reference to their holdings of CeNeS Shares as shown in the register of members of CeNeS at the Voting Record Time or, if such Meetings are adjourned, on the register of members 48 hours before the relevant adjourned Meeting.

### *10.1 The Court Meeting*

You will find set out in Appendix I to this document the notice of the Court Meeting which has been convened for 11:00 a.m. on 28 May 2008 at the offices of Morrison & Foerster, 7th Floor, CityPoint, One Ropemaker Street, London EC2Y 9AW at the direction of the Court for the purpose of considering and, if thought fit, approving the Scheme.

At the Court Meeting, voting will be by poll and not a show of hands and each member present in person or by proxy will be entitled to one vote for each Scheme Share held. The approval required at the Court Meeting is a majority in number representing at least 75 per cent. in nominal value of the Scheme Shares held by the Scheme Shareholders who are present and voting either in person or by proxy at the Court Meeting.

Scheme Shareholders have the right to raise any objections they may have to the Scheme at the Court Meeting, subject to compliance with the procedures described in paragraph 10.6 of this Part 2.

**It is especially important that as many votes as possible are cast (whether in person or by proxy) at the Court Meeting so that the Court can be satisfied that there is a fair representation of the opinion of Scheme Shareholders. You are therefore strongly urged either to complete the blue Form of Proxy for the Court Meeting and send it to the Registrars as soon as possible, and in any event so that it is received by the Registrars no later than 11:00 a.m. on 26 May 2008 or, if you hold your CeNeS Shares in uncertificated form (i.e. in CREST), to vote using the CREST proxy voting service so that the proxy is received by the Registrars no later than 11:00 a.m. on 26 May 2008. A Form of Proxy for the Court Meeting not lodged at the relevant time may be handed in to the Registrars on behalf of the Chairman of the Court Meeting before the taking of the poll.**

### *10.2 The General Meeting*

In addition to the Court Meeting, the General Meeting has been convened for the same date as the Court Meeting at the offices of Morrison & Foerster, 7th Floor, CityPoint, One Ropemaker Street, London EC2Y 9AW, at 11:30 a.m. on 28 May 2008 (or as soon thereafter as the Court Meeting is concluded or adjourned) to consider and, if thought fit, to pass a special resolution (which requires a vote in favour of not less than 75 per cent. of the votes cast) to approve:

- (A) the taking by the CeNeS Directors of all such actions as they may consider necessary or appropriate for carrying the Scheme into effect;
- (B) the Reduction and the issue of new CeNeS Shares to Paion provided for in the Scheme; and
- (C) certain amendments to the Articles in connection with the Acquisition as described below.

It is proposed that the Articles be amended so as to ensure that any CeNeS Shares issued at any time on or after the Voting Record Time but prior to the Scheme Record Time, including CeNeS Shares issued pursuant to the exercise or vesting of options or awards outstanding under the CeNeS Share Schemes, will be subject to the terms of the Scheme and that any CeNeS Shares issued after the Scheme Record Time (which are not subject to the terms of the Scheme) will automatically be acquired by Paion or its nominee(s) in consideration of, at Paion's sole discretion, either (i) the issue to such person of such number of Paion Shares as that person would have been entitled to had each share transferred to Paion or its nominee(s) been a Scheme Share at the Scheme Record Time or (ii) a cash payment by Paion to such person equal to the Closing Price of such number of Paion Shares as at the date of such transfer. This amendment will avoid any person other than Paion holding shares in the capital of CeNeS after the Effective Date.

Voting on the special resolution at the General Meeting will be on a show of hands unless a poll is demanded. The Chairman reserves his right to demand that the vote of CeNeS Shareholders be held by way of a poll and, in such event, each CeNeS Shareholder present in person or by proxy will be entitled to one vote for every CeNeS Share held.

You will find the notice of the General Meeting set out in Appendix J to this document. The quorum for the General Meeting will be two or more CeNeS Shareholders present in person or by proxy.

### *10.3 The Court Hearing*

Under the Companies Act 2006 and Companies Act 1985, the Scheme and the Reduction require the sanction of the Court. The Court Hearing to sanction the Scheme and to confirm the Reduction is expected to be held on 20 June 2008. Paion has confirmed that it will be represented by counsel at the Court Hearing so as to consent to the Scheme and to undertake to the Court to be bound thereby.

The Scheme and the Reduction will only become Effective upon delivery to the Registrar of Companies of a copy of (i) the Court Order(s) sanctioning the Scheme and confirming the Reduction and the Minute, and (ii) in relation to the Reduction, the registration of such order and the Minute.

**If the Scheme becomes Effective, it will be binding on all Scheme Shareholders irrespective of whether or not they attended or voted at the Court Meeting or the General Meeting. If the Scheme does not become Effective by 31 July 2008 (or such later date (if any) as CeNeS and Paion may agree and the Court may allow), the Scheme will not proceed.**

#### 10.4 *Modifications to the Scheme*

The Scheme contains a provision for CeNeS and Paion to consent on behalf of all persons affected to any modification of, or addition to, the Scheme or to any condition approved or imposed by the Court. The Court would be unlikely to approve any modification of, or additions to, or impose a condition to the Scheme which might be material to the interests of the Scheme Shareholders unless Scheme Shareholders were informed of any modification, addition or condition. It would be a matter for the Court to decide, in its discretion, whether or not a further meeting of Scheme Shareholders should be held in these circumstances. Similarly, if a modification, addition or condition is put forward which in the opinion of the CeNeS Directors is of such a nature or importance that it requires the consent of Scheme Shareholders to a further meeting, the CeNeS Directors will not take the necessary steps to enable the Scheme to become Effective unless and until such consent is obtained.

#### 10.5 *Conditions to the Acquisition*

The Conditions to the Acquisition are set out in full in Appendix A to this document. These include, inter alia:

- (A) the approvals of the CeNeS Shareholders referred to above;
- (B) the sanction of the Scheme and confirmation of the Reduction by the Court;
- (C) the other Conditions being satisfied or waived; and
- (D) the Scheme becoming Effective by not later than 31 July 2008 or such later date as CeNeS and Paion may agree and the Court may approve, failing which the Scheme will never become Effective.

#### 10.6 *Objections*

Any CeNeS Shareholder or other person who considers that he or she has an interest in the Scheme (each an “**Interested Party**”) and who is concerned that the Scheme may adversely affect them is entitled to be heard by the Court, as explained below.

If an Interested Party wishes to raise concerns in relation to the Scheme with the Court or appear at the Court Hearing, he or she should seek independent legal advice and lodge written answers to the petition with the Court at Parliament House, Parliament Square, Edinburgh EH1 1RQ within 21 days of the publication of the advertisement of the petition (which is currently expected to be 6 May 2008) and pay the required fee. Written answers are a formal court document which must comply with the rules of the Court and are normally prepared by Scottish counsel or a Scottish solicitor.

The Court may consider written objections which are not in the form of written answers and/or allow an Interested Party who has not lodged written answers to appear at the Court Hearing, but each Interested Party should note that the decision to do so is entirely at the discretion of the Court, and that the Court may require an Interested Party to lodge written answers in order to raise objections to the Scheme and/or appear at the Court Hearing.

### **11. Irrevocable Undertakings and Letter of Intent**

CeNeS Directors who hold CeNeS Shares have irrevocably undertaken to vote such CeNeS Shares (amounting, in aggregate, to 371,415 CeNeS Shares, representing approximately 1.7 per cent. of the existing issued share capital of CeNeS), or procure that they are voted, in favour of the Scheme and the Acquisition at the Court Meeting and the General Meeting (or, in the event that the Acquisition is implemented by way of a Takeover Offer, to accept or procure acceptance of such offer).

In addition, Paion has received irrevocable undertakings to vote in favour of the Scheme and the Acquisition at the Court Meeting and the General Meeting (or, in the event that the Acquisition is implemented by way of a Takeover Offer, to accept or procure acceptance of such offer) from Gartmore Investment Management in respect of 3,986,016 CeNeS Shares, from Avlar Bioventures Fund II in respect of 2,436,449 CeNeS Shares, from ATM Investment Limited in respect of 154,605 CeNeS Shares, from Avlar Bioventures Limited in respect of 58,047 CeNeS Shares, from the Avlar Pension Fund in respect of 33,333 CeNeS Shares and from Gavin Kilpatrick (Chief Scientific Officer of CeNeS) in respect of 15,079 CeNeS Shares.

In addition, Paion has received a letter of intent to vote in favour of the Scheme and the Acquisition at the Court Meeting and the General Meeting from Universities Superannuation Scheme in respect of 1,081,162 CeNeS Shares.

Paion has therefore received irrevocable undertakings and a letter of intent in respect of, in aggregate, 8,136,106 CeNeS Shares, representing approximately 37.1 per cent. of CeNeS's existing issued share capital.

The irrevocable undertakings given by the CeNeS Directors, Avlar Bioventures Fund II, ATM Investment Limited, Avlar Bioventures Limited, the Avlar Pension Fund and Gavin Kilpatrick will cease to be binding if (i) Paion announces (with the consent of the Panel) that it does not intend to proceed with the Acquisition; or (ii) the Acquisition lapses or is otherwise withdrawn.

The irrevocable undertaking given by Gartmore Investment Management will cease to be binding if: (i) a higher competing offer is made for CeNeS Shares which represents (in the reasonable opinion of Gartmore Investment Management) an improvement of more than 10 per cent. of the value of the consideration available under the Acquisition as at the date on which such higher competing offer is made; (ii) Paion announces (with the consent of the Panel) that it does not intend to proceed with the Acquisition; or (iii) the Acquisition lapses or is otherwise withdrawn.

Each CeNeS Director and Gavin Kilpatrick has agreed with Paion (i) not, directly or indirectly, to solicit, initiate, encourage or otherwise seek to procure any competing transaction, to (ii) notify Paion promptly of any approach made to him in relation to a competing transaction or any request for information under Rule 20.2 of the Code, and (iii) subject to the fiduciary duties of the CeNeS Directors, not to participate in discussions regarding a competing transaction.

Alan Goodman, Avlar Bioventures Fund II, ATM Investment Limited, Avlar Bioventures Limited and the Avlar Pension Fund have each irrevocably undertaken to Paion that:

- (i) prior to the Effective Date, they will make arrangements to hold the New Paion Shares to which they are beneficially entitled under the Scheme in a shareholding account with a depositary financial institution which is a participant in Clearstream such that, on the Scheme becoming Effective, settlement of the New Paion Shares to which they are beneficially entitled under the Scheme shall be effected by the transfer of such shares by the Trustee through Clearstream to such account; and
- (ii) on and following the Effective Date, they will not (for as long as they remain the beneficial owner of such shares) permit the issue of Paion DIs in respect of any New Paion Shares of which they are the beneficial owner.

## **12. Paion Prospectus**

Paion is expected to publish the Paion Prospectus in connection with the listing of the New Paion Shares on the Regulated Market of the Frankfurt Stock Exchange on or about 16 May 2008. Copies of the Paion Prospectus will be sent to CeNeS Shareholders prior to the Court Meeting and the General Meeting. The Paion Prospectus will be published in English, with a summary in German.

### **13. Management and employees**

Paion and CeNeS have agreed that, on completion of the Acquisition, Gavin Kilpatrick (currently Chief Scientific Officer of CeNeS) will be appointed to the management board of Paion.

It is also intended that, following completion of the Acquisition, Alan Goodman (currently Chairman of CeNeS) will become a member of the supervisory board of Paion.

Each of Ron Irwin, Peter Johnson and Alan Smith (currently non-executive directors of CeNeS), Alan Goodman, Neil Clark (currently CEO of CeNeS) and Tony Osborne (currently Finance Director of CeNeS) has agreed to resign as a CeNeS Director on the Scheme becoming Effective.

Paion and CeNeS both benefit from strong management teams and staff experienced in the drug development process. Paion intends to maintain the expertise that exists within CeNeS through the retention of the majority of CeNeS staff within the Enlarged Group and does not intend to make any material change in the conditions of employment of CeNeS staff.

The Paion Directors intend to maintain CeNeS and Paion's facilities in Cambridge, UK and Aachen, Germany, respectively.

Given that Lundbeck has assumed sole responsibility for the future development of Desmoteplase and in light of the Acquisition, the Paion Directors have decided to reduce Paion's headcount by approximately 20 employees over the course of 2008. If the Acquisition is completed, this reduction will be part of the overall headcount reduction that the Enlarged Group plans to implement. This decision reflects, among other things, the Paion Directors' expectation that the Acquisition will allow the Enlarged Group to benefit from CeNeS's technical expertise as well as the fact that the drug pipeline of the Enlarged Group will require a significantly less complex organisational structure than the one Paion had historically.

### **14. The CeNeS Directors and the effect of the Scheme on their interests**

The names of the CeNeS Directors and details of their interests in the share capital of CeNeS and options and awards over the share capital of CeNeS are set out in Appendix E to this document. CeNeS Shares held by the CeNeS Directors will be subject to the Scheme.

Alan Goodman and Neil Clark will (after the Court Meeting and the General Meeting) be permitted to exercise their existing options or awards under the Executive Plan in full so as to enable the CeNeS Shares arising on the exercise of such awards to be issued and allotted (and registered in the name of the allottee) prior to the Scheme Record Time.

Save as described in the preceding paragraph, proposals to be made to participants in the CeNeS Share Schemes described in paragraph 15 of this Part 2 will apply to the CeNeS Directors in the same way as other participants.

Particulars of the service contracts (including termination provisions) of the CeNeS Directors are set out in Appendix E to this document.

Alan Goodman, Neil Clark and Tony Osborne will each enter into arrangements with CeNeS relating to the termination of their employment by CeNeS with effect from completion of the Acquisition. Details of these termination arrangements are set out in Appendix E to this document.

In addition, each of Alan Goodman, Neil Clark and Tony Osborne will receive a bonus from CeNeS on completion of the Acquisition. Details of such bonuses are set out in Appendix E to this document.

Furthermore, it is proposed that Tony Osborne be engaged as a consultant to CeNeS as from completion of the Acquisition and that Alan Goodman be appointed to the supervisory board of Paion. Further details of these arrangements are set out in Appendix E to this document.

The CeNeS Directors have irrevocably undertaken to Paion to vote in favour of the Scheme in respect of their own beneficial holdings of 371,415 CeNeS Shares representing approximately 1.7 per cent. of the existing issued ordinary share capital of CeNeS.



In addition, Alan Goodman has irrevocably undertaken to Paion that:

- (i) prior to the Effective Date, he will make arrangements to hold the New Paion Shares to which he is beneficially entitled under the Scheme in a shareholding account with a depositary financial institution which is a participant in Clearstream such that, on the Scheme becoming Effective, settlement of the New Paion Shares to which he is beneficially entitled under the Scheme shall be effected by the transfer of such shares by the Trustee through Clearstream to such account; and
- (ii) on and following the Effective Date, he will not (for as long as he remains the beneficial owner of such shares) permit the issue of Paion DIs in respect of any New Paion Shares of which he is the beneficial owner.

Save as set out above, the effect of the Scheme on the interests of CeNeS Directors does not differ from its effect on the like interests of any other CeNeS Shareholder.

## **15. CeNeS Share Schemes**

Save to the extent otherwise exercisable prior thereto, options under the CeNeS Share Schemes will become exercisable on or shortly after the Effective Date.

Participants under the CeNeS Share Schemes will receive further details of the actions they can take in respect of their outstanding options.

## **16. Implementation Agreement and inducement fee**

CeNeS and Paion have entered into the Implementation Agreement which sets out, among other things, various matters in relation to the implementation of the Scheme (or, if applicable the Takeover Offer), the conduct of CeNeS's business prior to the Effective Date or the lapse or withdrawal of the Acquisition, an inducement fee, and non-solicit undertakings.

The Implementation Agreement will terminate in certain circumstances, including if the Acquisition lapses or is withdrawn or CeNeS Shareholders voting not to approve the Scheme at the Court Meeting or the special resolution relating to the Acquisition not being passed at the General Meeting.

Further details of the Implementation Agreement and inducement fee arrangements are set out in paragraph 7 of Appendix E to this document.

## **17. Cancellation of trading of CeNeS Shares on AIM**

The last day of dealings in, and for registration of transfers of, CeNeS Shares will be 19 June 2008 following which the CeNeS Shares will be temporarily suspended from AIM. No transfers of CeNeS Shares will be registered after this date.

Prior to the Scheme becoming Effective an application will be made to the London Stock Exchange for trading on AIM of the CeNeS Shares to be cancelled. It is expected that this cancellation will take place on the Effective Date.

On the Effective Date, share certificates in respect of CeNeS Shares will cease to be valid and should, if so requested by CeNeS, be sent to CeNeS for cancellation. In addition, entitlements to CeNeS Shares held within the CREST system will be cancelled on the Effective Date.

## **18. Admission**

Application will be made for the New Paion Shares to be admitted to trading on the Regulated Market (*Regulierter Markt*) of the Frankfurt Stock Exchange (with simultaneous admission to the sub-segment of the Regulated Market with additional post admission obligations (Prime Standard)) and for all Paion Shares, including the New Paion Shares, to be admitted to trading on AIM. Unless the Scheme becomes Effective the New Paion Shares will not be issued and neither such admission will become effective.



Paion Shares are being traded under the ISIN code DE 000A0B65S3. The quotation of Paion Shares on the Frankfurt Stock Exchange is in Euro. The quotation of Paion Shares on AIM will be in Sterling.

It is expected that admission to trading of the New Paion Shares on the Regulated Market of the Frankfurt Stock Exchange will become effective on the Effective Date. It is expected that admission of the Paion Shares to trading on AIM will become effective within two dealing days after the Effective Date.

## **19. Overseas Shareholders**

In this paragraph 19, any reference to a New Paion Share includes any interest in a New Paion Share represented by a Paion DI.

### *19.1 General*

As regards Overseas Shareholders, the Acquisition may be affected by the laws of their relevant jurisdictions. Such Overseas Shareholders should inform themselves about and observe any applicable legal requirements. It is the responsibility of each Overseas Shareholder to satisfy himself or herself as to the full observance of the laws of the relevant jurisdiction in connection with the Acquisition, including the obtaining of any governmental, exchange control or other consents which may be required, or the compliance with other necessary formalities which are required to be observed and the payment of any issue, transfer or other taxes due in such jurisdiction.

**Any person outside the UK who is resident in or who has a registered address in, or is a citizen of, an overseas jurisdiction and is to receive New Paion Shares pursuant to the Scheme should consult his or her professional advisers and satisfy himself or herself as to the full observance of the laws of the relevant jurisdiction in connection with the Scheme.**

This document does not constitute an offer to sell or issue or the solicitation of an offer to buy or subscribe for shares or other securities in any jurisdiction in which such offer or solicitation is unlawful.

### *19.2 US Securities laws*

The New Paion Shares will not be, and are not required to be, registered under the US Securities Act in reliance upon the exemption from the registration requirements of the US Securities Act provided by Section 3(a)(10) thereof. Neither the SEC nor any state securities commission has approved or disapproved of these securities or passed an opinion on the adequacy or accuracy of this document. Any representation to the contrary is a criminal offence in the United States. The information disclosed in this document is not the same as that which would have been disclosed if this document had been prepared for the purpose of complying with the registration requirements of the US Securities Act.

Consequently, CeNeS Shareholders who are US Persons resident in the US and are not subject to any securities laws of any jurisdiction other than the US or the UK will not be treated as Restricted Overseas Persons and may therefore receive New Paion Shares, subject to any applicable restrictions on transfer mentioned below.

For the purpose of qualifying from the exemption from the registration requirements of the US Securities Act provided by Section 3(a)(10) of that Act with respect to New Paion Shares issued pursuant to the Scheme, the Court will be advised that Paion will rely on the Section 3(a)(10) exemption based on the Court's sanctioning of the Scheme which will be relied upon by Paion for the purposes of the exemption as an approval of the Scheme following a hearing on its fairness to CeNeS Shareholders, at which hearing CeNeS Shareholders may (subject to compliance with the procedures described in paragraph 10.6 of this Part 2) to attend in person or through counsel to support or oppose the sanctioning of the Scheme and with respect to which notification has been given to all CeNeS Shareholders.

The New Paion Shares have not and will not be listed on a US securities exchange or quoted on the National Association of Securities Dealers Automated Quotation System or on any other inter-dealer quotation system in the United States. Paion does not intend to take any action to facilitate a market in New Paion Shares in the United States. Consequently Paion believes that it is unlikely that an active trading market in the United States will develop for the New Paion Shares.

### 19.3 *Certain US transfer restrictions*

Where New Paion Shares are issued to a CeNeS Shareholder who is not an affiliate of Paion, after the Scheme becomes Effective, such shares will not be “restricted securities” under the US Securities Act and therefore not subject to transfer restrictions.

An “affiliate” is defined in Rule 144 under the US Securities Act and will include individuals who, and entities that, control directly or indirectly, or are controlled by or under common control with Paion and may include certain officers and directors of Paion and holders of more than 10 per cent. of the outstanding shares of Paion. The Paion Directors are affiliates of Paion, both before and after the Scheme becomes Effective, and the CeNeS Directors may become affiliates of Paion after the Scheme becomes Effective.

“Affiliates” of Paion who wish to sell New Paion Shares in the United States pursuant to Rule 144 under the US Securities Act will be subject to timing, manner of sale and volume restrictions. Alternatively they may sell such New Paion Shares under any other available exemption under the US Securities Act, including Regulation S. CeNeS Shareholders who believe they may be affiliates of Paion after the Scheme becomes Effective for the purposes of the US Securities Act should consult their own legal advisers prior to any sale of New Paion Shares received pursuant to the Scheme.

**CeNeS Shareholders who are citizens or residents of the United States should consult their own legal and tax advisers with respect to the legal and tax consequences of the Scheme in their particular circumstances.**

### 19.4 *Other overseas securities laws*

Where a Scheme Shareholder has his or her registered address in a Restricted Overseas Jurisdiction and in any other case where delivery of New Paion Shares to an Overseas Shareholder under the Scheme would or may infringe the laws of any jurisdiction outside the United Kingdom or would or may require Paion or CeNeS to obtain or observe any governmental or other consent or any registration, filing or other formality (including ongoing requirements) with which Paion or CeNeS is unable to comply or which Paion or CeNeS, acting reasonably, regards as unduly onerous, such Scheme Shareholder will be treated as a Restricted Overseas Person.

Restricted Overseas Persons will not, by reason of restrictions imposed by relevant securities laws, be able to receive the New Paion Shares to which they would otherwise be entitled under the Scheme and arrangements will be made (as set out in the terms of the Scheme in Part 3 of this document) for the sale, on behalf of such Restricted Overseas Persons, of such new Paion Shares. Such sale will be effected as soon as practicable after the Effective Date and the proceeds of each such sale (net of the expenses of the sale) will be remitted to each relevant Restricted Overseas Person, except that entitlements of under €5 will be retained for the benefit of Paion.

No steps have been taken, nor will any be taken, to enable the New Paion Shares to be offered in compliance with the applicable securities laws of any of the Restricted Overseas Jurisdictions. Accordingly New Paion Shares are not being and, unless permitted by applicable law and regulation, may not be offered, sold, resold, delivered, transferred or distributed, directly or indirectly, in or into or from any Restricted Overseas Jurisdiction or any other jurisdiction in respect of which such action would not be lawful or for the account or benefit of any Restricted Overseas Person.

This document has been prepared for the purposes of complying with English law, and where applicable in relation to the Scheme, Scots law, the Code and the AIM Rules for Companies and the information disclosed may not be the same as that which would have been disclosed if this document had been prepared in accordance with the laws of jurisdictions outside the United Kingdom.

## **20. United Kingdom Taxation**

Your attention is drawn to Appendix F to this document. If you are in any doubt as to your tax position you should consult an independent professional adviser.

## **21. DIs and settlement**

### *21.1 Issue of DIs representing entitlements to New Paion Shares*

Trades in the New Paion Shares, being German securities, would not be capable of being settled within CREST, the usual UK settlement system. Furthermore, opening a shareholding account with a depositary financial institution which is a participant in Clearstream (the German settlement system) and trading the New Paion Shares through Clearstream may involve a number of unfamiliar formalities for certain UK and other investors (although each of Alan Goodman, Avlar Bioventures Fund II, ATM Investment Limited, Avlar Bioventures Limited and the Avlar Pension Fund have agreed with Paion that, prior to the Effective Date, they will make arrangements to open such an account).

Therefore, in order to facilitate trading of the New Paion Shares in the UK, and to enable it to comply with the AIM Rules following the proposed admission of Paion Shares to trading on AIM, Paion intends that the New Paion Shares will initially be delivered, held and settled in CREST by means of the issue of DIs, as described below. The proposed arrangements described below will not apply to the New Paion Shares to which each of Alan Goodman, Avlar Bioventures Fund II, ATM Investment Limited, Avlar Bioventures Limited and the Avlar Pension Fund are beneficially entitled.

Under the proposed arrangements, Capita IRG Trustees Limited will issue dematerialised depositary interests representing entitlements to New Paion Shares (“**DIs**”). DIs may be held, transferred and settled solely within CREST, but DI holders, in cancelling their DIs, are able to deliver their underlying shares to a depositary financial institution which is a participant in the relevant settlement system (Clearstream). Upon receipt of Paion DIs, CeNeS Shareholders will therefore not be the direct holders of the New Paion Shares to which they are entitled as a result of the implementation of the Scheme. The direct holder of such New Paion Shares will be Capita IRG Trustees Limited. However, ownership of Paion DIs will represent each CeNeS Shareholder’s entitlement to such New Paion Shares, as described below.

As described in more detail in sub-paragraph 21.2 below, a holder of Paion DIs will, at his option, be able to effect the cancellation of his Paion DIs in CREST in order to hold his underlying Paion Shares directly (upon sending an instruction to CREST to that effect (via the corporate nominee in the case of a holder via the corporate nominee facility described in sub-paragraph 21.2(A) below)) and will be entitled to arrange for the transfer of his Paion Shares (as represented by his holding of Paion DIs) into a shareholding account with a depositary financial institution which is a participant in Clearstream.

The terms and conditions upon which the Paion DIs are issued and held in CREST will be set out in a trust deed poll to be executed by Capita IRG Trustees Limited on or prior to the Effective Date.

As described in more detail in paragraphs 21.2 and 21.3 below, where a CeNeS Shareholder holds his CeNeS Shares in certificated form at the Scheme Record Time (for example because he does not have access to an account in CREST), Paion will arrange for Capita IRG Trustees Limited to hold Paion DIs in CREST as a corporate nominee on behalf of such CeNeS Shareholder. The terms and conditions of these arrangements will be sent to all CeNeS Shareholders who hold CeNeS Shares in certificated form not less than 14 days prior to the Effective Date. It will be necessary for a CeNeS Shareholder who holds CeNeS Shares in

certificated form to agree to these terms and conditions prior to the Effective Date in order for the corporate nominee to hold Paion DIs in CREST on his behalf. Capita IRG Trustees Limited will provide its corporate nominee services to CeNeS Shareholders who have so agreed to the terms and conditions of their appointment, further details of which services will be provided to CeNeS Shareholders together with the terms and conditions of appointment. CeNeS Shareholders located in certain jurisdictions outside the UK will not be eligible to participate in these corporate nominee arrangements. A list of the jurisdictions from which CeNeS Shareholders may participate in these corporate nominee arrangements (“**Eligible Jurisdictions**”) will be sent to CeNeS Shareholders together with the terms and conditions of appointment.

In the event that a CeNeS Shareholder who holds his CeNeS Shares in certificated form does not agree to the terms and conditions of the corporate nominee arrangements prior to the Effective Date (or is not located in an Eligible Jurisdiction), the New Paion Shares to which such CeNeS Shareholder is entitled under the Scheme will be held by Capita Trust Company Limited on trust for such CeNeS Shareholder. The corporate nominee services to be provided by Capita IRG Trustees Limited as referred to above will not be provided to those CeNeS Shareholders who hold their interest in such New Paion Shares under such trust arrangements. The relevant CeNeS Shareholder may, however, subsequently direct Capita Trust Company Limited either (i) that he wishes to hold Paion DIs through CREST, or (ii) (if located in an Eligible Jurisdiction) that he wishes to hold Paion DIs through the corporate nominee facility and agrees to the terms and conditions of such facility, or (iii) that he wishes to arrange for the transfer of his Paion Shares into a shareholding account with a depositary financial institution which is a participant in Clearstream. However, unless and until such a direction is given, Capita Trust Company Limited will continue to hold the New Paion Shares on trust for the relevant CeNeS Shareholder.

Paion proposes to enter into arrangements to effect the settlement arrangements described in this paragraph 21 on terms such that no fees will be charged to Scheme Shareholders for: the exercise of rights attaching to Paion DIs; the services of Capita IRG Trustees Limited as corporate nominee; or the holding of any interest in New Paion Shares on trust by Capita Trust Company Limited under the arrangements described above.

Normal CREST procedures (including timings) apply in relation to any CeNeS Shares that are, or are to be, converted from uncertificated to certificated form (rematerialisation), or from certificated to uncertificated form (dematerialisation), prior to the Effective Date (whether any such conversion arises as a result of a transfer of CeNeS Shares or otherwise). Holders of CeNeS Shares who are proposing to convert any such CeNeS Shares are recommended to ensure that such conversions have been completed prior to the Scheme Record Time.

#### *21.2 Settlement*

As soon as reasonably practicable after the Effective Date, Paion shall deliver such New Paion Shares as are required to be delivered to give effect to the Scheme to or at the direction of, the Trustee, as trustee for the persons entitled to such New Paion Shares and to be settled as set out below. Paion shall further procure the deposit with Clearstream of a global certificate representing the New Paion Shares to which the relevant Scheme Shareholders are entitled for credit to the securities deposit account of the Trustee.

As a result, the Trustee will be the first holder of the New Paion Shares and will hold such shares on trust for the relevant Scheme Shareholders. The Trustee will in turn (i) credit the New Paion Shares to which each of Alan Goodman, Avlar Bioventures Fund II, ATM Investment Limited, Avlar Bioventures Limited and the Avlar Pension Fund are beneficially entitled to the respective shareholding accounts with a depositary financial institution which is a participant in Clearstream opened by or on behalf of such persons, and (ii) credit the remaining New Paion Shares to a depositary account of a custodian and Clearstream participant acting on behalf of Capita IRG Trustees Limited. Shortly following the aforementioned steps having been taken, Capita IRG Trustees Limited shall:

- (A) in the case of Scheme Shares which at the Scheme Record Time are in certificated form and provided that the relevant Scheme Shareholder is located in an Eligible Jurisdiction

and has agreed to the terms and conditions of such arrangements, issue Paion DIs to Capita IRG Trustees Limited as a corporate nominee, and Capita IRG Trustees Limited as corporate nominee shall thereupon, as soon as reasonably practicable, and in any event no later than the fourteenth day following the Effective Date, deliver (or procure the delivery on its behalf of) a statement of entitlement detailing the relevant Scheme Shareholder's entitlement to Paion DIs;

- (B) in the case of Scheme Shares which at the Scheme Record Time are in certificated form and where the relevant Scheme Shareholder is not located in an Eligible Jurisdiction and/or has not agreed to the terms and conditions of the corporate nominee arrangements, transfer the New Paion Shares to which such Scheme Shareholder is entitled to a depository account of a custodian and Clearstream participant acting on behalf of Capita Trust Company Limited, who will hold the New Paion Shares on trust for the relevant Scheme Shareholder. The terms of the trust will be set out in a deed to be executed by Capita Trust Company Limited and the relevant Scheme Shareholder's interests under the trust will be subject to such terms. It is intended that this deed will contain (inter alia) provisions for the protection of the trustee and limiting its liability, dealing with its possible retirement and replacement, and dealing with communications between the trustee and the Scheme Shareholders, the voting of the New Paion Shares held in trust, distributions in respect of those shares (including provisions dealing with the investment of monies and the making of payments) and the exercise of subscription rights, and placing on the Scheme Shareholders the obligation to comply with all applicable laws and regulations; and
- (C) in the case of Scheme Shares which at the Scheme Record Time are in uncertificated form, issue and deliver Paion DIs through CREST (to the stock account in CREST in which each such Scheme Shareholder held Scheme Shares) such Scheme Shareholder's entitlement to Paion DIs as soon as reasonably practicable, and in any event no later than the fourteenth day following the Effective Date.

### 21.3 *Rights attaching to Paion DIs*

The holders of Paion DIs will have a beneficial entitlement to the New Paion Shares to which they are entitled under the Scheme but will not be the direct holders thereof. Accordingly, the holders of Paion DIs will be able to enforce and exercise the rights relating to the New Paion Shares only via Capita IRG Trustees Limited and not directly against Paion.

Paion intends that, in order to allow the holders of Paion DIs to exercise rights relating to the New Paion Shares, prior to the Effective Date, it will enter into arrangements pursuant to which it will procure that, with effect from the Effective Date, all holders of Paion DIs (including those held via the corporate nominee facility) will:

- receive notices, in English, of all shareholders meetings of Paion;
- be able to give directions as to voting at all shareholders meetings of Paion;
- have made available to them and will be sent at their request, copies of the annual report and accounts of Paion and all of the documents issued by Paion to the holders of Paion Shares (in each case, in English); and
- so far as is reasonably practicable taking into account the nature of their rights as holders of Paion DIs, be treated in the same manner as the holders of Paion Shares in respect of all other rights attaching to Paion Shares,

in each case, so far as possible in accordance with applicable law and regulations.

To the extent permissible under applicable law and regulations and to the extent reasonably practicable, Paion may also make arrangements to allow the holders of Paion DIs (including those held via the corporate nominee facility) to attend shareholder meetings of Paion.

To the extent such arrangements are not put in place for any shareholders' meeting of Paion, holders of Paion DIs (including those held via the corporate nominee facility) wishing to use the voting rights attaching to the Paion Shares represented by their Paion DIs in person or otherwise at a shareholders' meeting of Paion would first have to effect the cancellation of their Paion DIs for their underlying Paion Shares so that such shares are held with a depository financial



institution which is a participant in Clearstream in time for the record date of the relevant shareholders' meeting. On so doing, they would, subject to and in accordance with the articles of association of Paion, be able to attend and vote in person at the relevant shareholders' meeting (as set out in Appendix B to this document). Details of how such cancellation can be effected will be obtainable from Paion by writing to Paion AG, Investor Relations, Martinstrasse 10-12, 52062 Aachen, Germany.

Any amounts in respect of dividends paid by Paion on Paion Shares represented by Paion DIs will be paid by Capita IRG Trustees Limited to the holders of Paion DIs in Euro.

All CeNeS Shareholders who hold their shares in certificated form will be sent, prior to the Effective Date, a booklet containing the terms and conditions of the corporate nominee arrangements. This booklet will also include a description of the procedure to be followed for cancelling Paion DIs and effecting the transfer of the underlying Paion Shares together with provisions relating to exclusion of liability on the part of the corporate nominee to Paion DI holders. It will be necessary for CeNeS Shareholders who hold their shares in certificated form to agree to these terms and conditions in advance of the Effective Date in order for the corporate nominee to hold Paion DIs in CREST on their behalf.

## **22. Action to be taken**

The Scheme is subject to a number of Conditions described in paragraph 9.5 of this Part 2 and set out in full in Appendix A. The Scheme will require approval at the Court Meeting to be held at the offices of Morrison & Foerster, 7th Floor, CityPoint, One Ropemaker Street, London EC2Y 9AW on 28 May 2008 at 11:00 a.m. In order to become Effective, the Scheme must be approved by a majority in number of the Scheme Shareholders representing 75 per cent. or more in value of the Scheme Shares, present and voting, either in person or by proxy, at the Court Meeting. Implementation of the Scheme will also require the passing by CeNeS Shareholders of the special resolution relating to the Acquisition to be proposed at the General Meeting to be held at the same place at 11:30 a.m. on the same date (or as soon thereafter as the Court Meeting is concluded or adjourned) and the subsequent sanction of the Court. **Once Effective, the Scheme will be binding on all Scheme Shareholders, whether or not they voted at the Court Meeting or the General Meeting.**

You will find enclosed with this document:

- (A) a blue Form of Proxy for use in respect of the Court Meeting to be held on 28 May 2008; and
- (B) a pink Form of Proxy for use in respect of the General Meeting to be held on 28 May 2008.

Subject to the next following paragraph if you are a registered CeNeS Shareholder, whether or not you plan to attend both or either of the Meetings, please complete the enclosed Forms of Proxy and return them in accordance with the instructions printed thereon, which apply whether or not your CeNeS Shares are in uncertificated form (i.e. in CREST). Such Forms of Proxy should be returned by post or, during normal business hours, by hand to Equiniti, Aspect House, Spencer Road, Lancing, BN99 6ZR as soon as possible and in any event so as to be received no later than 11:00 am on 26 May 2008 in the case of the Court Meeting (blue form) and no later than 11:30 am on 26 May 2008 in the case of the General Meeting (pink form) or in the case of any adjournment, not later than 48 hours before the time fixed for the holding of the adjourned meeting. If the blue Form of Proxy for use at the Court Meeting is not lodged by 11:00 a.m. on 26 May 2008, it may be handed to the Registrars on behalf of the chairman of the Court Meeting before the taking of the poll. However, in the case of the General Meeting, unless the pink Form of Proxy is received by 11:30 a.m. on 26 May 2008 (or, in the case of any adjournment, not later than 48 hours before the time fixed for the holding of the adjourned meeting), it will be invalid. The completion and return of a Form of Proxy will not prevent you from attending and voting at either the Court Meeting or the General Meeting, or any adjournment thereof, in person should you wish to do so.



Alternatively, if you hold your CeNeS Shares in uncertificated form (i.e. in CREST), you may vote using the CREST Proxy Voting service in accordance with the procedures set out in the CREST Manual (please also refer to the notes accompanying the notices of the Court Meeting and the General Meeting in Appendix I and Appendix J to this document respectively). Proxies submitted via CREST (under CREST participant ID 7RA01) must be received by the Registrars, not later than 11:00 a.m. on 26 May 2008 in the case of the Court Meeting and no later than 11:30 a.m. on 26 May 2008 in the case of the General Meeting (or, in the case of an adjourned meeting, not less than 48 hours prior to the time and date set for the adjourned meeting).

**It is important that, for the Court Meeting, as many votes as possible are cast so that the Court may be satisfied that there is a fair and reasonable representation of the opinion of the Scheme Shareholders. You are therefore strongly urged to sign and return your Forms of Proxy as soon as possible.**

Overseas Shareholders should refer to paragraph 19 of this Part 2. Details relating to settlement are included in paragraph 21 of this Part 2.

### **23. Further information**

The terms of the Scheme are set out in full in Part 3 of this document. Further financial information regarding CeNeS is set out in Appendix C to this document and further financial information regarding Paion is set out in Appendix D to this document. Further information about both CeNeS and Paion is set out in Appendix E to this document. Particulars of documents available for inspection are given in paragraph 9 of Appendix E to this document. Your attention is also drawn to the further information contained in Part 1 of this document and the Appendices, which form part of this document.

Yours truly,

for and on behalf of  
Nomura Code Securities Limited

**PART 3**  
**SCHEME OF ARRANGEMENT**

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**SCHEME OF ARRANGEMENT**  
**(under Part 26 of the Companies Act 2006)**

between

**CENES PHARMACEUTICALS PLC**

and

**THE SCHEME SHAREHOLDERS**  
**(as hereinafter defined)**

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**PRELIMINARY**

(A) In this scheme of arrangement, unless the context otherwise requires, the following expressions shall bear the following meanings:

**Business Day:** a day (excluding any Saturdays, Sundays or public holidays) on which banks are generally open for business in the City of London, Edinburgh and Aachen;

**CeNeS or the Company:** CeNeS Pharmaceuticals plc, a public limited company incorporated in Scotland with registered number SC166791;

**CeNeS Group:** CeNeS and its subsidiaries and subsidiary undertakings;

**CeNeS Shares:** ordinary shares of 30 pence each in the capital of CeNeS;

**certificated or in certificated form:** means in relation to a share or other security, a share or other security which is not in uncertificated form;

**Clause:** a clause of this Scheme;

**Clearstream:** Clearstream Banking AG, Frankfurt am Main;

**Companies Act 1985:** the Companies Act 1985 including any statutory modification or re-enactment thereof for the time being in force;

**Companies Act 2006:** the Companies Act 2006 including any statutory modification or re-enactment thereof for the time being in force;

**Court:** the Court of Session in Edinburgh, Scotland;

**Court Hearing:** the hearing by the Court of the petition to sanction this Scheme under Part 26 of the Companies Act 2006 and to confirm the associated reduction of capital provided for by this Scheme under section 137 of the Companies Act 1985;

**Court Meeting:** the meeting of Scheme Shareholders (or any adjournment thereof) convened by an order of the Court pursuant to Part 26 of the Companies Act 2006 for the purpose of considering and, if thought fit, approving this Scheme;

**CREST:** the system for the paperless settlement of trades in securities and the holding of securities in uncertificated form operated by Euroclear in accordance with the Regulations;

**DI:** a depository interest representing an entitlement to a share;

**Effective Date:** the date on which this Scheme becomes effective in accordance with its terms;

**Eligible Jurisdiction:** means a jurisdiction set out in the Terms and Conditions of Appointment as being a jurisdiction where Capita IRG Trustees Limited is able to act as corporate nominee for Scheme Shareholders who hold Scheme Shares in certificated form;

**Euro or €:** the single currency unit of the European Union;

**Euroclear:** Euroclear UK & Ireland Limited, being the current operators of CREST;

**Excluded Shares:** any CeNeS Shares beneficially owned by any member of the Paion Group and any CeNeS Shares held by CeNeS in treasury at the Scheme Record Time;

**holder:** includes any person(s) entitled by transmission;

**New Paion Shares:** the Paion Shares to be issued pursuant to this Scheme which will be issued fully paid and will rank pari passu in all respects with the existing Paion Shares;

**Paion:** PAION AG, a stock corporation incorporated in Germany at the local court (*Amtsgericht*) of Aachen with registered number HRB12528;

**Paion DI:** a DI representing an entitlement to one Paion Share;

**Paion Group:** Paion and its subsidiaries and subsidiary undertakings (excluding the CeNeS Group);

**Paion Shares:** ordinary no par value bearer shares representing a notional value equal to €1.00 per share in the capital of Paion;

**Panel:** the Panel on Takeovers and Mergers;

**penny, pence or £:** the lawful currency of the United Kingdom;

**Registrar of Companies:** the Registrar of Companies of Scotland;

**Regulations:** the Uncertificated Securities Regulations 2001 (SI 2001/3755);

**Regulatory Information Service:** any of the services authorised by the London Stock Exchange for the distribution to the public of AIM announcements and included within the list maintained on the London Stock Exchange's website [www.londonstockexchange.com](http://www.londonstockexchange.com);

**Scheme:** this scheme of arrangement in its present form or with or subject to any modification, addition or condition approved or imposed by the Court and agreed by CeNeS and Paion;

**Scheme Document:** the document dated 2 May 2008 addressed to CeNeS Shareholders containing this Scheme and an explanatory statement in accordance with Part 26 of the Companies Act 2006;

**Scheme Record Time:** 6:00 p.m. (London time) on the Business Day immediately preceding the Court Hearing;

**Scheme Shareholder:** a holder of Scheme Shares;

**Scheme Shares:** the shares in the Company that are subject to the terms of the Scheme, being CeNeS Shares:

- (i) in issue at the date of the Scheme Document;
- (ii) (if any) issued after the date of the Scheme Document and prior to the Voting Record Time; and
- (iii) (if any) issued on or after the Voting Record Time but before the Scheme Record Time on terms that the original or any subsequent holders shall be, or shall have agreed in writing by such time to be, bound by this Scheme,

in each case, excluding any Excluded Shares;

**Subscription Certificate:** the certificate to be executed by the Trustee, as trustee for the Scheme Shareholders in the form scheduled to the Trust Deed, with such modifications and additions, if any, as may be agreed between Paion, CeNeS and the Trustee;

**Terms and Conditions of Appointment:** the terms and conditions of Capita IRG Trustees Limited pursuant to which Capita IRG Trustees Limited shall offer to act as corporate nominee for Scheme Shareholders who hold Scheme Shares in certificated form;

**Trust Deed:** the trust deed to be executed by the Company (on behalf of the Scheme Shareholders) and the Trustee, under which the Trustee will subscribe for, receive, hold and transfer Paion Shares on trust for the Scheme Shareholders;

**Trustee:** Landsbanki Kepler, Frankfurt branch, in its capacity as trustee under the Trust Deed;

**UK or United Kingdom:** the United Kingdom of Great Britain and Northern Ireland;

**uncertificated or in uncertificated form:** in relation to a share or other security, a share or other security title to which is recorded on the relevant register of the share or security concerned as being held in uncertificated form in CREST and title to which, by virtue of the Regulations, may be transferred by means of CREST; and

**Voting Record Time:** 6:00 p.m. (London time) on 27 May 2008 or, if the Court Meeting is adjourned, 48 hours before the time appointed for any adjourned Court Meeting.

For the purpose of this scheme of arrangement “**subsidiary**” and “**subsidiary undertaking**” have the meanings given by the Companies Act 1985.

- (B) The authorised share capital of CeNeS at the date of this Scheme is £10,132,895.10, divided into 33,776,317 CeNeS Shares of which 21,920,192 CeNeS Shares are in issue and are fully paid up or credited as fully paid and the remainder are unissued.
- (C) Paion has agreed to appear by Counsel at the Court Hearing, to consent to this Scheme and to undertake to the Court to be bound thereby and to execute and do or procure to be executed and done all such documents, acts or things as may be necessary or desirable to be executed or done by it or on its behalf for the purpose of giving effect to this Scheme.

## THE SCHEME

### 1. Cancellation of Scheme Shares

- 1.1 The share capital of the Company shall be reduced by cancelling and extinguishing the Scheme Shares.
- 1.2 Forthwith and contingently upon the reduction of capital referred to in Clause 1.1 taking effect:
  - (A) the authorised share capital of the Company shall be increased to its former amount by the creation of such number of new CeNeS Shares as shall be equal to the aggregate of the number of Scheme Shares cancelled pursuant to Clause 1.1; and
  - (B) the reserve arising in the books of account of the Company as a result of the reduction of capital referred to in Clause 1.1 shall be applied by the Company in paying up in full at par the new CeNeS Shares created pursuant to Clause 1.2(A) which shall be allotted and issued (free from all liens, charges, encumbrances, rights of pre-emption and any other third party rights of any nature whatsoever) credited as fully paid to Paion.

### 2. Consideration for the cancellation of the Scheme Shares

- 2.1 In consideration for the cancellation of the Scheme Shares pursuant to Clause 1.1 and the issue of the new CeNeS Shares to Paion pursuant to Clause 1.2, Paion will (contingent upon the reduction of capital referred to in Clause 1.1 and the issue of the new CeNeS Shares referred to in Clause 1.2 taking effect) allot and issue to the Trustee, acting as trustee on behalf of the Scheme Shareholders, 0.3521 New Paion Shares for each Scheme Share held by each Scheme Shareholder immediately prior to such cancellation (subject to Clause 6.1).
- 2.2 The New Paion Shares issued pursuant to Clause 2.1 shall rank pari passu with all other Paion Shares in issue on the Effective Date and shall have the right to receive all dividends, distributions and other entitlements made or paid or declared thereon in respect of the period from 1 January 2008 onwards (but not otherwise).

### 3. Settlement

- 3.1 As soon as reasonably practicable after the Effective Date and in any event no later than the fourteenth day following the Effective Date, Paion shall deliver such New Paion Shares as are required to be delivered to give effect to the Scheme to, or at the direction of, the Trustee as trustee for the persons entitled to such New Paion Shares, and such consideration shall be settled as set out in this Clause 3.
- 3.2 Settlement shall be effected as follows: Paion shall procure the deposit with Clearstream of a global certificate representing the New Paion Shares to which the Scheme Shareholders are entitled for credit to the securities deposit account of the Trustee, as first holder of such shares, on trust for the relevant Scheme Shareholders, for immediate transfer by the Trustee through Clearstream (i) in respect of the New Paion Shares to which each of Alan Goodman, Avlar Bioventures Fund II, ATM Investment Limited, Avlar Bioventures Limited and the Avlar Pension Fund are beneficially entitled, to the respective shareholding accounts with a depository financial institution which is a participant in Clearstream opened by or on behalf of such persons in full satisfaction of their respective entitlements under Clause 2.1, and (ii) in respect of the remaining New Paion Shares, to a custodian and Clearstream participant acting on behalf of Capita IRG Trustees Limited. Shortly after the aforementioned steps have been taken, Capita IRG Trustees Limited shall take the following further steps in respect of the remaining New Paion Shares:
  - (A) in the case of Scheme Shares which at the Scheme Record Time are in certificated form and provided that the relevant Scheme Shareholder has agreed to the Terms

and Conditions of Appointment prior to the Effective Date and is located in an Eligible Jurisdiction, issue Paion DIs to Capita IRG Trustees Limited as corporate nominee, and Capita IRG Trustees Limited as corporate nominee shall, as soon as reasonably practicable, and in any event no later than the fourteenth day following the Effective Date, deliver (or procure the delivery on its behalf) to each relevant Scheme Shareholder a statement of entitlement detailing such Scheme Shareholder's entitlement to Paion DIs;

- (B) in the case of Scheme Shares which at the Scheme Record Time are in certificated form and where the relevant Scheme Shareholder has not agreed to the Terms and Conditions of Appointment prior to the Effective Date and/or is not located in an Eligible Jurisdiction, procure the transfer of New Paion Shares to which such Scheme Shareholder is entitled to a depository account of a custodian and Clearstream participant acting on behalf of Capita Trust Company Limited, who will hold such New Paion Shares on trust for the relevant Scheme Shareholder, and Capita Trust Company Limited shall, as soon as reasonably practicable, and in any event no later than the fourteenth day following the Effective Date, deliver (or procure the delivery on its behalf) of a notice to each relevant Scheme Shareholder stating the number of New Paion Shares so held on trust for such Scheme Shareholder together with details of how such Scheme Shareholder may instruct Capita Trust Company Limited either (i) that he wishes to hold Paion DIs through CREST, or (ii) (if located in an Eligible Jurisdiction) that he wishes to hold Paion DIs through the corporate nominee facility and agrees to the Terms and Conditions of Appointment, or (iii) that he wishes to arrange for the transfer of his Paion Shares into a shareholding account with a depository financial institution which is a participant in Clearstream (and Capita Trust Company Limited shall promptly implement any such instruction so received in accordance with such requirements); and
- (C) in the case of Scheme Shares which at the Scheme Record Time are in uncertificated form, issue and deliver Paion DIs through CREST (to the stock account in CREST in which each such Scheme Shareholder held Scheme Shares) such Scheme Shareholder's entitlement to Paion DIs as soon as reasonably practicable, and in any event no later than the fourteenth day following the Effective Date.

3.3 Statements of entitlement to be issued in accordance with Clause 3.2(A) above and notices to be given in accordance with Clause 3.2(B) above will be sent to the Scheme Shareholder concerned or, in the case of joint holders, to the holder whose name stood first in the register of members of the Company in respect of the joint holding concerned. Such statements of entitlement and written notices shall be despatched by first class post (or by other method approved by the Panel) addressed to the person entitled thereto to the address as appeared in the register of members of the Company as at the Scheme Record Time. None of the Company, the Trustee, Capita IRG Trustees Limited, Capita Trust Company Limited or Paion shall be responsible for any loss or delay on the transmission of statements of entitlement or notices sent to such Scheme Shareholders in accordance with this Clause 3.3 which shall be posted at the risk of the Scheme Shareholder.

#### **4. Trust Deed and Subscription Certificate**

On the Effective Date:

- (A) the Company, acting on behalf of the Scheme Shareholders, shall be authorised to and shall execute and deliver the Trust Deed;
- (B) the Trustee shall execute, in its own name but as trustee for the Scheme Shareholders, and deliver the Trust Deed; and
- (C) the Trustee, acting as trustee for the Scheme Shareholders, shall execute the Subscription Certificate.



## **5. Terms and Conditions of Appointment**

Paion shall procure that not less than fourteen days prior to the Effective Date the Terms and Conditions of Appointment (which shall be capable by acceptance at any time prior to the Effective Date by any Scheme Shareholder in respect of Scheme Shares held in certificated form) shall be sent to each Scheme Shareholder listed in the register of members of the Company as holding Scheme Shares in certificated form or, in the case of joint holders, to the holder whose name stood first in the register of members of the Company in respect of the joint holding concerned. Such Terms and Conditions of Appointment shall be despatched by first class post (or by other method approved by the Panel) to each such holder to the address as appeared in the register of members of the Company in respect of such holder as at 6:00 p.m. on the Business Day prior to being so despatched. None of the Company, the Trustee, Capita IRG Trustees Limited, Capita Trust Company Limited or Paion shall be responsible for any loss or delay on the transmission of such Terms and Conditions of Appointment sent to such Scheme Shareholders in accordance with this Clause 5 which shall be posted at the risk of the Scheme Shareholder.

## **6. Fractional entitlements and payments**

6.1 The aggregate number of New Paion Shares to which a Scheme Shareholder is entitled under Clause 2 shall, in each case, be rounded down to the nearest whole number.

6.2 No fraction of a New Paion Share shall be allotted to any Scheme Shareholder.

## **7. Overseas Shareholders**

7.1 The provisions of Clauses 1, 2, 3 and 5 shall be subject to any prohibition or condition imposed by law. If in the case of any Scheme Shareholder the law of a country or territory outside the United Kingdom precludes the allotment or issue of New Paion Shares or the crediting of Paion DIs or the delivery of a statement of entitlement or the giving of notice in respect of any interest held on trust or the delivery of the Terms and Conditions of Appointment or the creating of a stock account in CREST (in each case in accordance with the settlement procedure described in Clause 3.2) in respect of Scheme Shares previously held by him, or precludes the same except after the obtaining of, or compliance by the Company, the Trustee, Capita IRG Trustees Limited, Capita Trust Company Limited or Paion (as the case may be) with, any governmental or other consent or any registration, filing or other formality or condition with which the Company, the Trustee, Capita IRG Trustees Limited, Capita Trust Company Limited or Paion (as the case may be) is unable to comply or which the Company, the Trustee, Capita IRG Trustees Limited, Capita Trust Company Limited or Paion (as the case may be), acting reasonably, regards as unduly onerous, then Paion may in its sole discretion determine that the New Paion Shares to which such Scheme Shareholder is otherwise entitled shall not be subject to the settlement procedures set out in Clause 3.2 but instead the New Paion Shares to which such Scheme Shareholder would otherwise have been entitled shall be allotted and issued to a nominee appointed by Paion as nominee for such Scheme Shareholder, on terms that the nominee shall be authorised on behalf of such Scheme Shareholder to procure that such New Paion Shares shall, as soon as practicable following the Effective Date, be sold on behalf of such Scheme Shareholder.

7.2 Any such sale shall be carried out at the best price which can reasonably be obtained and the net proceeds of such sale shall (after deduction of all expenses and commissions incurred in connection with such sale, including any amount in respect of value added tax thereon) be paid to such holder by making a payment to such Scheme Shareholder in accordance with Clause 7.3, except that entitlements of less than €5 shall be retained for the benefit of Paion. To give effect to any such sale, the person appointed by Paion as nominee shall be authorised as attorney on behalf of the holder concerned to execute and deliver as transferor an instrument or instruction of transfer and to give such instructions and to do all other things which he may consider necessary or expedient to effect such

sale. In the absence of bad faith or wilful default, none of the Company, Paion, the Trustee, Capita IRG Trustees Limited, Capita Trust Company Limited, the nominee, the person so appointed or any broker or agent of any of them shall have any liability for any loss arising as a result of the timing or terms of any such sale.

- 7.3 Payment of any amounts to which a Scheme Shareholder is entitled under Clause 7.1 will be made by cheque drawn in Euros on a branch of a clearing bank in Germany made payable to the Scheme Shareholder concerned, or in the case of joint holders, to the holder whose name stood first in the register of members of the Company in respect of the joint holding concerned. Such cheque shall be despatched by first class post (or by other method approved by the Panel) addressed to the person entitled thereto to the address as appeared in the register of members of the Company as at the Scheme Record Time. None of the Company, the Trustee, Capita IRG Trustees Limited, Capita Trust Company Limited, Paion or the nominee shall be responsible for any loss or delay on the transmission of cheques sent to such Scheme Shareholders in accordance with this Clause 7.3 which shall be posted at the risk of the Scheme Shareholder.

## **8. Certificates representing Scheme Shares**

With effect from the Effective Date:

- (A) all certificates representing Scheme Shares shall cease to be valid as documents of title to the shares represented thereby and every holder thereof shall be bound at the request of the Company to deliver up such certificate(s) for cancellation to the Company or as it may direct; and
- (B) Euroclear shall be instructed to cancel the entitlements of Scheme Shareholders to Scheme Shares in uncertificated form.

## **9. Effective Date**

- 9.1 This Scheme shall become effective as soon as a certified copy of the order of the Court under Part 26 of the Companies Act 2006 sanctioning the Scheme and confirming the reduction of capital under section 137 of the Companies Act 1985 and a certified copy of the minute of reduction in relation thereto shall together have been delivered to the Registrar of Companies for registration by him and such order confirming the reduction of capital under section 137 of the Companies Act 1985 and the minute of reduction in relation thereto has been registered by the Register of Companies under Section 138 of the Companies Act 1985.
- 9.2 Unless this Scheme shall become effective on or before 31 July 2008 or such later date, if any, as the Company and Paion may agree and the Court may allow, this Scheme shall never become effective.

## **10. Modification**

The Company and Paion may jointly consent on behalf of all persons concerned to any modification of or addition to this Scheme or to any condition which the Court may think fit to approve or impose.

Dated 2 May 2008

## APPENDIX A

### Conditions to the Acquisition and the Implementation of the Scheme

- (1) The Acquisition is conditional upon the Scheme becoming Effective by no later than 31 July 2008 or such later date (if any) as, subject to the Code, CeNeS and Paion may agree and (if required) the Court may allow.
- (2) The Scheme is conditional upon:
  - (a) its approval by a majority in number representing not less than 75 per cent. in value of the CeNeS Shareholders present and voting either in person or by proxy at the Court Meeting (or any adjournment thereof);
  - (b) the resolutions in connection with or required to approve and implement the Scheme and to approve certain related matters being duly passed by the requisite majority at the General Meeting (or any adjournment thereof);
  - (c) (i) the sanction of the Scheme and the confirmation of the Reduction by the Court (in either case with or without modification, but subject to such modification being acceptable to Paion), (ii) an office copy of the Court Order(s) and of the Minute being delivered for registration to the Registrar of Companies and (iii) the registration of the Reduction Order and of the Minute by the Registrar of Companies;
  - (d) the filing of an application for the listing of the New Paion Shares on the Regulated Market of the Frankfurt Stock Exchange and compliance with all other requirements under the statutory and listing rules of such exchange to ensure that upon the issuance of the New Paion Shares such exchange will admit the New Paion Shares to listing and trading;
  - (e) prior to the Scheme becoming Effective, Paion not having received any notice or intimation from the Frankfurt Stock Exchange that, as a result of any action or steps taken by a third party or any other matters outside the control of Paion, it would not upon the issuance of the New Paion Shares admit the New Paion Shares to listing and trading; and
  - (f) prior to the Scheme becoming Effective, no action or other steps having been taken by a third party which would prevent the registration by the commercial register (*Handelsregister*) of the local court (*Amtsgericht*) of Aachen of the capital increase in relation to the issue of the New Paion Shares in accordance with the German Stock Corporation Act.
- (3) In addition, CeNeS and Paion have agreed that the Scheme will also be conditional upon, and accordingly the necessary actions to make the Scheme become Effective will only be taken upon, the satisfaction or waiver of the following Conditions:
  - (a) the Office of Fair Trading or the appropriate Minister in the United Kingdom not referring the proposed acquisition of CeNeS by Paion or any matter arising therefrom or related thereto to the Competition Commission;
  - (b) no government or governmental, quasi-governmental, supranational, statutory, regulatory, environmental or investigative body, court, trade agency, association, institution or any other person or body whatsoever in any relevant jurisdiction (each a "**Third Party**") having decided to take, institute, implement or threaten any action, proceeding, suit, investigation, enquiry or reference, or having made, proposed or enacted any statute, regulation, decision or order, or taken any other steps which would or might reasonably be expected to:
    - (i) require, prevent, limit or delay the divestiture by any member of the Wider CeNeS Group or by any member of the Wider Paion Group of all or any portion of their respective businesses, assets, undertakings or properties or impose

any limitation on the ability of any of them to conduct all or any portion of their respective businesses or own or control all or any portion of their respective assets or properties or integrate or co-ordinate all or any portion of their respective businesses;

- (ii) require, prevent, limit or delay the divestiture by any member of the Wider Paion Group of any shares or other securities in any member of the Wider CeNeS Group;
- (iii) impose any limitation on, or result in any delay in the ability of any member of the Wider Paion Group to acquire or to hold or to exercise effectively, directly or indirectly, all or any rights of ownership of shares or loans or securities convertible into shares or other securities (or the equivalent) in any member of the Wider CeNeS Group or the Wider Paion Group or the ability of any member of the Wider Paion Group to exercise management control over any member of the Wider CeNeS Group;
- (iv) make the Acquisition or its implementation or the acquisition or proposed acquisition by Paion or any member of the Wider Paion Group of any shares or other securities in, or control of, CeNeS or any other member of the Wider CeNeS Group void, illegal, and/or unenforceable under the laws of any relevant jurisdiction, or otherwise, directly or indirectly, restrain, restrict, prohibit, delay or otherwise interfere with the same, or impose any additional conditions or obligations with respect thereto, or otherwise challenge, hinder or interfere therewith;
- (v) require any member of the Wider Paion Group or the Wider CeNeS Group to acquire, offer to acquire, redeem or repay any shares or other securities (or the equivalent) or interest in any member of the Wider CeNeS Group or the Wider Paion Group owned by any third party;
- (vi) impose any limitation on the ability of any member of the Wider Paion Group to co-ordinate its business, or any part of it, with the business of any member of the Wider CeNeS Group; or
- (vii) result in any member of the Wider Paion Group ceasing to be able to carry on business under any name under which it presently does so,

and all applicable waiting and other time periods during which any Third Party could institute, implement or thereafter take any such action, proceedings, suit, investigation, enquiry or reference or otherwise intervene under the laws of any relevant jurisdiction having expired, lapsed or been terminated;

- (c) all necessary filings or applications having been made in connection with the Scheme or the Acquisition and all necessary statutory or regulatory obligations in any jurisdiction having been complied with in connection with the Scheme or the Acquisition or the acquisition by any member of the Wider Paion Group of any shares or other securities in, or control of, CeNeS, and all necessary authorisations, orders, recognitions, grants, consents, licences, confirmations, clearances, permissions and approvals having been obtained in terms and in a form satisfactory to Paion (acting reasonably) from all appropriate Third Parties or persons with whom any member of the Wider CeNeS Group has entered into contractual arrangements and all such authorisations, orders, recognitions, grants, consents, licences, confirmations, clearances, permissions and approvals together with all authorisations, orders, recognitions, grants, licences, confirmations, clearances, permissions and approvals necessary or appropriate to carry on the business of any member of the Wider CeNeS Group remaining in full force and effect and all filings necessary for such purpose having been made and there being no notice or intimation of any intention to revoke or not to renew any of the same at the time at which the Scheme becomes Effective and all necessary statutory or regulatory obligations in any jurisdiction having been complied with;

- (d) except as fairly disclosed in writing by CeNeS to Paion or as publicly announced by CeNeS in accordance with the AIM Rules for Companies, in each case prior to the date hereof, there being no provision of any arrangement, agreement, licence, permit or other instrument to which any member of the Wider CeNeS Group is a party or by or to which any such member or any of its assets may be bound, entitled or subject and which, in consequence of the Scheme or the Acquisition, or the acquisition or proposed acquisition by any member of the Wider Paion Group of any shares or securities in CeNeS or because of a change in the control or management of CeNeS or otherwise could or might reasonably be expected to result in:
- (i) any monies borrowed by, or any other indebtedness (actual or contingent) of, or grant available to, any member of the Wider CeNeS Group being or becoming repayable or capable of being declared repayable immediately or prior to their or its stated maturity date or repayment date or the ability of any such member to borrow monies or incur any indebtedness being withdrawn or inhibited or being capable of becoming or being withdrawn or inhibited;
  - (ii) any such arrangement, agreement, licence, permit or instrument or the rights, liabilities, obligations or interests of any member of the Wider CeNeS Group thereunder being (or becoming capable of being) terminated, or adversely modified or affected, or any adverse action being taken by any third party, or any obligation or liability of any member of the Wider CeNeS Group arising thereunder;
  - (iii) any assets or interests of, or any asset the use of which is enjoyed by, any member of the Wider CeNeS Group being or falling to be disposed of or charged or ceasing to be available or any right arising under which any such asset or interest could be required to be disposed of or charged or could cease to be available;
  - (iv) the creation of any mortgage, charge or other security interest over the whole or any part of the business, property or assets of any member of the Wider CeNeS Group or any such security (whenever created, arising or having arisen) being enforced or becoming enforceable;
  - (v) the rights, liabilities, obligations, interests or business of any member of the Wider CeNeS Group in, or the business of any such member with, any person, firm or body (or any arrangement or arrangements relating to any such interest or business) being terminated or adversely modified or affected;
  - (vi) the value of any member of the Wider CeNeS Group or its financial or trading position or prospects being prejudiced or adversely affected;
  - (vii) any member of the Wider CeNeS Group ceasing to be able to carry on business under any name under which it presently does so; or
  - (viii) the creation of any liability, actual or contingent, by any member of the Wider CeNeS Group,

and no event having occurred which, under any provision of any agreement, arrangement, licence, permit, or other instrument to which any member of the Wider CeNeS Group is a party or by or to which, any such member or any of its assets may be bound, entitled or subject, is likely to result in any of the events or circumstances as are referred to in sub-paragraphs (i) to (viii) of this paragraph (d);

- (e) except as publicly announced by CeNeS in accordance with the AIM Rules for Companies, or fairly disclosed in writing by CeNeS to Paion, in each case prior to the date hereof, no member of the Wider CeNeS Group having (in the case of sub-paragraphs (i), (ii) and (vii) below, at any time, or in the case of each other sub-paragraph, since 31 December 2007):



- (i) save as between CeNeS and wholly-owned subsidiaries of CeNeS, issued, authorised or proposed the issue of additional shares of any class (other than the issue of shares in exercise of options as contemplated by the Implementation Agreement or the issue of shares to Paion pursuant to the Scheme);
- (ii) save as between CeNeS and wholly-owned subsidiaries of CeNeS, issued or agreed to issue, authorised or proposed the issue of securities convertible into shares of any class or rights, warrants or options to subscribe for, or acquire, any such shares or convertible securities;
- (iii) other than to another wholly owned member of the CeNeS Group, recommended, declared, paid, made or proposed to recommend, declare, pay or make any bonus, dividend or other distribution (whether payable in cash or otherwise);
- (iv) save for transactions between CeNeS and a wholly-owned subsidiary or between wholly-owned subsidiaries of CeNeS, merged or demerged with any body corporate or acquired or disposed of or transferred, mortgaged or charged or created any security interest over any assets or any right, title or interest in any asset (including shares and trade investments) or authorised or proposed or announced any intention to propose any merger, demerger, acquisition or disposal, transfer, mortgage, charge or security interest, in each case, other than in the ordinary course of business;
- (v) save for transactions between CeNeS and a wholly-owned subsidiary or between wholly-owned subsidiaries of CeNeS, made or authorised or proposed or announced an intention to propose any change in its loan capital;
- (vi) issued, authorised or proposed the issue of any debentures or incurred or increased any indebtedness or become subject to any contingent liability;
- (vii) other than pursuant to the Scheme, purchased, redeemed or repaid or announced any proposal to purchase, redeem or repay any of its own shares or other securities or reduced or, save in respect to the matters mentioned in sub-paragraph (i) above, made any other change to any part of its share capital;
- (viii) entered into, varied or authorised, proposed or announced its intention to enter into or vary any agreement, transaction, arrangement or commitment (whether in respect of capital expenditure or otherwise) which:
  - (A) is of a loss-making, long term, onerous or unusual nature or magnitude or which involves or could involve an obligation of such a nature or magnitude;
  - (B) is or is reasonably likely to be materially restrictive on the businesses of any member of the Wider CeNeS Group or the Wider Paion Group or which involves or could involve an obligation of such a nature or magnitude; or
  - (C) is other than in the ordinary course of business;
- (ix) implemented, or authorised, proposed or announced its intention to implement, any reconstruction, amalgamation, scheme, commitment, or other transaction or arrangement, in each case otherwise than in the ordinary course of business, or entered into or changed the terms of any contract with any CeNeS Director or senior executive of the CeNeS Group;
- (x) waived or compromised any material claim;



- (xi) taken or proposed any corporate action or had any proceedings started or threatened against it for its winding-up (voluntary or otherwise), dissolution, striking-off or reorganisation or for the appointment of a receiver, administrative receiver, administrator, trustee or similar officer of all or any of its assets or revenues or any analogous proceedings in any jurisdiction or had any such person appointed;
  - (xii) been unable, or admitted publicly or in writing that it is unable, to pay its debts (within the meaning of section 123 of the Insolvency Act 1986), or having stopped or suspended (or threatened to stop or suspend) payment of its debts generally or ceased or threatened to cease carrying on all or a substantial part of its business or proposed or entered into any composition or voluntary arrangement with its creditors (or any class of them) or the filing at Court of documentation in order to obtain a moratorium prior to a voluntary arrangement or, by reason of actual or anticipated financial difficulties, commenced negotiations with one or more of its creditors with a view to rescheduling all or any of its indebtedness or any form of insolvency proceeding or event similar or analogous to any of the aforementioned events in any jurisdiction;
  - (xiii) made any alteration to its memorandum or articles of association or other constitutional documents save as is necessary to implement the Scheme or the Acquisition;
  - (xiv) made or announced any proposal to make any change or addition to any retirement, death or disability benefit or any other employment-related benefit of or in respect of any of its directors, employees, former directors or former employees;
  - (xv) entered into any trust deeds constituting pension schemes established for its directors, employees, former directors or former employees and their dependants;
  - (xvi) save as contemplated by the Implementation Agreement, proposed, agreed to provide or modified the terms of any share option scheme, incentive scheme or other benefit relating to the employment or termination of employment of any person employed by the Wider CeNeS Group; or
  - (xvii) entered into any contract, commitment, arrangement or agreement or passed any resolution or made any offer (which remains open for acceptance) with respect to or announced any intention to, or to propose to, effect any of the transactions, matters or events referred to in this condition;
- (f) Since 31 December 2007 and save as publicly announced in accordance with the AIM Rules for Companies by CeNeS prior to the date hereof or as fairly disclosed in writing by CeNeS to Paion prior to the date hereof:
- (i) no adverse change or deterioration having occurred in the business, assets, financial or trading position, profits, prospects or value of any member of the Wider CeNeS Group (other than the depletion of financial resources in the ordinary course of business in accordance with the business plan fairly disclosed in writing by CeNeS to Paion prior to the date hereof);
  - (ii) no litigation, arbitration proceedings, prosecution or other legal proceedings to which any member of the Wider CeNeS Group is or may become a party (whether as plaintiff or defendant or otherwise) and no investigation by any third party against or in respect of any member of the Wider CeNeS Group having been instituted, threatened or publicly announced by or against or remaining outstanding in respect of any member of the Wider CeNeS Group which in any such case might be expected to adversely affect any member of the Wider CeNeS Group;

- (iii) no contingent or other liability having arisen or become reasonably apparent to Paion or increased which in any such case might be expected to adversely affect any member of the Wider CeNeS Group; and
  - (iv) no steps having been taken which are likely to result in the withdrawal, cancellation, termination or modification of any licence held by any member of the Wider CeNeS Group which is necessary for the proper carrying on of its business;
- (g) except as disclosed in the annual report and accounts of CeNeS for the year ended 31 December 2007, or as publicly announced in accordance with the AIM Rules for Companies by CeNeS prior to the date hereof or as fairly disclosed in writing by CeNeS to Paion prior to the date hereof, Paion not having discovered:
- (i) that the financial, business or other information concerning the Wider CeNeS Group disclosed at any time by or on behalf of any member of the Wider CeNeS Group (whether publicly, to any member of the Wider Paion Group, or otherwise) is misleading, or contains a misstatement of facts, or omits to state a fact necessary to make the information contained therein not misleading;
  - (ii) that any member of the Wider CeNeS Group is subject to any liability, contingent or otherwise, which is not disclosed in the annual report and accounts of CeNeS for the year ended 31 December 2007;
  - (iii) that any member of the Wider CeNeS Group has failed to comply with applicable statutory or regulatory obligations in any relevant jurisdiction;
  - (iv) that any partnership or company in which any member of the Wider CeNeS Group has a significant economic interest (being, in the case of a company, an interest carrying 20 per cent. or more of the voting capital of that company) and which is not a subsidiary of CeNeS is subject to any liability, contingent or otherwise, which is not disclosed in the annual report and accounts of CeNeS for the year ended 31 December 2007;
  - (v) that any past or present member of the Wider CeNeS Group has not complied with any applicable legislation or regulations of any jurisdiction with regard to the use, treatment, handling, storage, transport, release, disposal, discharge, spillage, leak or emission of any waste or hazardous substance or any substance likely to impair the environment or harm human health, or otherwise relating to environmental matters or the health and safety of any person, or that there has otherwise been any such use, treatment, handling, storage, transport, release, disposal, discharge, spillage, leak or emission (whether or not the same constituted a non-compliance by any person with any legislation or regulations and wherever the same may have taken place) which, in any case, would be likely to give rise to any liability (actual or contingent) or cost on the part of the member of the Wider CeNeS Group;
  - (vi) that there is, or is reasonably likely to be, any liability (actual or contingent) to make good, repair, reinstate or clean up any property or any controlled waters now or previously owned, occupied or made use of or controlled by any past or present member of the Wider CeNeS Group or any other property or any controlled waters under any environmental legislation, regulation, notice, circular, order or other lawful requirement of any relevant authority or third party or otherwise; or
  - (vii) that circumstances exist whereby a person or class of persons would be reasonably likely to have a claim in respect of any damage, loss or injury suffered as a result of or otherwise caused by any product or process of manufacture or materials used therein now or previously manufactured, sold or carried out by any past or present member of the Wider CeNeS Group.

- (4) Subject to the relevant requirements of the Panel, Paion reserves the right to waive, in whole or in part, all or any of the above Conditions, except Condition 2.
- (5) Paion shall be under no obligation to waive or treat as fulfilled any such Conditions earlier than the date of the sanction of the Scheme referred to in Condition 2 notwithstanding that the other Conditions may at such earlier date have been waived or fulfilled and that there are at such earlier date no circumstances indicating that any of such Conditions may not be capable of fulfilment.
- (6) If Paion is required by the Panel to make a general offer for CeNeS Shares under the provisions of Rule 9 of the Code, Paion may make such alterations to any of the above Conditions as are necessary to comply with the provisions of that Rule.
- (7) Save with the consent of the Panel, the Acquisition will lapse and the Scheme will not proceed if the proposed acquisition of CeNeS by Paion is referred by the Office of Fair Trading or the appropriate Minister to the Competition Commission before the Meetings are held.
- (8) Paion reserves the right, in its sole discretion (subject to the consent of the Panel), to elect to implement the Acquisition by way of a Takeover Offer. In such event, such offer will be implemented on the same terms (subject to appropriate amendments, including (without limitation and subject to the consent of the Panel) an acceptance condition set at such percentage (being more than 50 per cent.) as Paion may decide of (i) the CeNeS Shares to which such offer relates and (ii) the voting rights carried by the CeNeS Shares to which such offer relates), so far as applicable, as those which would apply to the Scheme.
- (9) In the event that the Acquisition is to be implemented by way of Takeover Offer, any CeNeS Shares acquired under the Acquisition will be acquired fully paid and free from all liens, equities, charges, encumbrances, rights of pre-emption and other interests and rights and together with all rights now and hereafter attaching thereto, including voting rights and the right to receive and retain in full all dividends and other distributions and other distributions (if any) declared, made or paid on or after 8 February 2008.
- (10) The Implementation Agreement is governed by English law and is subject to the jurisdiction of the English courts. The Scheme will be governed by Scots law and be subject to the jurisdiction of the Scottish courts. The Scheme will comply with the rules and regulations of the Financial Services Authority, the London Stock Exchange, the Code, applicable US securities laws and applicable German laws and regulations.

## APPENDIX B

### Rights attaching to the New Paion Shares

#### Introduction

The following overview presents a summary of certain information regarding the share capital of Paion, as well as of certain provisions of the articles of association of Paion and of German law. This overview does not purport to be exhaustive, and the information contained herein relates exclusively to German law in effect as of the date of this document. In particular, CeNeS Shareholders should note paragraph 21 of Part 2 of this document, which explains that the Paion Shares to be issued in connection with the Scheme (other than the Paion Shares to which each of Alan Goodman, Avlar Bioventures Fund II, ATM Investment Limited, Avlar Bioventures Limited and the Avlar Pension Fund are beneficially entitled) will initially be represented by Paion DIs, which will not make their recipients shareholders of Paion and will therefore not confer the rights described below directly on such recipients. Paragraph 21 of Part 2 of this document describes the steps such a recipient can take in order to become a shareholder of Paion should he so choose.

#### 1. Share Capital

As of 30 April 2008 (the latest practicable date prior to the publication of this document), the share capital of Paion amounted to €16,755,552.00, comprised of 16,755,552 ordinary no-par value bearer shares (*Stückaktien*), each with a notional value of €1.00 per share. The share capital has been fully paid in.

On 9 April 2008, the management board of Paion passed (as part of its approval of the Acquisition) a resolution, approved by the supervisory board on the same day and confirmed on the morning of 10 April 2008 prior to the release of the Announcement, for a capital increase against contribution in kind of up to 7,850,000 New Paion Shares utilising authorised capital and excluding subscription rights. The contributions in kind are to be provided by the cancellation of the Scheme Shares and the issue to Paion of new CeNeS Shares as part of the Scheme. The New Paion Shares will be created at the time the capital increase is registered in the Commercial Register, which is expected to occur on or about 23 June 2008. After registration of the implementation of the capital increase, Paion's share capital will amount to up to €24,605,552.00 comprised of up to 24,605,552 ordinary no-par value bearer shares each with a notional par value of €1.00 per share.

Each Paion Share has one vote in Paion's shareholders' meeting. There are no restrictions on voting rights.

#### 2. Form, Holding and Transfer of Paion Shares

The Paion Shares are ordinary no-par value bearer shares (*Stückaktien*), each with a notional value of €1.00. The Paion Shares may be transferred without the approval of a third party, and specifically without the approval of the management board or supervisory board of Paion.

Ownership in the New Paion Shares will be represented as co-ownership interests in a global share certificate deposited at Clearstream Banking AG, Neue Börsenstraße 1, 60487 Frankfurt am Main, Germany. According to Paion's articles of association, the holders of Paion Shares are not entitled to definitive share certificates for their shares unless mandated by the rules of stock exchanges to which the shares are admitted.

Neither German law nor the articles of association of Paion restrict the rights of non-residents of Germany or non-German persons to own Paion Shares and exercise voting rights arising therefrom.

#### 3. Disclosure of Holdings Exceeding Certain Percentages

Under the German Securities Trading Act (*Wertpapierhandelsgesetz – WpHG*), any shareholders whose voting interest in a listed company reaches, exceeds or falls below 3 per cent., 5 per cent., 10 per cent., 15 per cent., 20 per cent., 25 per cent., 30 per cent., 50 per cent. or 75 per cent. through acquisition, sale or by other means, must promptly notify the

relevant company and the BaFin in writing and no later than four trading days of the fact that any of the aforementioned thresholds have been reached, exceeded or are no longer met, and report the total voting interest currently held. A notification requirement may also be triggered in connection with options. Paion is required to forward this notice without undue delay and not later than three trading days after receipt thereof to the media for publication throughout Europe. Paion must forward the total voting interest at the end of any given calendar month in which the voting interest has increased or decreased to the media for publication throughout Europe. At the same time, it must notify BaFin of the publication. In addition, it must send this notice promptly following publication to the company register within the meaning of section 8b of the German Commercial Code (*Handelsgesetzbuch – HGB*) for filing.

In connection with these requirements, the German Securities Trading Act prescribes various rules, which are intended to attribute the shareholdings to those persons who in fact control the voting rights attaching to the shares in question. For example, a company will be attributed shares held by a third party if the former controls the latter, as well as any shares which are held by a third party for the account of the former or company controlled by the former. If the shareholder fails to file the aforementioned notice, then it will be prohibited from exercising its rights under the shares (including voting rights and the right to receive dividends). Moreover, the failure to meet the notice requirements may result in the imposition of monetary fines. Paion's articles of association do not contain any provisions above and beyond the statutory reporting requirements.

Furthermore, according to the German Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz – WpÜG*), anyone whose percentage of voting rights following the initial public offering of the Company's shares reaches or exceeds 30 per cent. of the voting shares of Paion is obligated to publish this fact, including his or her percentage of voting rights within seven calendar days on the Internet and through an electronic information system for the dissemination of financial information and thereafter, unless an exemption from this requirement has been granted, to make a mandatory public offer directed to all the shareholders of Paion.

#### **4. Shareholders' Meeting**

Paion's shareholders' meeting may be held at its registered office, in a German city having a stock exchange or in a German city with more than 100,000 residents. Each Paion Share carries one vote at the shareholders' meeting.

The shareholders' meeting adopts resolutions regarding, in particular:

- the appointment of members to the supervisory board;
- the appropriation of retained earnings (*Bilanzgewinn*);
- the formal approval of acts of the members of the management or supervisory boards;
- the appointment of auditors;
- capital procurement and capital reduction measures; and
- amendments to the articles of association.

Unless otherwise stipulated by mandatory statutory provisions or provisions of the articles of association of Paion, resolutions of the shareholders' meeting may be adopted by a simple majority of the votes cast, and, if statutory provisions require a capital majority, by a simple majority of the share capital represented at the adoption of the resolution. Pursuant to the articles of association of Paion, this also applies to resolutions amending the articles of association and to capital increases and capital reductions, unless a different majority is required by law. Stock corporation law requires that resolutions of fundamental importance must be passed by a majority of at least three-quarters of the share capital represented at the adoption of the resolution. In such cases, therefore, the stipulated majority exceeds the majority prescribed by the articles of association of Paion. Resolutions of fundamental importance include in particular:

- amendments to the articles of association;



- capital increases excluding shareholders' subscription rights;
- capital reductions;
- the creation of authorised or conditional capital;
- the split-up, spin-off or transfer of all of Paion's assets;
- the conclusion of inter-company agreements (in particular control agreements and profit pooling agreements);
- any change of corporate legal form; and
- the dissolution of the company.

A shareholders' meeting may be called by the management board, the supervisory board or by shareholders holding an aggregate of 5 per cent. of the share capital of Paion. The supervisory board must call a shareholders' meeting if the best interests of Paion so require. The annual shareholders' meeting of Paion is held within the first eight months of each fiscal year.

Pursuant to the articles of association, only those shareholders who have sent their registration together with the evidence of their ownership interest in writing (section 126b German Civil Code (*Bürgerliches Gesetzbuch – BGB*)) to Paion or to a designated agent before the end of the seventh day prior to the shareholders' meeting are entitled to attend the meeting and to exercise voting rights. If the seventh day before the shareholders' meeting is not a business day, the registration may be done on the following day which is a business day. The voting rights attached to Paion Shares may be exercised by proxy.

Neither German law nor the articles of association of Paion restrict the rights of foreign shareholders or shareholders who are not domiciled in Germany to hold Paion Shares or to exercise the voting rights attached to them.

## 5. Dividends

The payment of dividends on Paion Shares with respect to a given calendar year requires a resolution of the shareholders' meeting in the subsequent year, acting on the basis of a joint proposal by the management board and supervisory board. Unless otherwise specified in the resolution, dividends adopted by the shareholders' meeting are payable on the first business day following the annual general meeting. Shareholders must hold their shares directly prior to the payment of dividends in order to be eligible to receive dividends. Shares acquired on or after the "ex-dividend date" only carry dividend rights for the then-current fiscal year. Each Paion Share participates in the net income of Paion (calculated as described below) on an equal basis.

Under German law, claims for dividends generally become time-barred after three years. The limitation period commences at the end of the year in which a shareholder knows or, barring gross negligence on its part, should have known of the facts giving rise to the dividend claim. If the dividend claim is represented by a dividend coupon, such claim will lapse if the dividend coupon is not presented within four years following the year in which the dividends were initially payable. If it is presented, the claim will lapse two years following the expiration of the period allowed for presentation. If the claim for dividend payment has become time-barred, Paion may, but is not obliged to, satisfy such claim.

Since all Paion Shares are issued in the form of bearer shares represented by global certificates, any dividends will be disbursed by transfer of funds through Paion's paying agent to the accounts of the holders of Paion Shares at the relevant custodian banks. Details regarding the dividends will be published in the electronic version of the Federal Gazette (*Bundesanzeiger*). Dividends may only be distributed from retained earnings as reported in the individual financial statements of Paion prepared in accordance with German GAAP, and not by reference to the consolidated financial statements of Paion and its subsidiaries, which are prepared in accordance with IFRS, as adopted in the European Union. German GAAP differs in certain respects from IFRS. Dividends are subject to the deduction of German withholding tax.



No dividends have ever been paid on Paion Shares. Currently, Paion does not expect to generate net income for the foreseeable future. As long as Paion does not generate net distributable net income, it is not permitted to make dividend payments. If Paion generates net income in the future, it plans to allocate it to profit reserves and to use it to finance business development and organic growth. Therefore, Paion does not expect to pay dividends for the foreseeable future.

## **6. Authorised and Conditional Capital**

The details of the scope of the rights associated with Paion Shares and their terms of issuance are determined by the management board, subject to the consent of the supervisory board.

### *6.1 Authorised Capital*

Pursuant to a resolution adopted by the shareholders' meeting on 10 May 2006, the management board was authorised to increase the share capital of Paion on or prior to 10 May 2011, with the consent of the supervisory board, on one or more occasions, by up to an aggregate of €7,850,000.00 through the issuance of up to 7,850,000 new no-par value bearer shares in return for cash contributions or contributions in kind (Authorised Capital I). Pursuant to this resolution, only ordinary shares and/or non-voting preferred shares may be issued in each instance.

Holders of Paion Shares must normally be granted subscription rights in the event of new share issuances. Shareholders' subscription rights may however be excluded by the management board, subject to the consent of the supervisory board, if the shares were issued in order to acquire companies, interests in, or parts of, companies or to implement partnerships with companies. The management board is also authorised, with the consent of the supervisory board, to exclude the shareholders' subscription rights if the issue price for the new shares is not significantly less than the market price and the shares issued in return for cash contributions when no subscription rights are granted to shareholders, in accordance with Section 186 para. 3 sentence 4 AktG, do not exceed 10 per cent. of the registered share capital of Paion as of the date of the relevant resolution. Furthermore, the management board, subject to the consent of the supervisory board, may exclude subscription rights to the extent necessary to grant holders of convertible bonds, convertible warrants or options subscription rights, to the extent that they are entitled to such rights as shareholders following the exercise of their conversion or option rights.

The Authorised Capital I was entered in the Commercial Register on 18 May 2006.

The capital increase of Paion for the purposes of the Acquisition will be executed by utilising the full amount of the Authorised Capital I.

### *6.2 Conditional Capital*

Pursuant to a resolution adopted by the shareholders' meeting on 30 December 2004, the registered share capital of Paion was conditionally increased by an aggregate amount of up to €1,000,000.00 through the issuance of an aggregate amount of up to 1,000,000 new ordinary bearer shares with no par value (Conditional Capital II). Furthermore, the shareholders' meeting resolved on 26 August 2005 to conditionally increase the share capital by an aggregate amount of up to €110,000.00 through the issuance of up to 110,000 new ordinary bearer shares with no par value (Conditional Capital III). The conditional capital increases will be executed only to the extent that the holders of options over Paion Shares exercise their option rights.

In each case, the shareholders' meeting has authorised the management board of Paion to determine the additional rights attached to Paion Shares and the further terms and conditions of a conditional capital increase, subject to the consent of the supervisory board. The Conditional Capital II was entered in the Commercial Register on 5 January 2005 and the Conditional Capital III was entered in the Commercial Register on 11 October 2005.

Furthermore, pursuant to a shareholders' resolution adopted on 10 May 2006, the management board was authorised to conditionally increase on or before 10 May 2011 the share capital by an aggregate amount of up to €6,300,000.00 through the issuance of up to 6,300,000 new ordinary

bearer shares with no par value (Conditional Capital I). The conditional capital increase will only be executed to the extent that (i) holders of conversion rights or options linked to convertible or option bonds issued on or prior to 10 May 2011 by Paion or other companies under its direct or indirect majority control exercise their conversion or option rights, or (ii) holders of convertible bonds issued on or before 10 May 2011 by Paion or other companies under its direct or indirect majority control who are obligated to exercise their conversion rights exercise such conversion rights. Any new Paion Shares so issued will participate in retained earnings from the beginning of the fiscal year in which they are issued; however, the management board may, subject to the consent of the supervisory board, determine that such new Paion Shares (if they are issued prior to Paion's annual shareholders' meeting) participate in retained earnings from the beginning of the prior fiscal year. The Conditional Capital I was entered in the Commercial Register on 18 May 2006.

## **7. Management Participation Programmes**

### *Stock Option Plan 2005*

On 30 December 2004, the shareholders' meeting of Paion approved a stock option plan for the Paion Directors and employees of the Paion Group (the "**Stock Option Plan 2005**"). Under the Stock Option Plan 2005, a total of 1,102,888 stock options can be granted: 496,300 to the Paion Directors and 606,588 to other employees of the Paion Group. Each option entitles the holder to subscribe for one Paion Share, to be taken from Conditional Capital II or Conditional Capital III.

The options have a ten-year term and can only be exercised after a vesting period. The vesting period begins on the issue date: 50 per cent. of the options vest two years after the issue date, a further 25 per cent. vest three years after the issue date and the remaining 25 per cent. vest four years after the issue date. Options can only be exercised if the price of a Paion Share on the exercise date has increased by a cumulative 5 per cent. each year since the issue date of the option.

Details of the options granted to the Paion Directors are set out in paragraph 4 of Appendix E to this document.

### *Employee Participation Plan 2006*

Paion has an employee participation plan (the "**Employee Participation Plan 2006**") under which the Paion Directors and employees of the Paion Group have been granted stock appreciation rights. Under the Employee Participation Plan 2006, a total of 560,000 stock appreciation rights can be granted: 252,000 to the Paion Directors and 308,000 to other employees of the Paion Group. A stock appreciation right entitles the holder to receive a sum of money based on the share price of a Paion Share. The maximum amount payable on a stock appreciation right is limited to two times the exercise price. The stock appreciation rights have a ten-year term and can only be exercised after a vesting period of two years. Stock appreciation rights can only be exercised if the price of a Paion Share on the exercise date has increased by a cumulative 5 per cent. each year since the issue date of the stock appreciation right.

Details of the stock appreciation rights granted to the Paion Directors are set out in paragraph 4 of Appendix E to this document.

## **8. Authorisation to acquire own shares**

On 20 June 2007, the shareholders' meeting authorised the management board to acquire Paion Shares representing a total of up to 10 per cent. of the share capital of Paion existing as of the date on which the resolution was adopted for any legally admissible purpose and in accordance with the following provisions. Such authorisation is valid until 20 December 2008.

Paion Shares may be acquired on the stock exchange or by means of a public purchase offer directed to all shareholders. If Paion Shares are acquired on the stock exchange, the price per share paid by Paion (excluding ancillary costs) may not be more than 10 per cent. above or below the average exchange price of a Paion Share in the closing auction of the *Xetra* trading system (or any comparable successor system) on the Frankfurt Stock Exchange on the three

exchange trading days directly preceding the purchase transaction. In the case of a public purchase offer, the price per share paid by Paion (excluding ancillary costs) may not be more than 20 per cent. above or below the average exchange price of a Paion Share in the closing auction of the *Xetra* trading system (or any comparable successor system) on the Frankfurt Stock Exchange over the tenth to the fourth exchange trading day prior to the publication of the purchase offer. If a public offer is oversubscribed, acceptance shall take place on a pro rata basis. A preferential acceptance of smaller units of up to 100 tendered shares per shareholder may be stipulated.

The management board of Paion is authorised to use Paion Shares acquired pursuant to this authorisation (without limitation) for the purposes described below.

Subject to the consent of the supervisory board, such Paion Shares may be sold in a manner other than on the stock exchange or through an offer to all the shareholders, provided that the shares are sold against payment in cash and at a price not substantially below the price of Paion Shares on the stock exchange at the time of the sale.

Subject to the consent of the supervisory board, Paion Shares which have been repurchased may be offered and transferred to third parties for purposes of acquiring companies, parts of companies or equity interests in companies.

Paion Shares which have been repurchased by Paion may be used to satisfy option or conversion rights or conversion obligations under warrant-linked and/or convertible bonds issued by Paion or one of its subsidiaries.

Such Paion Shares may also be cancelled subject to the consent of the supervisory board without any additional resolution by the shareholders' meeting being required.

To the extent that any Paion Shares that are repurchased are utilised in accordance with the above authorisations (with the exception of cancellation), shareholders' pre-emptive rights are excluded. The authorisations to acquire, sell or cancel Paion Shares may be exercised independently of one another once or on several occasions, in whole or in part.

As of the date of this document, neither Paion nor any of its subsidiaries holds any Paion Shares.

## **9. Liquidation**

Other than in insolvency proceedings, Paion may be liquidated only by a resolution of the company in general meeting with a majority of at least 75 per cent. of the share capital represented. In such case the assets of Paion are distributed amongst the shareholders according to the regulations of the German Stock Corporation Act (AktG) according to their respective pro rata shareholding in the share capital after satisfaction of Paion's liabilities. Certain regulations ensuring creditor protection also need to be observed.

## **10. General Regulations as to Changes in Share Capital**

Under German stock corporation law, the share capital of a stock corporation (*Aktiengesellschaft*) may be increased by a resolution of the shareholders' meeting adopted by at least a 75 per cent. majority of the share capital represented at the adoption of the resolution, unless the company's articles of association require a different majority. Paion's articles of association stipulate that resolutions by the shareholders' meeting, to the extent not otherwise provided in the articles of association or by law, are adopted by a simple majority of the votes cast and, to the extent that a capital majority is also required, by a simple majority of the share capital represented at the adoption of the resolution.

Shareholders may also create authorised capital. The creation of authorised capital requires a resolution adopted by a three-fourths majority of the share capital represented at the adoption of the resolution authorising the management board within a period of not more than five years to issue shares at a specific amount. The nominal amount may not exceed 50 per cent. of the share capital existing at the time of the authorisation.

In addition, shareholders may create conditional capital for purposes of issuing (i) shares to holders of convertible bonds or other securities carrying a right to subscribe for shares, (ii) shares serving as consideration in the case of a merger with another company, or (iii) shares intended to be offered to executives and employees, provided that in each case a resolution adopted by a 75 per cent. majority of the share capital represented at the adoption of the resolution is required. The nominal amount of the contingent capital created for purposes of issuing shares to executives and employees may not exceed 10 per cent. of the share capital existing at the time the resolution is adopted. The total nominal amount of contingent capital may not exceed 50 per cent. of the share capital (at the time the shareholders' meeting adopts the resolution).

Resolutions to reduce the share capital require a 75 per cent. majority of the share capital represented at the adoption of the resolution.

## **11. General Regulations on Subscription Rights**

Under German stock corporation law, shareholders are generally entitled to subscription rights to subscribe for new shares to be issued pursuant to a capital increase (including convertible bonds, warrant-linked bonds, participation rights or participation bonds). Subscription rights are freely transferable and may be traded on a German stock exchange during a prescribed period prior to the expiration of the subscription period.

The shareholders' meeting may exclude subscription rights by a majority of at least 75 per cent. of the share capital represented at the adoption of the resolution. In order to exclude subscription rights, the management board must also prepare a report setting out the grounds for the exclusion of subscription rights, which shows that the company's interest in excluding subscription rights objectively outweighs the shareholders' interest in being granted such subscription rights. Statutory subscription rights may be excluded with respect to issuing new shares specifically in cases where:

- the company increases capital against cash contributions;
- the amount of the capital increase does not exceed 10 per cent. of the existing share capital; and
- the issue price of the new shares is not substantially below the exchange price.

## **APPENDIX C**

### **Financial information on the CeNeS Group**

#### **PART I**

##### **Introduction**

###### **Nature of financial information**

The summary financial information contained in Part II and Part III of this Appendix C has been extracted without material adjustment from the audited consolidated accounts of CeNeS. The financial years ending on 31 December 2006 and 2007 have been prepared in accordance with International Financial Reporting Standards and the financial year ending 31 December 2005 has been prepared in accordance with UK GAAP. The summary financial information contained in Part IV of this Appendix C for the 3 month period ending 31 March 2008 has been extracted from the unaudited financial statement announced by CeNeS on 24 April 2008. The financial information contained in this Appendix C does not constitute statutory accounts for these three financial years within the meaning of section 240 of the Act.

## PART II

### Financial years 2006 and 2007 (IFRS)

#### Consolidated Income Statement

	<i>Years ended</i> <i>31 December</i>	
	<i>2007</i>	<i>2006</i>
	<i>£'000</i>	<i>£'000</i>
<b>Revenue</b>	<u>541</u>	<u>53</u>
Research and development expenditure	(5,850)	(7,200)
Administrative expenses	(2,273)	(2,602)
Other operating income	<u>—</u>	<u>26</u>
<b>Operating loss</b>	<u>(7,582)</u>	<u>(9,723)</u>
Finance income	<u>188</u>	<u>267</u>
<b>Loss before tax</b>	<u>(7,394)</u>	<u>(9,456)</u>
Income tax credit	<u>837</u>	<u>815</u>
<b>Loss for the year</b>	<u><u>(6,557)</u></u>	<u><u>(8,641)</u></u>
<b>Loss per ordinary share</b> <b>– basic and diluted</b>	<u><u>(36.0p)</u></u>	<u><u>(62.5p)</u></u>



## Consolidated Balance Sheet

	<i>As at</i> <i>31 December</i> <i>2007</i> <i>£'000</i>	<i>As at</i> <i>31 December</i> <i>2006</i> <i>£'000</i>
<b>Non-current assets</b>		
Intangible assets	6,370	6,375
Property, plant and equipment	20	26
Trade and other receivables	148	148
	<u>6,538</u>	<u>6,549</u>
<b>Current assets</b>		
Trade and other receivables	272	366
Income tax asset	836	650
Cash and cash equivalents	4,261	6,296
	<u>5,369</u>	<u>7,312</u>
<b>Current liabilities</b>		
Trade and other payables	(1,756)	(2,993)
Provisions for liabilities and charges	(321)	(321)
	<u>3,292</u>	<u>3,998</u>
<b>Net current assets</b>	<u>9,830</u>	<u>10,547</u>
<b>Total assets less current liabilities</b>	<u>9,830</u>	<u>10,547</u>
<b>Non-current liabilities</b>		
Provisions for liabilities and charges	(638)	(638)
	<u>9,192</u>	<u>9,909</u>
<b>Net assets</b>	<u>9,192</u>	<u>9,909</u>
<b>Capital and reserves</b>		
Share capital	6,576	4,839
Share capital to be issued	3,687	3,687
Share premium	4,010	116,866
Capital redemption reserve	15,697	15,697
Other reserves	10,396	10,396
Profit and loss account	(31,174)	(141,576)
	<u>9,192</u>	<u>9,909</u>
<b>Total equity</b>	<u><u>9,192</u></u>	<u><u>9,909</u></u>

## Consolidated Statement of Changes in Equity

	<i>Share capital</i>	<i>Share capital to be issued</i>	<i>Share redemption premium</i>	<i>Capital redemption reserve</i>	<i>Other reserves</i>	<i>Retained loss</i>	<i>Total</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
<b>As at 1 January 2006</b>	4,098	3,899	113,080	15,697	10,396	(133,102)	14,068
Share based payments	—	—	—	—	—	167	167
Lapsed share options	—	(212)	—	—	—	—	(212)
Issue of share capital (net of expenses)	741	—	3,786	—	—	—	4,527
Loss for the period	—	—	—	—	—	(8,641)	(8,641)
<b>As at 31 December 2006</b>	<u>4,839</u>	<u>3,687</u>	<u>116,866</u>	<u>15,697</u>	<u>10,396</u>	<u>(141,576)</u>	<u>9,909</u>
Share based payments	—	—	—	—	—	93	93
Capital reorganisation	—	—	(116,866)	—	—	116,866	—
Issue of share capital (net of expenses)	1,737	—	4,010	—	—	—	5,747
Loss for the period	—	—	—	—	—	(6,557)	(6,557)
<b>As at 31 December 2007</b>	<u><u>6,576</u></u>	<u><u>3,687</u></u>	<u><u>4,010</u></u>	<u><u>15,697</u></u>	<u><u>10,396</u></u>	<u><u>(31,174)</u></u>	<u><u>9,192</u></u>

Included in other reserves as at 31 December 2007 is a merger reserve of £10,370,000 (2006: £10,370,000) and a share option reserve of £26,000 (2006: £26,000).

The capital redemption reserve of £15.7 million arose as a result of a sub-division of shares in August 2003.

Capital reorganisation relates to a write off of share premium balance £116,866,000, against the brought forward losses following a court order issued by the Scottish Court on 10 July 2007. The capital restructuring was approved by shareholders at the Annual General Meeting held on 5 July 2005.

## Consolidated Cash Flow Statement

	<i>Year ended</i>	
	<i>31 December</i>	
	<i>2007</i>	<i>2006</i>
	<i>£'000</i>	<i>£'000</i>
Operating loss	(7,582)	(9,723)
Depreciation	12	11
Amortisation	5	3
IFRS 2 share based payment	93	167
Decrease in trade and other receivables	98	121
Increase/(decrease) in trade and other payables	<u>(1,236)</u>	<u>1,478</u>
<b>Operating activities</b>		
Net cash outflow from operating activities	(8,610)	(7,943)
Research and development tax credit received	<u>651</u>	<u>1,065</u>
Net cash used in operating activities	<u>(7,959)</u>	<u>(6,878)</u>
<b>Investing activities</b>		
Interest received	183	267
Purchases of plant and equipment	(6)	—
Purchase of intangible assets	<u>—</u>	<u>(77)</u>
Net cash generated from investing activities	<u>177</u>	<u>190</u>
<b>Financing activities</b>		
Proceeds from issue of shares	6,079	4,821
Transaction costs	(332)	(294)
Repayment of loans	<u>—</u>	<u>(7)</u>
Net cash generated from financing activities	<u>5,747</u>	<u>4,520</u>
Net decrease in cash and cash equivalents	(2,035)	(2,168)
Cash and cash equivalents at beginning of year	<u>6,296</u>	<u>8,464</u>
<b>Cash and cash equivalents at end of year</b>	<u><u>4,261</u></u>	<u><u>6,296</u></u>

## **Notes to the Financial Statements**

### **for the years ended 31 December 2006 and 31 December 2007**

#### **1. General information**

CeNeS is a company incorporated and domiciled in the United Kingdom. The address of the registered office of CeNeS is Riverside Way, Riverside Business Park, Irvine KA11 5DJ, Scotland.

#### **2. Principal accounting policies**

The principal accounting policies adopted in the preparation of the CeNeS Group's financial statements are set out below:

##### **Basis of preparation**

These financial statements have been prepared in accordance with International Financial Reporting Standards (“**IFRS**”) as adopted for use by the EU and endorsed by 31 December 2007 and International Financial Reporting Interpretation Committee (“**IFRIC**”) interpretations and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS.

The financial statements have been prepared on the historical cost convention except for certain financial assets and liabilities, which are measured at fair value. The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the CeNeS Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 4.

##### **Going concern**

The CeNeS Group does not have sufficient cash resources to fund its current level of activities for the next twelve months. This represents a material uncertainty which may cast significant doubt on the CeNeS Group's ability to continue as a going concern.

On 10 April 2008, it was announced by Paion that it proposes to acquire all of the issued and to be issued share capital of CeNeS by a court sanctioned scheme of arrangement under Part 26 of the Companies Act 2006. If the proposed acquisition is completed, CeNeS will have a considerably strengthened financial position by being part of the Enlarged Group, which will assist with partnering and clinical development decisions.

If the Acquisition is completed, CeNeS, as part of the Enlarged Group, will continue to maintain its focus on advancing each of its programmes, with a number of key milestones and deliverables expected in 2008. The results of the first of two planned Phase II studies for CNS 5161 will report results mid-2008. An IND (Investigational New Drug) filing in the US and proof of concept Phase I study for CNS 7056 in sedation is planned for H2 2008. The CeNeS Directors believe that a successful outcome from this trial will transform the value of this asset. CeNeS's partner Ono is planning a Phase I study in anaesthesia in Japan in H2 2008.

Based on the structure of the Enlarged Group and the broadened pipeline the CeNeS Directors believe the Enlarged Group will be able to achieve significant pre-clinical, clinical and commercial milestones.

In the event that the Acquisition is not completed, the Company will need to raise additional funding through one or a combination of equity fund raising, partnering or collaboration opportunities activity in order to continue as a going concern. The CeNeS Directors have a reasonable expectation that CeNeS can raise such additional cash resources. Therefore, the directors consider that it is appropriate to prepare the financial statements on a going concern basis. If CeNeS was unable to continue in operational existence in the foreseeable future, adjustments would have to be made to revise the balance sheet values of assets to their recoverable amounts, to provide for further liabilities that might arise and to reclassify fixed assets as current assets.

(a) *First time adoption*

These financial statements are the first to be prepared under IFRS.

IFRS 1 “First Time Adoption of International Financial Reporting Standards” sets out the approach to be followed when IFRS are applied for the first time. As a general principle, IFRS 1 requires that accounting policies are to be applied retrospectively although IFRS 1 provides a number of optional exceptions including where the cost of compliance is deemed to exceed the benefits to users of the financial statements. Where applicable, the options selected by management under IFRS 1 are set out in note 21).

(b) *Standards, amendment and interpretations effective in 2007*

IFRS 7, ‘Financial instruments: Disclosures’, and the complementary amendment to IAS 1, ‘Presentation of financial statements – Capital disclosures’, introduces new disclosures relating to financial instruments and does not have any impact on the classification and valuation of the CeNeS Group’s financial instruments, or the disclosures relating to taxation and trade and other payables.

IFRIC 8, ‘Scope of IFRS 2’, requires consideration of transactions involving the issuance of equity instruments, where the identifiable consideration received is less than the fair value of the equity instruments issued in order to establish whether or not they fall within the scope of IFRS 2. This standard does not have any impact on the CeNeS Group’s financial statements.

IFRIC 10, ‘Interim financial reporting and impairment’, prohibits the impairment losses recognised in an interim period on goodwill and investments in equity instruments and in financial assets carried at cost to be reversed at a subsequent balance sheet date. This standard does not have any impact on the CeNeS Group’s financial statements.

(c) *Interpretations early adopted by the Group and company*

IFRIC 11, ‘IFRS 2—Group and treasury share transactions’, was early adopted in 2007. IFRIC 11 provides guidance on whether share-based transactions involving treasury shares or involving group entities (for example, options over a parent’s shares) should be accounted for as equity-settled or cash-settled share-based payment transactions in the stand-alone accounts of the parent and group companies. This interpretation does not have an impact on the CeNeS Group’s financial statements.

(d) *Standards, amendments and interpretations effective in 2007 but not relevant*

The following standards, amendments and interpretations to published standards are mandatory for accounting periods beginning on or after 1 January 2007 but they are not relevant to the CeNeS Group’s operations:

IFRS 4, ‘Insurance contracts’;

IFRIC 7, ‘Applying the restatement approach under IAS 29, Financial reporting in hyper-inflationary economies’; and

IFRIC 9, ‘Re-assessment of embedded derivatives’.

(e) *Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the CeNeS Group*

The following standards, amendments and interpretations to existing standards have been published and are mandatory for the CeNeS Group’s accounting periods beginning on or after 1 January 2008 or later periods, but the CeNeS Group has not adopted them early:

IAS 23 (Amendment), ‘Borrowing costs’ (effective from 1 January 2009). The amendment to the standard is still subject to endorsement by the European Union. The CeNeS Group will apply IAS 23 (Amended) from 1 January 2009, subject to endorsement by the EU but is currently not applicable to the CeNeS Group as there are no qualifying assets.

IFRS 8, 'Operating segments' (effective from 1 January 2009). IFRS 8 replaces IAS 14 and aligns segment reporting with the requirements of the US standard SFAS 131, 'Disclosures about segments of an enterprise and related information'. Management do not expect a material change to the current presentation.

IFRS 3 (revised), 'Business Combinations' (effective for business combinations after 1 July 2009). The revision to this standard continues to apply the acquisition method to business combinations, with some significant changes. The standard is applicable to business combinations occurring in accounting periods beginning on or after 1 July 2009, with earlier application permitted. This standard may have a significant impact on the accounting for any future business combinations the CeNeS Group may enter into.

IAS 27 (revised), 'Consolidated and separate financial statements' (effective from 1 January 2008). IAS 27 (revised) requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control. They will no longer result in goodwill or gains and losses. The standard also specifies the accounting when control is lost. Any remaining interest in the entity is re-measured to fair value and a gain or loss is recognised in profit or loss. This standard is not expected to have any impact on the results of the CeNeS Group.

IAS 1 (as revised in 2007), 'Presentation of financial statements'. IAS 1 (revised) amended the terminology used throughout IFRSs. These amendments apply for annual periods beginning on or after 1 January 2009.

(f) *Interpretations to existing standards that are not yet effective and not relevant for the Group's operations*

The following interpretations to existing standards have been published and are mandatory for the CeNeS Group's accounting periods beginning on or after 1 January 2008 or later periods but are not relevant for the CeNeS Group's operations:

IFRIC 14, 'IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction' (effective from 1 January 2008). IFRIC 14 provides guidance on assessing the limit in IAS 19 on the amount of the surplus that can be recognised as an asset. It also explains how the pension asset or liability may be affected by a statutory or contractual minimum funding requirement. IFRIC 14 is not relevant as the CeNeS Group does not operate any defined benefit pension schemes.

### **Basis of consolidation**

The consolidated financial statements include the financial information of CeNeS and all of its subsidiary undertakings.

Subsidiaries are all entities over which the CeNeS Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the CeNeS Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the CeNeS Group. They are de-consolidated from the date that control ceases.

The acquisition of CeNeS Drug Delivery Limited has been consolidated using the principles of 'merger accounting'. The principles of merger accounting are that the assets and liabilities of the acquired company are not restated to fair value, no goodwill arises and the consolidated financial information incorporates the combined companies' results as if the companies had always been combined.

All other subsidiaries have been consolidated using the principles of acquisition accounting under IFRS 3. Under IFRS 3, the results of acquired subsidiaries are included in the consolidated income statement from the date that they are acquired. The cost of an acquisition is the fair value of consideration, including costs directly attributable to the acquisition. All of the



subsidiary's assets and liabilities that exist at the date of acquisition are recorded at their fair values. The excess of the cost of acquisition over the fair value of CeNeS's share of the identifiable net assets acquired is recorded as goodwill.

Intra-group transactions, profits and balances are eliminated in full on consolidation.

### **Intangible fixed assets**

#### *(a) Goodwill*

Goodwill arising on the acquisition of subsidiary undertakings and businesses, representing the excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised as an asset on the balance sheet. Goodwill is tested annually for impairment or when events or changes in circumstances indicate the carrying value may be impaired, and is carried at cost less accumulated impairment losses.

Goodwill arising on acquisitions before the date of transition to IFRS has been retained at the previous UK GAAP amount.

#### *(b) Patent rights and licences*

Purchased patents and licenses are recognised at cost on acquisition and are subject to amortisation over their useful life from the point at which the asset is available for use. The amortisation charge is calculated on a straight—line basis over their estimated useful lives (15 years).

### **Financial assets**

The Group classifies its financial assets in the following categories: at fair value through profit and loss and loans and receivables. Management determines the classification of its financial assets at initial recognition.

#### *(a) Financial assets at fair value through profit and loss*

Financial assets at fair value through profit and loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Assets in this category are classified as current assets.

#### *(b) Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for those assets with maturities greater than 12 months after the balance sheet date, which are classified as non-current assets. The CeNeS Group's loans and receivables comprise 'trade and other receivables' and cash and cash equivalents in the balance sheet.

### **Derivative financial instruments and hedging**

The CeNeS Group does not currently have any derivative financial instruments or hedging activities.

### **Research and development expenditure**

The CeNeS Group considers that the regulatory, technical and market uncertainties inherent in the development of new products mean that internal development costs should not be capitalised as intangible fixed assets until, inter alia, commercial viability of a product is demonstrable and appropriate resource is in place to launch the product. Except in those circumstances, research and development expenditure is expensed as incurred.

### **Property, plant and equipment**

Property, plant and equipment is stated at cost, net of depreciation and any provision for impairment. Depreciation is provided on all property, plant and equipment at rates calculated to

write off the cost, less estimated residual value, of each asset on a straight line basis over its expected useful life as follows:

Leasehold improvements	over the shorter of the lease term or 10 years
Fixtures, fittings and computers	over 2 – 7 years
Plant and machinery	over 5 – 10 years
Laboratory equipment	over 3 – 5 years
Office equipment	over 2 – 7 years

### **Trade receivables**

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the CeNeS Group will not be able to collect all amounts due according to the original terms of the receivables.

The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the income statement. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written off are credited against 'selling and marketing costs' in the income statement.

### **Cash and cash equivalents**

Cash and cash equivalents comprise cash in hand and deposits with banks that have a maturity of three months or less from the date of inception.

The CeNeS Group does not currently have any deposits that have a maturity of greater than three months.

### **Foreign currencies**

#### *(a) Functional and presentation currency*

Items included in the financial statements of each of the CeNeS Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in 'sterling' (£), which is CeNeS's functional and presentation currency.

#### *(b) Transactions and balances*

Transactions in foreign currencies are recorded at the rate of exchange prevailing at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are reported at the rate of exchange prevailing at that date. All exchange gains arising on the retranslation of assets and liabilities are dealt with in the income statement.

### **Leases**

Rentals under operating leases are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis. Provisions are made in respect of onerous leases to the extent that the CeNeS Directors believe that costs will be incurred under the terms of the lease with no benefit to the CeNeS Group.

### **Taxation**

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is provided in full using the liability method in respect of temporary timing differences arising from differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases. Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary difference can be utilised. Their carrying amount is reviewed at each balance sheet date on the same basis.

Deferred tax is measured on an undiscounted basis, and at the tax rates that are expected to apply in the period in which the asset is realised or liability is settled. It is recognised in the income statement except when it relates to items credited or charged directly to equity, in which case the deferred tax is also dealt with in equity.

### **Research and development tax credits**

The CeNeS Group makes claims each year for Research and Development Tax Credits. The amount of expected cash benefit for each year is accrued into that year's financial statements.

### **Revenue recognition**

Revenue consists of income received, in the normal course of business, from licence and development agreements and is stated net of any VAT and other sales related taxes. Income from these agreements is typically in the form of fees on signature, milestone receipts on achievement of predetermined events, and royalties on the sale of the product once marketed.

Revenue is recognised when licence rights are granted to the extent that the CeNeS Group has performed its contractual obligations, based on the fair value of the right to consideration for each component of the agreement.

#### *Interest income*

Interest income is recognised on a time-proportion basis using the effective interest method.

### **Share capital**

CeNeS Shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

### **Trade payables**

Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

### **Employee benefits**

#### *(a) Post-retirement benefits*

The CeNeS Group makes defined contributions to personal pension arrangements of its executive directors and employees. The amount charged to the income statement in respect of pension costs is the contribution payable in the period.

Differences between contributions payable in the period and contributions actually paid are shown either as accruals or prepayments in the balance sheet. Termination benefits payable are charged to the income statement in the period in which they are payable.

#### *(b) Share-based payments*

The CeNeS Group operates a number of executive and employee share schemes. For all grants of share options and awards, the fair value as at the date of grant is calculated using an appropriate option pricing model and the corresponding expense is recognised over the vesting period.

The CeNeS Group has taken advantage of the transitional provisions of IFRS 2 in respect of equity-settled awards and has applied IFRS 2 only to equity-settled awards granted after 7 November 2002 that had not vested by 1 January 2005. National Insurance payable on the

exercise of share-based payments is treated as a cash-settled share-based payment under IFRS 2 and the CeNeS Group makes charges to the income statement based on an estimate of the National Insurance liability in respect of the outstanding awards at each period end. Where the National Insurance liability is virtually certain to be recovered from the relevant employees a corresponding receivable amount is also recognised in the income statement.

### **3. Financial risk management**

#### **Financial risk factors**

The CeNeS Group's activities expose it to a variety of financial risks: market risk, credit risk, interest rate and liquidity risk. The CeNeS Group's risk management programme seeks to minimise where possible, potential adverse effects of the Group's financial performance. Currently the CeNeS Group does not use derivative financial instruments to hedge certain risk exposures because they are not considered to be material. Risk is assessed on an ongoing basis by the CeNeS Directors and the Audit Committee of CeNeS who have put in place certain controls and policies to manage the risks.

#### *(a) Market risk*

##### *(i) Foreign exchange risk*

The CeNeS Group is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the Euro and the U.S. dollar. Foreign exchange risk arises from future commercial transactions and recognised assets and liabilities.

Management reviews foreign exchange risk on a regular basis and currently it is not considered to be significant. Where possible expenditure in foreign currency is matched to income in the same currency. The CeNeS Group does not currently have an active policy to hedge its foreign currency risks because it is not considered significant.

The CeNeS Group has no investments in foreign operations.

The CeNeS Group has \$1 million held in a treasury deposit as at 31 December 2007 (2006: \$nil). It is anticipated that this will be used to meet US dollar expenditure for the remainder of the year, including the Phase I study for CNS 7056 scheduled to commence in Q3 2008.

At 31 December 2007, if the US dollar had weakened/strengthened by 10 per cent. against the British pound with all other variables held constant, post tax losses would have been c.£45,000 higher/lower as a result of losses/gains on treasury deposits held in US dollars.

The CeNeS Group does not have any trade receivables denominated in a foreign currency.

##### *(ii) Price risk*

The CeNeS Group is exposed to equity securities price risk because of investments held by the CeNeS Group. The CeNeS Group is not exposed to commodity price risk. The CeNeS Group does not actively manage the equity security price risk as it is not considered to be significant to the CeNeS Group.

The CeNeS Group's equity investment is not publicly traded and it has been fully written down in the financial statements. As a result there would be no impact on the income statement from a decrease in the value of the investment.

##### *(iii) Cash flow and fair value interest rate risk*

The CeNeS Group has no significant interest bearing assets and therefore the CeNeS Group's operating cash flows are substantially independent of changes in market interest rates. The CeNeS Group has no long term borrowings.

#### *(b) Credit risk*

Credit risk arises from cash and cash equivalents, and deposits with banks and financial institutions. The CeNeS Group does not have any trade receivables. For banks and financial institutions, only independently rated parties with a minimum rating of 'A' are accepted.

Apart from loan receivable explained in note 15, the fair value of other receivables and trade and other payables is equal to the carrying value.

The table below shows the credit limit and balance of the CeNeS Group's two major banks at the balance sheet date.

<i>Counterparty</i>	<i>Rating</i>	<i>At 31 December</i>	<i>At 31 December</i>
		<i>2007</i>	<i>2006</i>
		<i>£'000</i>	<i>£'000</i>
Lloyds TSB	AAA	499	63
Bank of Scotland	AA	3,757	6,204

(c) *Liquidity risk*

Prudent liquidity risk management implies maintaining sufficient cash and cash equivalents to meet the liabilities of the CeNeS Group as they fall due. Management monitors rolling forecasts on a regular basis to assess the Group's liquidity.

The table below shows the CeNeS Group's financial liabilities which are not discounted and which are all due within one year.

	<i>At 31 December</i>	<i>At 31 December</i>
	<i>2007</i>	<i>2006</i>
	<i>£'000</i>	<i>£'000</i>
Trade and other payables	1,756	2,993

The CeNeS Group does not currently have any derivative financial instruments.

**Capital risk management**

The CeNeS Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

CeNeS is not subject to externally imposed capital requirements.

The CeNeS Group does not currently have any gearing.

**Fair value estimation**

The CeNeS Group does not currently have any financial instruments traded in active markets.

The fair value of financial instruments that are not traded in active markets is determined using valuation techniques.

**4. Critical accounting estimates and judgments**

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

**Critical accounting estimates and assumptions**

The CeNeS Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(a) *Estimated impairment of goodwill*

The CeNeS Group tests annually whether goodwill has suffered any impairment, in accordance with the accounting policy stated in note 2. The CeNeS Group uses risk adjusted Net Present Value ("rNPV") calculations based on expected future cash flows and industry standard assumptions to measure the value of these programmes. These calculations require the use of estimates (Note 13).

(b) *Fair value of financial instruments*

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The CeNeS Group uses its judgement to select the method and make assumptions that are mainly based on conditions existing at each balance sheet date. The CeNeS Group has used discounted cash flow analysis for fair valuation of non-current loan receivables

## 5. Segmental information

The CeNeS Directors are of the opinion that under IAS 14 – ‘Segmental Information’ the CeNeS Group has only one business segment, being drug development. In addition the CeNeS Directors are of the opinion that there is only one geographical segment, the UK.

## 6. Loss on ordinary activities before taxation

The following items have been included in arriving at the loss on ordinary activities before taxation:

	<i>2007</i> £'000	<i>2006</i> £'000
Depreciation of owned assets	12	11
Amortisation of licences	5	3
Operating lease rentals: land and buildings	474	447
Operating lease rentals: other	17	25
Auditors' remuneration:		
Fees payable to Company's auditors for the audit of parent company and consolidated financial statements	22	16
Fees payable to the Company's auditors and its associates for other services:		
– The audit of Company's subsidiaries pursuant to legislation	14	10
– Other services pursuant to legislation – Interim review work	11	7
– Tax services	11	7

## 7. Other operating income

	<i>2007</i> £'000	<i>2006</i> £'000
Rental income	<u>—</u>	<u>26</u>

## Finance income

	<i>2006</i> £'000	<i>2007</i> £'000
Interest receivable on short term bank deposits	<u>188</u>	<u>267</u>

## 9. Staff costs

The average monthly number of employees during the year (including executive directors) was:

	<i>2007</i> Number	<i>2006</i> Number
Administration	8	9
Research and development	8	8
	<u>16</u>	<u>17</u>



Their aggregate remuneration comprised:

	<i>2007</i> £'000	<i>2006</i> £'000
Wages and salaries	1,614	1,551
Social security costs	168	177
Other pension costs (see note 23)	107	100
Termination payments	87	—
Share-based payments	93	167
	<u>2,069</u>	<u>1,995</u>

The CeNeS Directors consider the key management to currently comprise the three senior managers and the three executive Directors and Dr Smith who left CeNeS in 2007. Compensation for key management was:

	<i>2007</i> £'000	<i>2006</i> £'000
Wages and salaries	1,058	899
Social security costs	119	110
Other pension costs	78	67
Termination payments	87	—
Share-based payments	72	75
	<u>1,414</u>	<u>1,151</u>

The termination payment of £87,000 was made to Dr Terry Smith, who was Development Director, and who left in May 2007.

#### **10. Directors' remuneration**

	<i>2007</i> £'000	<i>2006</i> £'000
Aggregate emoluments	548	482
Pension costs	34	30
	<u>582</u>	<u>512</u>
Highest paid Director		
Aggregate emoluments	256	248
Pension costs	19	18
	<u>275</u>	<u>266</u>

Retirement benefits are accruing to three Directors (2006: two) under defined contribution pension schemes.

#### **11. Tax credit on loss on ordinary activities**

	<i>2007</i> £'000	<i>2006</i> £'000
UK corporation tax – research and development tax credits	(836)	(650)
Adjustment in respect of prior periods	(1)	(165)
	<u>(837)</u>	<u>(815)</u>

The tax result for the period is different from the standard rate of corporation tax in the UK (16 per cent.) (2006: 16 per cent.).

The differences are explained below:

	2007 £'000	2006 £'000
Loss on ordinary activities before tax	(7,394)	(9,456)
Loss on ordinary activities multiplied by the rate at which UK R&D tax credits may be claimed of 16% (2006: 16%)	(1,183)	(1,513)
Effects of:		
Expenses not deductible for tax purposes	36	64
Accelerated capital allowances and other timing differences	(3)	1
Tax losses unutilised in the year	314	798
Adjustment in respect of prior periods	(1)	(165)
Current tax credit for the period	<u>(837)</u>	<u>(815)</u>

## 12. Loss per ordinary share

The basic and diluted loss per ordinary share is based on a CeNeS Group loss for the financial year of £6.6 million (2006: £8.6 million) on 18,208,800 (2006: 13,821,312) ordinary shares (after share consolidation per note 20), the weighted average number of shares in issue during the year.

## 13. Intangible assets

	<i>Licences</i> £'000	<i>Goodwill</i> £'000	<i>Total</i> £'000
<b>Cost</b>			
As at 1 January 2006	1,939	50,746	52,685
Additions	77	—	77
Adjustment	—	(212)	(212)
<b>As at 31 December 2006 and at 31 December 2007</b>	<u>2,016</u>	<u>50,534</u>	<u>52,550</u>
<b>Amortisation and impairment</b>			
As at 1 January 2006	1,939	44,233	46,172
Amortisation for the year	3	—	3
<b>As at 31 December 2006 and at 1 January 2007</b>	<u>1,942</u>	<u>44,233</u>	<u>46,175</u>
Amortisation for the year	5	—	5
<b>As at 31 December 2007</b>	<u>1,947</u>	<u>44,233</u>	<u>46,180</u>
<b>Net book value as at 31 December 2007</b>	<u>69</u>	<u>6,301</u>	<u>6,370</u>
Net book value as at 31 December 2006	74	6,301	6,375
Net book value as at 31 December 2005	—	6,513	6,513

The adjustment of goodwill in 2006 arose from the reduction in the original assessment of the fair value of contingent consideration payable.

Licences relate to patent rights acquired for £77,000 from Alza Corporation in July 2006. This amount has been capitalised in the balance sheet and is being amortised on a straight line basis over the life of the license (15 years).

### *Impairment tests for goodwill*

The CeNeS Group tests goodwill annually for impairment, or more frequently if there are indications that goodwill may be impaired, in accordance with IAS 36. The CeNeS Group uses a risk adjusted Net Present Value (“rNPV”) model which incorporates future cash inflows, including milestones and royalties, and cash outflows, including clinical development costs, marketing and sales costs. Goodwill is allocated to the CeNeS Group’s value generating

research and development programmes, categorised by the initial company acquisition. Thus, the rNPV of M6G, which was acquired with the acquisition of CeNeS Limited in December 1999, is used to test the goodwill arising on the acquisition of CeNeS Limited for impairment. Similarly CNS 7056 is used to test the goodwill arising on the acquisition of TheraSci Limited for impairment.

The following key assumptions are used in the rNPV model:

- discount rate of 20 per cent. – the management consider this to be suitable for biotechnology companies
- term of cash flows used to calculate rNPV – the expected patent life or market exclusivity period.
- no growth in market sizes has been assumed.
- peak sales forecasts used are based on publicly known and paid for market research information. Management has reduced the peak sales forecast by half in these calculations to provide an extra level of comfort.

The resultant rNPV values for both M6G and CNS 7056 were in excess of the carrying values of goodwill for CeNeS Limited and TheraSci Limited respectively as at 31 December 2007 and therefore no impairment has been made.

#### 14. Property, plant and equipment

	<i>Plant, machinery and leasehold improvements £'000</i>	<i>Computers, office equipment, laboratory equipment £'000</i>	<i>Furniture, and fittings £'000</i>	<i>Total £'000</i>
<b>Cost</b>				
As at 1 January 2007	1,908	56	333	2,297
Additions	—	—	6	6
<b>As at 31 December 2007</b>	<u>1,908</u>	<u>56</u>	<u>339</u>	<u>2,303</u>
<b>Depreciation</b>				
As at 1 January 2007	1,908	56	307	2,271
Charge for the year	—	—	12	12
<b>As at 31 December 2007</b>	<u>1,908</u>	<u>56</u>	<u>319</u>	<u>2,283</u>
<b>Net book value as at 31 December 2007</b>	<u>—</u>	<u>—</u>	<u>20</u>	<u>20</u>
Net book value as at 31 December 2006	—	—	26	26

There are no items held under existing finance lease or hire purchase agreements included within property, plant and equipment.

	<i>Plant, machinery and leasehold improvements £'000</i>	<i>Computers, office equipment, laboratory equipment £'000</i>	<i>Furniture, and fittings £'000</i>	<i>Total £'000</i>
<b>Cost</b>				
As at 1 January 2006	1,908	56	332	2,296
Additions	—	—	1	1
<b>As at 31 December 2006</b>	<u>1,908</u>	<u>56</u>	<u>333</u>	<u>2,297</u>
<b>Depreciation</b>				
As at 1 January 2006	1,908	56	296	2,260
Charge for the year	—	—	11	11
<b>As at 31 December 2006</b>	<u>1,908</u>	<u>56</u>	<u>307</u>	<u>2,271</u>
<b>Net book value as at 31 December 2006</b>	<u>—</u>	<u>—</u>	<u>26</u>	<u>26</u>
Net book value as at 31 December 2005	—	—	36	36

#### 15. Trade and other receivables – Non current assets

	<i>2007 £'000</i>	<i>2006 £'000</i>
Xention Ltd loan note	375	375
Less: provision for impairment	(227)	(227)
	<u>148</u>	<u>148</u>

The loan note was issued by Xention Limited to CeNeS Limited in 2002 as part of its consideration for the acquisition of the Channelwork division from CeNeS Limited. The nominal value of the loan note is £375,000 and is receivable on 31 December 2009.

The fair value assigned to the loan notes is £148,000 to reflect the risk that the full value of the loan note may not be recoverable given the inherent high risk of small unquoted biotechnology companies.

#### 16. Trade and other receivables

	<i>2007 £'000</i>	<i>2006 £'000</i>
Other receivables	84	246
Prepayments and accrued income	188	120
	<u>272</u>	<u>366</u>

#### 17. Trade and other payables

	<i>2007 £'000</i>	<i>2006 £'000</i>
Trade payables	1,239	1,541
Other taxation and social security	48	45
Other payables	16	3
Accruals	453	1,404
	<u>1,756</u>	<u>2,993</u>

## 18. Deferred Income tax

Deferred tax assets have not been recognised as the CeNeS Directors consider that this would be inappropriate as the CeNeS Group is not expected to realise sufficient profits in the foreseeable future. This will be reassessed at such time as the CeNeS Group makes a profit. The amount unprovided/unrecognised of the total potential liability/(asset) is as follows:

	2007		2006	
	Amount recognised £'000	Amount unrecognised £'000	Amount recognised £'000	Amount unrecognised £'000
Tax effect of timing differences:				
Excess of capital allowances over depreciation	—	(129)	—	(134)
Short term timing differences	—	(112)	—	(90)
Tax effect of losses carried forward	—	(15,947)	—	(16,045)
Other provision	—	(6)	—	(13)
	<u>—</u>	<u>(16,194)</u>	<u>—</u>	<u>(16,282)</u>

The rate of UK corporation tax will be reduced from 30 per cent. to 28 per cent. with effect from 1 April 2008. The change in tax rate has been applied to timing differences at 31 December 2007 where applicable.

## 19. Provisions for liabilities and charges

	2007 £'000	2006 £'000
At 1 January	959	959
Utilised in year	(354)	(354)
Amortisation of discount	32	32
Additions to provision	<u>322</u>	<u>322</u>
<b>At 31 December</b>	<u><u>959</u></u>	<u><u>959</u></u>

The maturity of the provision at the year end was as follows:

	2007 £'000	2006 £'000
Amounts falling due:		
Within one year	321	321
After more than one year	<u>638</u>	<u>638</u>
	<u><u>959</u></u>	<u><u>959</u></u>

The CeNeS Group has reviewed and recalculated the onerous lease provision of £1.0 million (31 December 2006: £1.0 million) which reflects the expected liability relating to the leases of premises in Scotland that are no longer required by the CeNeS Group. The provision balance is based on the Directors' current expectations for the time it will take to sublet the properties. Of this provision, £0.7 million (2006: £0.7 million) is due after more than one year and £0.3 million (2006: £0.3 million) is due within one year.

The fair values of future lease payments are based on cash flows discounted using a rate based on the market interest rate and the risk premium (2007: 10 per cent.; 2006: 10 per cent.).

## 20. Share capital

The share capital of CeNeS is shown below:

	<i>2007</i> <i>Number</i>	<i>2007</i> <i>£'000</i>	<i>Restated*</i> <i>2006</i> <i>Number</i>	<i>2006</i> <i>£'000</i>
<b>Authorised</b>				
Ordinary shares of 30p each	<u>33,776,318</u>	<u>10,133</u>	<u>33,776,318</u>	<u>10,133</u>
		<i>Number of ordinary 30p shares</i>	<i>Issued share capital £'000</i>	<i>Share capital to be issued £'000</i>
<b>Allotted, issued and fully paid</b>				
At 1 January 2007 (restated*)		16,131,055	4,839	3,687
Issues of new shares – placing		<u>5,789,137</u>	<u>1,737</u>	<u>—</u>
<b>At 31 December 2007</b>		<u>21,920,192</u>	<u>6,576</u>	<u>3,687</u>

\* On 22 August 2007, CeNeS consolidated its ordinary shares of 1 pence each into ordinary shares of 30 pence each.

Also, on 22 August 2007 CeNeS raised £5,747,000 net of £332,000 issue costs, by a placing of 5,789,137 new CeNeS Shares of 30 pence each at 105 pence per share. The issue resulted to £1,737,000 additional share capital and £4,010,000 share premium.

### *Shares to be issued*

Following the reverse takeover of Core Group plc by CeNeS Limited in December 1999 there are 250,725 ordinary 30p shares to be issued as deferred consideration to holders of options over ordinary shares in CeNeS Limited. These were valued at approximately £13 per share at the date of the reverse takeover of Core Group plc by CeNeS Limited giving a value of £3,003,000 after deducting £371,000 receivable by CeNeS Limited on exercise of the options.

There are also 28,948 (2006: 28,948) ordinary 30p shares to be issued as deferred consideration to holders of options over shares in Cambridge NeuroScience Inc. These were valued at approximately £19.85 per share at the date of the takeover of Cambridge NeuroScience Inc in December 2000 giving them a value of £390,000 after deducting £185,000 receivable by CeNeS on exercise of the options.

On 21 November 2003, the Company acquired the entire share capital of TheraSci Limited (“TheraSci”). A further allotment of 120,752 ordinary 30p shares, valued at £294,000, is due to GlaxoSmithKline plc subject to the achievement of a project milestone.



## **Schedule of options outstanding as at 31 December 2007**

	Note	As at 31/12/2007	Exercise price	Date of grant	Contracted remaining life
Approved share option scheme	1	12	£15.45	9 November 1998	1.8 years
Approved share option scheme	1	508	£24.60	11 May 2000	2.3 years
Unapproved share option scheme	1	12,500	£16.05	18 December 2000	3 years
Unapproved share option scheme	1	19,082	£2.40	1 January 2002	1 year
Approved share option scheme	1	10,832	£2.40	1 January 2002	4 years
Unapproved share option scheme	1	58,333	£1.20	1 August 2003	2.6 years
Unapproved share option scheme	1	33,333	£2.14	21 November 2003	2.9 years
Unapproved share option scheme	1	152,330	£3.11	20 April 2004	3.3 years
Unapproved share option scheme	1	164,884	£2.33	22 December 2004	4 years
Unapproved share option scheme	1	10,000	£2.70	5 May 2005	4.3 years
Unapproved share option scheme	1	25,000	£2.33	1 November 2005	4.8 years
Unapproved share option scheme	1	296,662	£2.06	2 February 2006	5.1 years
Unapproved share option scheme	1	283,326	£1.84	30 March 2007	6.2 years
Executive Share Option Plan	2	4,230	£1 in aggregate	30 June 2000	2.5 years
Executive Share Option Plan	2	3,365	£1 in aggregate	3 July 2000	2.5 years
Executive Share Option Plan	2	70,155	£1 in aggregate	31 December 2001	4 years
Executive Share Option Plan	2	98,228	£1 in aggregate	1 August 2003	5.6 years
Executive Share Option Plan	2	76,666	£1 in aggregate	20 April 2004	6.3 years
<b>Total</b>		<u>1,319,446</u>			

### **Notes:**

- (1) Subject to the satisfaction of any applicable condition of exercise, options may be exercised in whole or in part at any time and from time to time after the earliest of the third anniversary of grant, the death of the option holder, or the option holder ceasing to be a director or employee of CeNeS by reason of injury, disability or redundancy, or retirement, or at the discretion of the Remuneration Committee, for any reason. No options were exercised (2006: nil) and 273,385 (2006: 25,469) options lapsed during the year.
- (2) The CeNeS Executive Share Option Plan (the "Plan") provides for the grant of rights to acquire shares by way of purchase to eligible employees of CeNeS. Under the Plan options are granted at an aggregate exercise price of £1 and will normally only vest after the third anniversary of the date of grant and if CeNeS's share price has exceeded the growth in total shareholder return for the FTSE All-Share 900 Companies over that period.

## **Schedule of options outstanding as at 31 December 2006**

	Note	As at 31/12/2007	Exercise price	Date of grant	Contracted remaining life
Approved share option scheme	1	400	£0.52	9 November 1998	1.8 years
Unapproved share option scheme	1	103,658	£0.82	11 May 2000	0.3 years
Approved share option scheme	1	15,243	£0.82	11 May 2000	3.3 years
Approved share option scheme	1	9,422	£0.82	26 September 2000	3.7 years
Unapproved share option scheme	1	24,540	£0.82	3 October 2000	0.7 years
Unapproved share option scheme	1	375,000	£0.54	18 December 2000	4 years
Unapproved share option scheme	1	2,198,125	£0.08	1 January 2002	2 years
Approved share option scheme	1	569,750	£0.08	1 January 2002	5 years
Unapproved share option scheme	1	3,360,000	£0.04	1 August 2003	3.6 years
Unapproved share option scheme	1	1,000,000	£0.07	21 November 2003	3.9 years
Unapproved share option scheme	1	5,870,000	£0.10	20 April 2004	4.3 years
Unapproved share option scheme	1	5,840,470	£0.08	22 December 2004	5 years
Unapproved share option scheme	1	300,000	£0.09	5 May 2005	5.3 years
Unapproved share option scheme	1	750,000	£0.08	1 November 2005	5.8 years
Unapproved share option scheme	1	100,000	£0.07	30 November 2005	5.9 years
Unapproved share option scheme	1	10,090,000	£0.07	2 February 2006	6.1 years
Executive Share Option Plan	2	126,923	£1 in aggregate	30 June 2000	3.5 years
Executive Share Option Plan	2	100,961	£1 in aggregate	3 July 2000	3.5 years
Executive Share Option Plan	2	2,104,688	£1 in aggregate	31 December 2001	5 years
Executive Share Option Plan	2	2,946,875	£1 in aggregate	1 August 2003	6.6 years
Executive Share Option Plan	2	2,300,000	£1 in aggregate	20 April 2004	7.3 years
<b>Total</b>		<b><u>38,186,055</u></b>			

### **Notes:**

- (1) Subject to the satisfaction of any applicable condition of exercise, options may be exercised in whole or in part at any time and from time to time after the earliest of the third anniversary of grant, the death of the option holder, or the option holder ceasing to be a director or employee of CeNeS by reason of injury, disability or redundancy, or retirement, or at the discretion of the Remuneration Committee, for any reason. No options were exercised (2005: nil) and 727,490 (2005: 120,951) options lapsed during the year.
- (2) The CeNeS Executive Share Option Plan (the "Plan") provides for the grant of rights to acquire shares by way of purchase to eligible employees of CeNeS. Under the Plan options are granted at an aggregate exercise price of £1 and will normally only vest after the third anniversary of the date of grant and if CeNeS's share price has exceeded the growth in total shareholder return for the FTSE All-Share 900 Companies over that period.

## 21. Share based payments

All employees of the CeNeS Group are awarded share options. Recently option grants to UK employees have been made under the CeNeS Unapproved Share Option Scheme share option scheme ('Unapproved'). Previously options have also been granted under the CeNeS Approved Share Option Scheme and the Executive Share Option Plan ('ESOP'). Options granted under the Unapproved scheme have a fixed exercise price based on the market price at the date of grant. The contractual life of the options is seven years. Options cannot normally be exercised before the third anniversary of the date of grant. For options granted to all directors and employees, the options are exercisable only if at the time of exercise, a performance condition has been met.

Options were valued using the Black-Scholes option pricing model. The CeNeS Group has taken the exemption provided in IFRS 2 which allows the charge for share-based payment to be calculated only in respect of options granted to employees after 7 November 2002 which had not vested by 1 January 2005.

The fair value per award granted and the assumptions used in the calculations are as follows:

<i>Date of grant</i>	<i>Option Scheme</i>	<i>Number of awards</i>	<i>Exercise price at grant date (£)</i>	<i>Share price (£)</i>	<i>Discount factor re Performance conditions</i>	<i>Fair value per option</i>
01/08/2003	Unapproved	128,000	1.20	1.20	25%	£0.265
21/11/2003	Unapproved	33,333	2.14	2.14	25%	£0.472
20/04/2004	Unapproved	200,000	3.11	3.11	25%	£0.688
22/12/2004	Unapproved	202,242	2.32	2.32	25%	£0.514
05/05/2005	Unapproved	10,000	2.70	2.70	25%	£0.597
01/11/2005	Unapproved	25,000	2.32	2.32	25%	£0.514
30/11/2005	Unapproved	3,333	2.06	2.06	25%	£0.456
02/02/2006	Unapproved	100,000	2.10	2.10	25%	£0.452
02/02/2006	Unapproved	236,333	2.06	2.06	25%	£0.456
30/03/2007	Unapproved	319,992	1.84	1.84	25%	£0.412
01/08/2003	ESOP	98,229	£1 in aggregate	1.20	38%	£0.384
20/04/2004	ESOP	76,667	£1 in aggregate	3.11	38%	£1.058

The key assumptions used are as follows:

- (1) The expected future volatility is calculated at 60 per cent. This is based on historical volatility for the period since January 2002.
- (2) The risk-free rate of return of 5.35 per cent. is the yield on zero-coupon UK government bonds of a term consistent with the expected option life. The expected dividend yield is nil.
- (3) The charge is spread over the expected vesting period.
- (4) Discount factors of 25 per cent. for the Unapproved scheme and 38 per cent. for the ESOP have been applied to take account of the performance conditions which must be met before the options can be exercised.
- (5) The expected life of options has been estimated at five years after the grant date.

A reconciliation of movements in all options over the year to 31 December 2007 is shown below:

	2007		2006	
	Number (‘000)	Weighted average exercise price	Number (‘000)	Weighted average exercise price
Outstanding at 1 January	1,273	204p	962	207p
Granted	320	184p	336	207p
Forfeited	(273)	290p	(25)	240p
Outstanding at 31 December	<u>1,320</u>	<u>189p</u>	<u>1,273</u>	<u>204p</u>
Exercisable at 31 December	<u>210</u>	<u>120p</u>	<u>210</u>	<u>120p</u>

The total charge for the year relating to employee share based payment plans was £93,000 (2006: £167,000) all of which related to equity-settled share based payment transactions. The fair value of options granted during the year was £117,000 (2006: £138,000).

## 22. Contingent liabilities and guarantees

CeNeS has a guarantee in relation to the lease arrangements for 3 Riverside Way, Irvine, entered into by CeNeS Drug Delivery Limited. The lease has a 25 year term, commencing 12 February 1998, with a break point at year 20. The annual amount payable is £168,000. This property is no longer required and CeNeS is actively seeking to sublet the property.

In September 1999, Core Technologies Limited concluded an agreement to take a lease of new, additional premises adjacent to the main site at Riverside Way, Irvine. The lease term is until March 2010 and the annual rental is £186,500. CeNeS is actively seeking to sublet the property.

CeNeS has reviewed and recalculated the onerous lease provision of £1.0 million (31 December 2006: £1.0 million) which reflects the expected liability relating to the leases of premises in Scotland that are no longer required by the CeNeS Group. Of this provision, £0.7 million (2006: £0.7 million) is due after more than one year and £0.3 million (2006: £0.3 million) is due within one year.

CeNeS has entered into cross guarantees within the CeNeS Group as part of its banking arrangements.

## 23. Pension commitments

CeNeS has a stakeholder pension scheme which is available to all UK based employees. The pension charge for the year was £107,000 (2006: £100,000). At 31 December 2007 contributions totalling £22,000 (2006: £45,000) were payable to these pension arrangements.

## 24. Financial commitments

Obligations under non-cancellable operating leases are as follows:

	Land and buildings		Land and buildings	
	2007 £'000	Other 2007 £'000	2006 £'000	Other 2006 £'000
Due no later than one year	442	15	442	17
Due later than one year but no later than five years	1,152	2	1,426	17
Due later than five years	860	—	1,028	—
	<u>2,454</u>	<u>17</u>	<u>2,896</u>	<u>34</u>

## 25. Subsidiary companies

The CeNeS Group has included the following subsidiaries in its consolidation:

<i>Summary of subsidiary undertakings:</i>	<i>Nature of business</i>	<i>Country of incorporation</i>	<i>% holding (all classes of shares)</i>
Subsidiary undertakings held directly			
CeNeS Drug Delivery Limited	Non trading	Scotland	100%
CeNeS Limited	Drug development	England	100%
CeNeS Pharmaceuticals Inc.	Dormant	USA	100%
CeNeS (Bermuda) Limited	Dormant	Bermuda	100%
TheraSci Limited	Dormant	England	100%

## 26. Related party disclosures

During the year ended 31 December 2007 the CeNeS Directors subscribed for new CeNeS Shares as follows:

<i>Director</i>	<i>Number of shares subscribed</i>	<i>Price per share</i>	<i>Date</i>
Alan Goodman	9,523	105p	22/08/07
Neil Clark	9,523	105p	22/08/07
Ron Irwin	4,761	105p	22/08/07
Alan Smith	4,761	105p	22/08/07

The following fees and expenses were incurred during the period from the associated companies of the non-executive directors of the CeNeS Group as follows:

	<i>2007 £'000</i>	<i>2006 £'000</i>
Irwin Associates International (Mr T Ronald Irwin)	33	31
Johnson Partners (Dr Peter Johnson)	33	31

The balances due at the year end and included in creditors and accruals were as follows:

	<i>2007 £'000</i>	<i>2006 £'000</i>
Irwin Associates International (Mr T Ronald Irwin)	13	16

Alan Goodman, the Chairman of CeNeS, and Alan Smith, a non-executive Director of CeNeS are also Directors of Avlar Bioventures Limited. One of the funds managed by Avlar Bioventures Limited holds 2,436,449 CeNeS ordinary shares.

Refer to note 9 for details of key management compensation.

The CeNeS Directors consider that there is no ultimate controlling party to CeNeS.

## 27. Reporting under International Financial Reporting Standards ("IFRS")

CeNeS has produced its consolidated financial statements in accordance with IFRS.

The commentary below highlights the key changes that have arisen due to the transition from reporting under UK GAAP to reporting under IFRS. The CeNeS Group's date of transition to IFRS is 1 January 2006, which is the beginning of the comparative period for the 2007 financial year. Therefore the opening balance sheet for IFRS purposes is that reported at 1 January 2006 as amended for changes due to IFRS.

These financial statements are the first to be prepared under IFRS. The comparative figures have been prepared on the same basis and are therefore restated from those previously reported under UK GAAP. To help understand the impact of the transition, reconciliations have been produced below to show the changes made to statements previously reported under UK GAAP in arriving at the equivalent statements under IFRS. The following reconciliations are provided:

1. Consolidated balance sheet at 1 January 2006

2. Consolidated income statement for the year to 31 December 2006
3. Consolidated balance sheet at 31 December 2006

The income statement for the year ended 31 December 2007 and the balance sheet at that date are reported under IFRS. As they have not previously been reported under UK GAAP no reconciliation to IFRS is required.

The net effect of presenting the 2006 full year financial statements under IFRS rather than UK GAAP is to decrease the loss after tax reported from £9.7 million to £8.6 million and to increase net assets by £1.1 million.

Income tax credits of £1,065,000 received during the year ended 2006 are classified as a part of operating cash flows under IFRSs, but were included in a separate category of tax cash flows under UK GAAP. There are no other material differences between the cash flow statement presented under IFRSs and the cash flow statement presented under UK GAAP.

Where applicable, the options selected by management under IFRS 1 are set out in the explanatory notes below.

### Reconciliation of equity

UK GAAP to IFRS as at 1 January 2006

	<i>As reported under UK GAAP £'000</i>	<i>Effects of transition to IFRS £'000</i>	<i>Restated under IFRS £'000</i>
<b>Non-current assets</b>			
Intangible assets	6,513	—	6,513
Property, plant and equipment	36	—	36
Trade and other receivables	148	—	148
	<u>6,697</u>		<u>6,697</u>
<b>Current assets</b>			
Trade and other receivables	487	—	487
Income tax asset	900	—	900
Cash and cash equivalents	8,464	—	8,464
	<u>9,851</u>	—	<u>9,851</u>
<b>Current liabilities</b>			
Trade and other payables	(1,471)	—	(1,471)
Provisions for liabilities and charges	—	(491)	(491)
	<u>8,380</u>	<u>(491)</u>	<u>7,889</u>
<b>Net current assets</b>			
	<u>15,077</u>	<u>(491)</u>	<u>14,586</u>
<b>Non-current liabilities</b>			
Provisions for liabilities and charges	(1,009)	491	(518)
	<u>14,068</u>	<u>—</u>	<u>14,068</u>
<b>Capital and reserves</b>			
Share capital	4,098	—	4,098
Share capital to be issued	3,899	—	3,899
Share premium	113,080	—	113,080
Capital redemption reserve	15,697	—	15,697
Other reserves	10,396	—	10,396
Profit and loss account	(133,102)	—	(133,102)
<b>Total equity</b>	<u>14,068</u>	<u>—</u>	<u>14,068</u>

Goodwill is not amortised under IFRS but is measured at cost less impairment losses. Under UK GAAP, goodwill was amortised on a straight line basis over an estimate time that the Group was



to benefit from it. This change does not affect equity as at 1 January 2006 because as permitted under IFRS 1, goodwill arising on acquisition before January 2006 (date of transition to IFRS) has been frozen at the UK GAAP amounts subject to being tested for impairment at that date, the results of which indicated no such impairment.

Provisions for liabilities and charges have been split between current liabilities and non-current liabilities in accordance with IAS 1, "Presentation of financial statements".

### Reconciliation of equity

UK GAAP to IFRS for the year ended 31 December 2006

	<i>Notes</i>	<i>As reported under UK GAAP £'000</i>	<i>Effects of transition to IFRS £'000</i>	<i>Restated under IFRS £'000</i>
<b>Revenue</b>		53	—	53
Research and development costs	(i)	(7,277)	77	(7,200)
Administrative expenses	(ii)	(3,552)	950	(2,602)
Other operating income		26	—	26
<b>Operating loss</b>		(10,750)	1,027	(9,723)
Finance income		267	—	267
<b>Loss before tax</b>		(10,483)	1,027	(9,456)
Income tax credit		815	—	815
<b>Loss for the period, Being retained loss for the year</b>		<u>(9,668)</u>	<u>1,027</u>	<u>(8,641)</u>

Notes:

- (i) Licence acquired for £77,000 from Alza Corporation in July 2006 has been capitalised in the balance sheet, in accordance with IAS38. The amount is being amortised over the licence period (15 years). The amortisation charge for 2006 was £3,000.
- (ii) Goodwill is not amortised under IFRS but is reviewed annually for impairment. Goodwill amortisation under UK GAAP was £953,000. This amount is netted off against the licence amortisation of £3,000.

## Reconciliation of the equity

UK GAAP to IFRS as at 31 December 2006

	<i>Notes</i>	<i>As reported under UK GAAP £'000</i>	<i>Effects of transition to IFRS £'000</i>	<i>Restated under IFRS £'000</i>
<b>Non-current assets</b>				
Intangible assets	(i)	5,348	1,027	6,375
Property, plant and equipment		26	—	26
Trade and other receivables		148	—	148
		<u>5,522</u>	<u>1,027</u>	<u>6,549</u>
<b>Current assets</b>				
Trade and other receivables		366	—	366
Income tax asset		650	—	650
Cash and cash equivalents		6,296	—	6,296
		<u>7,312</u>	<u>—</u>	<u>7,312</u>
<b>Current liabilities</b>				
Trade and other payables		(2,993)	—	(2,993)
Provisions for liabilities and charges		(321)	—	(321)
		<u>3,998</u>	<u>—</u>	<u>3,998</u>
<b>Net current assets</b>				
		<u>9,520</u>	<u>1,027</u>	<u>10,547</u>
<b>Total assets less current liabilities</b>				
<b>Non-current liabilities</b>				
Provisions for liabilities and charges		(638)	—	(638)
		<u>8,882</u>	<u>1,027</u>	<u>9,909</u>
<b>Net assets</b>				
<b>Capital and reserves</b>				
Share capital		4,839	—	4,839
Share capital to be issued		3,687	—	3,687
Share premium		116,866	—	116,866
Capital redemption reserve		15,697	—	15,697
Other reserves		10,396	—	10,396
Profit and loss account		(142,603)	1,027	(141,576)
		<u>8,882</u>	<u>1,027</u>	<u>9,909</u>

Notes:

- (i) Goodwill amortisation of £953,000 under UK GAAP is not required under IFRS. The licence acquired for £77,000 in July 2006 has been capitalised, and is amortised over the life of the

## PART III

### Financial year 2005 (UK GAAP)

#### Consolidated Profit and Loss Account

	<i>Year ended 31 December 2005 £'000</i>
<b>Turnover</b>	<u>55</u>
Gross profit	55
Research and development costs	(4,893)
Administrative expenses	(3,235)
Other operating income	<u>174</u>
<b>Operating loss</b>	<u>(7,899)</u>
Net interest receivable	<u>535</u>
<b>Loss on ordinary activities before taxation</b>	<u>(7,364)</u>
Tax credit on ordinary activities	<u>625</u>
<b>Loss for the year</b>	<u>(6,739)</u>
<b>Loss per ordinary share – basic and diluted</b>	<u>(1.6p)</u>

#### Consolidated Statement of Total Recognised Gains and Losses

	<i>Year ended 31 December 2005 £'000</i>
Loss for the year	<u>(6,739)</u>
<b>Total recognised gains and losses for the year</b>	<u>(6,739)</u>

## Consolidated Balance Sheet

	<i>As at 31 December 2005 £'000</i>
<b>Fixed assets</b>	
Intangible assets	6,513
Tangible assets	36
	<u>6,549</u>
<b>Current assets</b>	
Debtors	1,535
Cash at bank and in hand	8,464
	<u>9,999</u>
Creditors: amounts falling due within one year	<u>(1,471)</u>
<b>Net current assets/(liabilities)</b>	<u>8,528</u>
<b>Total assets less current liabilities</b>	15,077
Provisions for liabilities and charges	(1,009)
	<u>14,068</u>
<b>Net assets</b>	<u><u>14,068</u></u>
<b>Capital and reserves</b>	
Called up share capital	4,098
Share capital to be issued	3,899
Share premium account	113,080
Capital redemption reserve	15,697
Other reserves	10,396
Profit and loss account	(133,102)
	<u>14,068</u>
<b>Total shareholders' funds</b>	<u><u>14,068</u></u>

## Consolidated Cash Flow Statement

	<i>Year ended 31 December 2005 £'000</i>
<b>Net cash outflow from operating activities</b>	(6,855)
<b>Returns on investments and servicing of finance</b>	
Interest received	563
Interest paid	(5)
	<u>558</u>
<b>Net cash inflow from returns on investment and servicing of finance</b>	558
<b>Taxation</b>	
Research and Development Tax Credit	516
	<u>516</u>
<b>Capital expenditure</b>	
Payment to acquire tangible fixed assets	(28)
Net cash outflow from capital expenditure	(28)
	<u>(5,809)</u>
Cash outflow before use of liquid resources and financing	(5,809)
Decrease in short term deposits with banks	10,000
	<u>4,191</u>
<b>Net cash inflow before financing</b>	4,191
<b>Financing</b>	
Repayment of loans	(47)
	<u>(47)</u>
<b>Net cash outflow from financing</b>	(47)
<b>Increase in cash</b>	<u><u>4,144</u></u>

## Reconciliation of Net Cash Flow to Movements in Net Funds

	<i>Year ended 31 December 2005 £'000</i>
Increase in cash in the period	4,144
Cash outflow due to changes in debt	47
Movements in deposits	<u>(10,000)</u>
<b>Movement in net funds</b>	<u>(5,809)</u>
<b>Net funds brought forward</b>	<u>14,266</u>
<b>Net funds carried forward</b>	<u><u>8,457</u></u>

## Notes to the Financial Statements for the year ended 31 December 2005

### 1. Accounting policies

The Financial Statements for the year ended 31 December 2005 were prepared in accordance with applicable accounting standards in the United Kingdom. A summary of the more important accounting policies, which have been reviewed by the CeNeS in accordance with Financial Reporting Standard ('FRS') 18 'Accounting policies', is set out below, together with an explanation of where changes have been made to previous policies on the adoption of new accounting standards in the year.

The Financial Statements for the year ended 31 December 2005 were prepared in accordance with the historical cost convention.

#### *Changes in accounting standards*

The CeNeS Group has adopted FRS 21 'Events after the balance sheet date', FRS 22 'Earnings per share' and FRS 25 'Financial Instruments: Disclosure and presentation' in these financial statements.

#### (a) *Basis of consolidation*

The CeNeS Group Financial Statements consolidate the Financial Statements of CeNeS and its wholly owned subsidiary undertaking, CeNeS Drug Delivery Limited, under merger accounting principles and its subsidiary undertakings, which are also wholly owned, CeNeS Limited, CeNeS Pharmaceuticals Inc., Cambridge Cognition Guarantee Limited, CeNeS (Bermuda) Limited and TheraSci Limited under acquisition accounting principles.

#### (b) *Intangible fixed assets*

Goodwill, arising on the acquisition of subsidiary undertakings and businesses, representing the excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised as an asset on the balance sheet and amortised over its useful economic life which the CeNeS Directors estimate to be as follows:

CeNeS Limited	15 years
TheraSci Limited	5 years

Provision is made for any impairment.

#### (c) *Intangible assets – licences*

Licences with an immediate defined revenue stream are included at cost and depreciated in equal instalments over a period of five years which is their estimated useful economic life. Provision is made for any impairment.

Other licences acquired are expensed immediately as part of research and development costs.

#### (d) *Tangible fixed assets and depreciation*

Tangible fixed assets are stated at cost or valuation, net of depreciation and any provision for impairment. Depreciation is provided on tangible fixed assets at rates calculated to write off the cost, less estimated residual value, of each asset on a straight-line basis over its expected useful life as follows:

Leasehold improvements	over the shorter of the lease term or 10 years
Fixtures, fittings and computers	over 2 – 7 years
Plant and machinery	over 5 – 10 years
Laboratory equipment	over 3 – 5 years

#### (e) *Investments*

Investments in subsidiary companies which are accounted for under merger accounting principles are shown at the nominal value of shares issued in accordance with the provisions of the Companies Act 1985.



Investments in subsidiary companies which are accounted for under acquisition accounting principles are shown at cost less any provision for impairment.

Short term investments comprise bank deposits which are not repayable on demand. Movements in such investments are included under “use of liquid resources” in the CeNeS Group’s Cash Flow Statement.

(f) *Foreign currency*

The assets and liabilities of subsidiaries denominated in foreign currencies have been translated into sterling at rates of exchange ruling at the balance sheet date. Profit and loss accounts of overseas subsidiary undertakings are translated at the monthly exchange rates during the year. Differences on exchange arising from the retranslation of the opening net investment in subsidiary companies are taken to reserves and reported in the Consolidated Statement of Total Recognised Gains and Losses.

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are reported at the rates of exchange prevailing at this date.

(g) *Leasing and hire purchase commitments*

Rentals under operating leases are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis. Benefits received and receivable as an incentive to sign an operating lease are similarly spread on a straight-line basis over the lease term, except where the period to the review date on which the rent is first expected to be adjusted to the prevailing market rate is shorter than the full lease term, in which case the shorter period is used.

Provisions are made in respect of onerous leases to the extent that the CeNeS Directors believe that costs will be incurred under the terms of the lease with no benefit to the CeNeS Group.

(h) *Taxation*

Current tax is provided at amounts expected to be paid or recovered using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Provision is made for deferred taxation, in accordance with FRS 19, ‘Deferred Tax’ on all material timing differences. Deferred tax assets are recognised to the extent that they are regarded as recoverable. Deferred tax assets and liabilities are not discounted.

(i) *Turnover*

Turnover represents amounts receivable from licence fees net of VAT and other sales related taxes.

Revenue is recognised when there is evidence of an arrangement, delivery of the product has occurred, the selling price is determinable and recovery of the debt is reasonably assured.

- i. Product sales are recognised as revenue upon shipment to customers.
- ii. Licence fees are deferred and recognised over the period of the associated research and development agreement.
- iii. Revenue is recognised immediately in respect of sales of technology where there are no further obligations to provide any services under the terms of the sale.

(j) *Research and development*

Fixed assets used for research and development are included as tangible fixed assets and written off in accordance with the depreciation policy above. Other research and development expenditure is charged to the Profit and Loss Account as incurred and includes relevant staff costs as well as an apportionment of occupancy costs, general overheads and depreciation.

(k) *Pensions*

CeNeS operates defined contribution schemes for its employees. The amount charged to the Profit and Loss Account in respect of pension costs is the contributions payable during the year. Differences between contributions payable in the year and contributions actually paid are shown either as accruals or prepayments in the balance sheet.

(l) *Share options*

In accordance with UITF 17, "Employee share schemes", a charge is made in the Profit and Loss Account representing the intrinsic value at the date of grant of share options awarded under the CeNeS Group's Long Term Incentive Plan. As the awards are conditional on certain performance conditions being met, this is reflected in the number of shares on which the charge is calculated. The charge is credited back to the reserves.

(m) *Financial instruments*

The CeNeS Group's financial instruments comprise cash, liquid resources, trade debtors and trade creditors, which arise directly from its operations. The main purpose of these financial instruments is to raise finance for the CeNeS Group's operations. The CeNeS Group does not enter into derivative transactions for speculative purposes. It has been, throughout the year under review, the CeNeS Group's policy that no trading in financial instruments shall be undertaken. The main risks arising from the CeNeS Group's financial instruments are interest rate risk, liquidity risk and foreign currency risk. The CeNeS Board reviews and agrees policies for managing each of these risks and they are summarised in note 26. These policies have remained unchanged during the year.

## 2. Turnover and segmental information

Turnover comprises licence fees. All turnover is derived from the principal activities of the CeNeS Group, originates in the UK and arises in North America.

## 3. Other operating income

	<i>2005</i> <i>£'000</i>
Rental income	137
Other income	37
	<hr/>
	174
	<hr/> <hr/>

## 4. Net interest receivable

	<i>2005</i> <i>£'000</i>
Interest receivable	540
Interest on loans	(5)
	<hr/>
	535
	<hr/> <hr/>

## 5. Loss on ordinary activities before taxation

The loss on ordinary activities before taxation is stated after charging/(crediting):

	<i>2005</i> <i>£'000</i>
Auditors' remuneration:	
Audit services	
– statutory audit (Company: £9,000 (2005: £9,000))	23
Non-audit services	
– reporting accountant fees	10
– tax compliance and advisory work	19
Depreciation of owned assets	9
Amortisation of intangible fixed assets	953
Operating lease rentals: land and buildings	447
Operating lease rentals: other	18
	<u>          </u> <u>          </u>

## 6. Staff costs

The number of employees (including Executive Directors) at 31 December 2005 was 17 (2004: 14). The average monthly number of employees during the year (including Executive Directors) was:

	<i>2005</i> <i>Number</i>
Administration	8
Research and development	8
	<u>          </u> <u>          </u>

Their aggregate remuneration comprised:

	<i>2005</i> <i>£'000</i>
Wages and salaries	1,359
Social security costs	150
Other pension costs (see note [24])	95
	<u>          </u> <u>          </u>

CeNeS had no employees in 2005 or 2004 and no staff costs were incurred by CeNeS during the year ended 31 December 2005 (2004: £nil).

## 7. Directors' remuneration

	<i>2005</i> <i>£'000</i>
Aggregate emoluments	418
Pension costs	28
	<u>          </u> <u>          </u>
Highest paid Director	
Aggregate emoluments	209
Pension costs	17
	<u>          </u> <u>          </u>

Retirement benefits are accruing to two Directors (2004: two) under defined contribution pension schemes.

## 8. Loss for the financial year

As permitted by Section 230 of the Companies Act 1985, the parent company's Profit and Loss Account has not been included in these Financial Statements. The parent company's loss for the financial year was £5,450,000 (2004: £5,055,000).

## 9. Tax credit on loss on ordinary activities

	<i>2005</i> <i>£'000</i>
UK corporation tax – research and development tax credits	(625)
Adjustment in respect of prior periods	—
	<u>(625)</u>

## 9. Tax credit on loss on ordinary activities (continued)

### *Current taxation*

The tax result for the period is different from the standard rate of corporation tax in the UK (16 per cent.) (2004: 16 per cent.).

The differences are explained below:

	<i>2005</i> <i>£'000</i>
Loss on ordinary activities before tax	(7,364)
Loss on ordinary activities multiplied by the rate at which UK R&D tax credits may be claimed of 16% (2004: 16%)	(1,178)
Effects of:	
Expenses not deductible for tax purposes	(26)
Accelerated capital allowances and other timing differences	3
Tax losses unutilised in the year	576
Adjustment in respect of prior periods	—
Difference in overseas tax rates	—
Current tax credit for the period	<u>(625)</u>

## 10. Loss per ordinary share

The basic and diluted loss per ordinary share is based on a CeNeS Group loss for the financial year of £6.6 million (2004: £4.9 million) on 409,762,474 (2004: 282,395,474) ordinary shares, the weighted average number of shares in issue during the year.

## 11. Intangible fixed assets

<i>Group</i>	<i>Licences</i> <i>£'000</i>	<i>Goodwill</i> <i>£'000</i>	<i>Total</i> <i>£'000</i>
<b>Cost</b>			
As at 1 January 2005	1,939	50,746	52,685
Adjustment	—	(212)	212
<b>As at 31 December 2005</b>	<u>1,939</u>	<u>50,534</u>	<u>52,473</u>
<b>Amortisation</b>			
As at 1 January 2005	1,939	43,280	45,219
Charge for the year	—	953	953
<b>As at 31 December 2005</b>	<u>1,939</u>	<u>44,233</u>	<u>46,172</u>
<b>Net book value as at 31 December 2005</b>	<u>—</u>	<u>6,513</u>	<u>6,513</u>
Net book value as at 31 December 2004	<u>—</u>	<u>7,502</u>	<u>7,502</u>

The adjustment to goodwill arises as a result of a reduction in the original assessment of the fair value of the contingent consideration payable (note 18).

CeNeS has no intangible fixed assets (2004: £nil).

## 12. Tangible fixed assets

	<i>Plant, machinery and leasehold improvements £'000</i>	<i>Computers, office equipment, laboratory equipment £'000</i>	<i>Furniture, and fittings £'000</i>	<i>Total £'000</i>
<b>Group</b>				
<b>Cost</b>				
As at 1 January 2005	1,908	56	305	2,269
Additions	—	—	27	27
<b>As at 31 December 2005</b>	<u>1,908</u>	<u>56</u>	<u>332</u>	<u>2,296</u>
<b>Depreciation</b>				
As at 1 January 2005	1,908	56	287	2,251
Charge for the year	—	—	9	9
<b>As at 31 December 2005</b>	<u>1,908</u>	<u>56</u>	<u>296</u>	<u>2,260</u>
<b>Net book value as at 31 December 2005</b>	<u>—</u>	<u>—</u>	<u>36</u>	<u>36</u>
Net book value as at 31 December 2004	—	—	18	18

There are no items held under existing finance lease or hire purchase agreements included within fixed assets.

CeNeS has no tangible fixed assets (2004: £nil).

## 13. Investments

In subsidiary companies:

	<i>Company £'000</i>
<b>Cost</b>	
As at 1 January 2005	22,375
Adjustment	(36)
<b>As at 31 December 2005</b>	<u>22,339</u>
Amounts written off	
As at 1 January 2005 and 31 December 2005	(11,042)
Net book value	
<b>As at 31 December 2005</b>	<u>11,297</u>
As at 31 December 2004	<u>11,333</u>

The adjustment to goodwill arises as a result of a reduction in the original assessment of the fair value of the contingent consideration payable (note 18).

<i>Summary of subsidiary undertakings:</i>	<i>Country of incorporation</i>	<i>% holding (all classes of shares)</i>
Subsidiary undertakings held directly		
CeNeS Drug Delivery Limited	Scotland	100%
CeNeS Limited	England	100%
CeNeS Pharmaceuticals Inc. (formerly Cambridge NeuroScience Inc.)	USA	100%
CeNeS (Bermuda) Limited	Bermuda	100%
Cambridge Cognition Guarantee Limited	England	100%
TheraSci Limited	England	100%

The principal activity of CeNeS Limited is the development of pharmaceutical products for the treatment of pain and disorders of the central nervous system. The activities of CeNeS Drug Delivery Limited and TheraSci Limited have been discontinued. Cambridge Cognition Guarantee Limited, CeNeS Pharmaceuticals Inc. and CeNeS (Bermuda) Limited are dormant companies.

#### **14. Debtors**

	<i>Group 2005 £'000</i>
Debtors: amounts falling due within one year	
Trade debtors	6
Other debtors	267
Corporation tax recoverable	900
Prepayments and accrued income	214
	<u>1,387</u>
Debtors: amounts falling due after more than one year	
Loan note – Xention Limited	148
	<u>1,535</u>

The loan note was issued by Xention Limited to CeNeS Limited in 2002 as part of its consideration for the acquisition of the Channelwork division from CeNeS Limited. The loan note was valued at £375,000 and is receivable on 31 December 2009.

The fair value assigned to the loan notes is £148,000 to reflect the risk that the full value of the loan note may not be recoverable.

#### **15. Creditors: amounts falling due within one year**

	<i>Group 2005 £'000</i>
Trade creditors	859
Other taxation and social security	45
Other loans	7
Other creditors	18
Accruals	542
	<u>1,471</u>

An accrual for future lease costs of £366,000 which was included in accruals in 2004 is now included in provisions (see note 16).



## 16. Provisions for liabilities and charges

Deferred tax assets have not been recognised as the Directors consider that this would be inappropriate as the CeNeS Group is not expected to realise sufficient profits in the foreseeable future. This will be reassessed at such time as the CeNeS Group makes a profit. The amount unrecognised of the total potential liability/(asset) is as follows:

<i>Group</i>	<i>2005</i>	
	<i>Amount recognised £'000</i>	<i>Amount unrecognised £'000</i>
Tax effect of timing differences:		
Excess of capital allowances over depreciation	—	(130)
Short term timing differences	—	(2)
Tax effect of losses carried forward	—	(14,216)
Other provision	—	(14)
	<u>—</u>	<u>(14,362)</u>
	<u>—</u>	<u>(14,362)</u>

  

<i>Company</i>	<i>2005</i>	
	<i>Amount recognised £'000</i>	<i>Amount unrecognised £'000</i>
Tax effect of timing differences:		
Short term timing differences	—	(2)
Tax affect of losses carried forward	—	(1,924)
	<u>—</u>	<u>(1,926)</u>
	<u>—</u>	<u>(1,926)</u>

The CeNeS Group has reviewed and recalculated the onerous lease provision of £1.0 million (31 December 2004: £0.9 million) which reflects the expected liability relating to the leases of premises in Scotland that are no longer required by the Group. Of this provision, £0.5 million (2004: £0.6 million) is due after more than one year and £0.5 million (2004: £0.4 million) is due within one year.

	<i>Lease provision Restated £'000</i>	<i>Total £'000</i>
At 1 January 2005 as previously reported	915	915
Utilised in year	94	94
<b>At 31 December 2005</b>	<u>1,009</u>	<u>1,009</u>

The maturity of the provision at the year end was as follows:

	<i>Group 2005 £'000</i>
Amounts falling due:	
Within one year	525
After more than one year	484
	<u>1,009</u>
	<u>1,009</u>

CeNeS has no provision for liabilities and charges (2004: £nil).

## 17. Called up share capital

The share capital of CeNeS is shown below:

	<i>2005</i> <i>Number</i>	<i>2005</i> <i>£'000</i>
<b>Authorised</b>		
Ordinary shares of 1p each	<u>1,013,289,538</u>	<u>10,133</u>
	<i>Number</i> <i>of ordinary</i> <i>1p shares</i>	<i>Issued</i> <i>share capital</i> <i>£'000</i>
		<i>Share capital</i> <i>to be issued</i> <i>£'000</i>
<b>Allotted, issued and fully paid</b>		
At 1 January and 31 December 2005	409,762,474	3,935
Lapse of share options	—	(36)
	<u>409,762,474</u>	<u>3,899</u>

### *Shares to be issued*

Following the reverse takeover of Core Group plc by CeNeS Limited in December 1999 there are 7,506,558 ordinary 1p shares to be issued as deferred consideration to holders of options over ordinary shares in CeNeS Limited. These were valued at 45p per share at the date of the reverse takeover of Core Group plc by CeNeS Limited giving a value of £3,215,000 after deducting £369,000 receivable by CeNeS on exercise of the options. During the year options over 80,212 ordinary 1p shares with a value of £36,000 lapsed.

There are also 868,463 (2004: 868,463) ordinary 1p shares to be issued as deferred consideration to holders of options over shares in Cambridge NeuroScience Inc. These were valued at approximately 66p per share at the date of the takeover of Cambridge NeuroScience Inc in December 2000 giving them a value of £390,000 after deducting £185,000 receivable by CeNeS on exercise of the options.

On 21 November 2003, CeNeS acquired the entire share capital of TheraSci Limited ("TheraSci"). A further allotment of 3,622,558 ordinary 1p shares, valued at £294,000, is due to GlaxoSmithKline plc subject to the achievement of a project milestone.

*Schedule of options outstanding as at 31 December 2005*

	Note	As at 31/12/2005	Exercise price	Date of grant
Approved share option scheme	1	400	£0.52	9 November 1998
Unapproved share option scheme	1	103,658	£0.82	11 May 2000
Approved share option scheme	1	63,413	£0.82	11 May 2000
Approved share option scheme	1	9,422	£0.82	26 September 2000
Unapproved share option scheme	1	24,540	£0.82	3 October 2000
Unapproved share option scheme	1	375,000	£0.54	18 December 2000
Unapproved share option scheme	1	2,198,125	£0.08	1 January 2002
Approved share option scheme	1	697,875	£0.08	1 January 2002
Unapproved share option scheme	1	3,640,000	£0.04	1 August 2003
Unapproved share option scheme	1	1,000,000	£0.07	21 November 2003
Unapproved share option scheme	1	6,000,000	£0.10	20 April 2004
Unapproved share option scheme	1	6,018,250	£0.08	22 December 2004
Unapproved share option scheme	1	300,000	£0.09	5 May 2005
Unapproved share option scheme	1	750,000	£0.08	1 November 2005
Unapproved share option scheme	1	100,000	£0.07	30 November 2005
Executive Share Option Plan	2	126,923	£1 in aggregate	30 June 2000
Executive Share Option Plan	2	100,961	£1 in aggregate	3 July 2000
Executive Share Option Plan	2	2,104,688	£1 in aggregate	31 December 2001
Executive Share Option Plan	2	2,946,875	£1 in aggregate	1 August 2003
Executive Share Option Plan	2	2,300,000	£1 in aggregate	20 April 2004

*Notes:*

- (1) Subject to the satisfaction of any applicable condition of exercise, options may be exercised in whole or in part at any time and from time to time after the earliest of the third anniversary of grant, the death of the option holder, or the option holder ceasing to be a Director or employee of CeNeS by reason of injury, disability or redundancy, or retirement, or at the discretion of the Remuneration Committee, for any reason. No options were exercised (2004: nil) and 120,951 (2004: 212,195) options lapsed during the year.
- (2) The CeNeS Incentive Plan (the "Plan") provides for the grant of rights to acquire shares by way of purchase to eligible employees of CeNeS. Under the Plan options are granted at an aggregate exercise price of £1 and will normally only vest after the third anniversary of the date of grant and if the Company's share price has exceeded the growth in total shareholder return for the FTSE All-Share 900 Companies over that period.

## 18. Reserves

	Other reserves £'000	Capital redemption reserve £'000	Share premium £'000	Profit and loss account £'000
<i>The Group</i>				
As at 1 January 2005	10,396	15,697	113,080	(126,495)
Loss for the year to 31 December 2005	—	—	—	(6,607)
<b>As at 31 December 2005</b>	<u>10,396</u>	<u>15,697</u>	<u>113,080</u>	<u>(133,102)</u>

Included in other reserves as at 31 December 2005 is a merger reserve of £10,370,000 and a share option reserve of £26,000.

	Other reserves £'000	Capital redemption reserve £'000	Share premium £'000	Profit and loss account £'000
<i>The Company</i>				
As at 1 January 2005	26	15,697	113,080	(120,206)
Loss for the year to 31 December 2005	—	—	—	(5,450)
<b>As at 31 December 2005</b>	<u>26</u>	<u>15,697</u>	<u>113,080</u>	<u>(125,656)</u>

Other reserves comprise a share option reserve.

## 19. Reconciliation of movements in Group shareholders' funds

	<i>Group 2005 £'000</i>
Loss for the financial year	(6,739)
Movement in share capital to be issued	(36)
FRS 20 share option charge	132
Net decrease in shareholders' funds for the year	(6,643)
Opening shareholders' funds	20,711
<b>Closing shareholders' funds</b>	<b>14,068</b>

## 20. Reconciliation of operating loss to net cash outflow from operating activities

	<i>2005 £'000</i>
Operating loss	(7,899)
Depreciation	9
FRS 20 share option charge	132
Amortisation of intangible fixed assets	953
Decrease/(increase) in debtors	(11)
Increase/(decrease) in creditors	(39)
Net cash outflow from operating activities	(6,855)

## 21. Analysis and reconciliation of net funds

	<i>1 January 2005 £'000</i>	<i>Cash flow £'000</i>	<i>31 December 2005 £'000</i>
Cash in hand and at bank	4,320	4,144	8,464
Debt due after one year	(7)	7	—
Debt due within one year	(47)	40	(7)
Short term deposits	10,000	(10,000)	—
	<u>14,266</u>	<u>(5,809)</u>	<u>8,457</u>

## 22. Contingent liabilities and guarantees

CeNeS has a guarantee in relation to the lease arrangements for 3 Riverside Way, Irvine, entered into by CeNeS Drug Delivery Limited. The lease has a 25 year term, commencing 12 February 1998, with a break point at year 20. The annual amount payable is £168,000. As a result of the restructuring this property is no longer required and CeNeS is actively seeking to sublet the property.

In September 1999, Core Technologies Limited concluded an agreement to take a lease of new, additional premises adjacent to the main site at Riverside Way, Irvine. The lease term is for ten years and the annual rental is £186,500. CeNeS sublet the building until March 2006 and is currently seeking new tenants.

CeNeS has reviewed and recalculated the onerous lease provision of £1.0 (31 December 2004: £0.9 million) which reflects the expected liability relating to the leases of premises in Scotland that are no longer required by the Group. Of this provision, £0.5 million (2004: £0.6 million) is due after more than one year and £0.5 million (2004: £0.4 million) is due within one year.

CeNeS has entered into cross guarantees within the CeNeS Group as part of its banking arrangements.

### 23. Pension commitments

CeNeS has a stakeholder pension scheme which is available to all UK based employees. The pension charge for the year was £95,000 (2004: £81,000). At 31 December 2005 contributions totalling £46,000 (2004: £36,000) were payable to these pension arrangements. The Core Technologies Pension Scheme has been wound up.

### 24. Operating lease commitments

Annual obligations under non-cancellable operating leases are as follows:

<i>Group</i>	<i>Land and buildings</i>	<i>Other</i>
<i>Expiry date</i>	<i>2005</i>	<i>2005</i>
	<i>£'000</i>	<i>£'000</i>
Within one year	96	1
Within two to five years	—	17
After five years	354	—
	<u>450</u>	<u>18</u>

### 25. Related party transactions

The following fees and expenses were incurred during the period from the associated companies of the Non-executive CeNeS Directors of the CeNeS Group as follows:

	<i>Group</i>
	<i>2005</i>
	<i>£'000</i>
Irwin Associates International (Mr T Ronald Irwin)	29
Johnson Partners (Dr Peter Johnson)	29

The balances due at the year end and included in creditors and accruals were as follows:

	<i>Group</i>
	<i>2005</i>
	<i>£'000</i>
Irwin Associates International (Mr T Ronald Irwin)	16

Alan Goodman, the Chairman of CeNeS, and Alan Smith, a Non-executive Director of CeNeS are also directors of Avlar Bioventures Limited. One of the funds managed by Avlar Bioventures Limited holds 26,807,760 CeNeS ordinary shares after the acquisition of TheraSci Limited in November 2003. The acquisition was treated as a related party transaction (as defined in the AIM rules).

CeNeS has taken advantage of the exemption available to parent companies under FRS 8 'Related Party Disclosures' not to disclose transactions and balances with CeNeS Group entities which have been eliminated on consolidation.

### 26. Financial instruments

The CeNeS Group's financial instruments comprise cash and liquid resources and various items arising directly from its operations such as trade debtors and trade creditors. The CeNeS Group undertakes certain foreign currency transactions in the course of its operations, predominantly in Euros and US dollars. To date the CeNeS Group has not hedged any transactional currency exposure.

It is, and has been throughout the year, the CeNeS Group's policy that no trading in financial instruments shall be undertaken, other than placing funds on treasury deposit.

The main risks arising from the CeNeS Group's financial instruments are interest rate risk, foreign currency risk and liquidity risk. The CeNeS Board and the Audit Committee review and agree policies for managing each of these risks and they are summarised below.

Short term debtors and creditors have been excluded from all the following disclosures, other than currency risk disclosures.

**Interest rate profile**

The CeNeS Group has no short term deposits at the year end (2004: £10.0 million).

Interest rate profile of the CeNeS Group's financial liabilities, which all have fixed interest rates, was as follows:

	31 December 2005 £'000
Sterling	
– Borrowings	7

The weighted average interest rate is 5.0 per cent. (2004: 7.1 per cent.).

Interest rate profile of the CeNeS Group's financial assets:

During the year cash and short term treasury deposits were the only financial asset within the CeNeS Group. Cash was subject to floating rates of interest equal to 1 per cent. below base rate and the short term deposits were placed for periods of less than three months at fixed rates of interest between 4.6 per cent. and 4.85 per cent. (2004: between 3.8 per cent. and 4.78 per cent.).

*Currency risk*

At the end of the year the CeNeS Group's individual operations had no (2004: £nil) net monetary assets and liabilities in currencies other than their functional currency.

*Liquidity risk*

The CeNeS Board closely monitors the liquidity of the CeNeS Group through regular review of financial information and takes appropriate action to reduce liquidity risk in terms of meeting working capital requirements.

*Fair values*

There is no difference between the fair value and the carrying value of bank and cash balances (2004: £nil). Carrying values approximate to fair values because of the short maturity periods of these financial instruments.

The carrying value of the Xention Limited loan note of £148,000 is considered to approximate fair value. The carrying value of this asset has previously been written down to reflect the risk that the full face value of the loan note may not be recovered.

**27. Capital commitments**

As at 31 December 2005 capital amounts contracted for, but not provided in the accounts, amounted to £nil (2004: £nil).



## PART IV

### Three months ending 31 March 2008 (Unaudited)

#### Condensed consolidated quarterly income statement For the three months ended 31 March 2008

		<i>Unaudited 3 months ended 31 March 2008 £'000</i>	<i>Unaudited 3 months ended 31 March 2007 £'000</i>
	<i>Notes</i>		
<b>Revenue</b>		—	13
Research and development expenditure		(1,150)	(1,826)
Administrative expenses		(615)	(525)
<b>Operating loss</b>		(1,765)	(2,338)
Financial income		30	58
<b>Loss for the period before taxation</b>	7	(1,735)	(2,280)
Income tax credit	8	185	258
<b>Loss for the period</b>		(1,550)	(2,022)
<b>Loss per ordinary share</b>			
<b>– basic and diluted</b>	14	(7.1p)	(12.5p)

The notes form an integral part of this condensed consolidated quarterly financial information.

**Condensed consolidated quarterly balance sheet**  
**As at 31 March 2008**

	<i>Notes</i>	<i>Unaudited 31 March 2008 £'000</i>	<i>Unaudited 31 December 2007 £'000</i>
<b>Non-current assets</b>			
Intangible assets	9	6,369	6,370
Property, plant and equipment		18	20
Trade and other receivables	10	148	148
		<u>6,535</u>	<u>6,538</u>
<b>Current assets</b>			
Trade and other receivables	11	239	272
Income tax asset		1,021	836
Cash and cash equivalents		2,141	4,261
		<u>3,401</u>	<u>5,369</u>
<b>Current liabilities</b>			
Trade and other payables	12	(1,309)	(1,756)
Provisions for liabilities and charges	13	(321)	(321)
		<u>1,771</u>	<u>3,292</u>
<b>Net current assets</b>		<u>8,306</u>	<u>9,830</u>
<b>Total assets less current liabilities</b>		<u>7,668</u>	<u>9,192</u>
<b>Non-current liabilities</b>			
Provisions for liabilities and charges	13	(638)	(638)
<b>Net assets</b>		<u>7,668</u>	<u>9,192</u>
<b>Capital and reserves</b>			
Share capital	15	6,576	6,576
Share capital to be issued	15	3,687	3,687
Share premium		4,010	4,010
Capital redemption reserve		15,697	15,697
Other reserves		10,396	10,396
Profit and loss account		(32,698)	(31,174)
<b>Total equity</b>		<u>7,668</u>	<u>9,192</u>

The notes form an integral part of this condensed consolidated quarterly financial information.

## Condensed consolidated quarterly statement of changes in equity (unaudited)

	<i>Share capital £'000</i>	<i>Share capital to be issued £'000</i>	<i>Share premium £'000</i>	<i>Capital redemption reserve £'000</i>	<i>Other reserves £'000</i>	<i>Profit and loss reserve £'000</i>	<i>Total £'000</i>
<b>At 31 December 2006</b>	4,839	3,687	116,866	15,697	10,396	(141,576)	9,909
Share based payments	—	—	—	—	—	8	8
Loss for the period	—	—	—	—	—	(2,022)	(2,022)
<b>At as at 31 March 2007</b>	4,839	3,687	116,866	15,697	10,396	(143,590)	7,895
Share based payments	—	—	—	—	—	85	85
Capital reorganisation	—	—	(116,866)	—	—	116,866	—
Issue of share capital (net of expenses)	1,737	—	4,010	—	—	—	5,747
Loss for the period	—	—	—	—	—	(4,535)	(4,535)
<b>At as at 31 December 2007</b>	6,576	3,687	4,010	15,697	10,396	(31,174)	9,192
Share based payments	—	—	—	—	—	26	26
Loss for the period	—	—	—	—	—	(1,550)	(1,550)
<b>At as at 31 March 2008</b>	6,576	3,687	4,010	15,697	10,396	(32,698)	7,668

Included in other reserves as at 31 March 2008 is a merger reserve of £10,370,000 (Q1 2007: £10,370,000) and a share option reserve of £26,000 (Q1 2007: £26,000).

The capital redemption reserve of (Q1 2007: £15.7 million) arose as a result of a sub-division of shares in August 2003.

Capital reorganisation relates to the write off of the share premium balance of £116,866,000 against the brought forward losses following a court order issued by the Scottish court on 10 July 2007. The capital restructuring was approved by shareholders at the Annual General Meeting held on 5 July 2005.

The notes form an integral part of this condensed and consolidated quarterly financial information.

**Condensed consolidated quarterly cash flow statement**  
**For the three months to 31 March 2008**

	<i>Unaudited</i> <i>3 months</i> <i>ended</i> <i>31 March</i> <i>2008</i> <i>£'000</i>	<i>Unaudited</i> <i>3 months</i> <i>ended</i> <i>31 March</i> <i>2007</i> <i>£'000</i>
Operating loss	(1,765)	(2,338)
Depreciation	3	3
Amortisation	1	1
IFRS 2 share based payment	26	8
Decrease in trade and other receivables	33	39
Decrease in trade and other payables	<u>(446)</u>	<u>(1,211)</u>
<b>Operating activities</b>		
Net cash used in operating activities	<u>(2,148)</u>	<u>(3,498)</u>
<b>Investing activities</b>		
Interest received	30	58
Purchases of plant and equipment	<u>(2)</u>	<u>—</u>
Net cash generated from investing activities	<u>28</u>	<u>58</u>
Net decrease in cash and cash equivalents	(2,120)	(3,440)
Cash and cash equivalents at beginning of year	<u>4,261</u>	<u>6,296</u>
<b>Cash and cash equivalents at period end</b>	<u><u>2,141</u></u>	<u><u>2,856</u></u>

The notes form an integral part of this condensed consolidated quarterly financial information.

## **Notes to the condensed consolidated quarterly information**

1. CeNeS is a company incorporated and domiciled in the United Kingdom and is traded on the Alternative Investment Market (“AIM”). The address of its registered office is Riverside Business Park, Riverside Way, Irvine, KA11 5DJ, Scotland.

The financial information set out in the quarterly financial information does not comprise CeNeS’s statutory accounts within the meaning of section 240 of the Companies Act 1985. Results for the three months periods ended 31 March 2008 and 31 March 2007 have not been audited.

Statutory accounts for the year ended 31 December 2007 were approved by the CeNeS Directors on 10 April 2008 and will be delivered to the Registrar of Companies. The report of the auditors on these accounts was unqualified but contained an emphasis of matter referring to going concern.

### **2. Basis of preparation**

This condensed consolidated quarterly information for the quarter ended 31 March 2008 has been prepared in accordance with the Disclosure and Transparency Rules of the Financial Services Authority and with IAS 34, ‘Interim financial reporting’ as adopted by the European Union. The condensed consolidated quarterly information should be read in conjunction with the annual financial statements for the year ended 31 December 2007, which have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as adopted by the European Union.

### **3. Accounting policies**

The accounting policies adopted are consistent with those of the annual financial statements for the year ended 31 December 2007.

### **4. Basis of consolidation**

The consolidation of the financial statements has been carried out in accordance with the policies contained in the CeNeS Group’s 2007 statutory accounts.

### **Going concern**

The CeNeS Group does not have sufficient cash resources to fund its current level of activities for the next twelve months. This represents a material uncertainty which may cast significant doubt on the CeNeS Group’s ability to continue as a going concern.

On 10 April 2008, it was announced by Paion that it proposes to acquire all of the issued and to be issued share capital of CeNeS by a court sanctioned scheme of arrangement under Part 26 of the Companies Act 2006. If the proposed acquisition is completed, CeNeS will have a considerably strengthened financial position by being part of the Enlarged Group, which will assist with partnering and clinical development decisions.

In the event that the Acquisition is not completed, CeNeS will need to raise additional funding through one or a combination of equity fund raising, partnering or collaboration opportunities activity in order to continue as a going concern. The CeNeS Directors have a reasonable expectation that CeNeS can raise such additional cash resources. Therefore, the CeNeS Directors consider that it is appropriate to prepare the financial statements on a going concern basis. If CeNeS was unable to continue in operational existence in the foreseeable future, adjustments would have to be made to revise the balance sheet values of assets to their recoverable amounts, to provide for further liabilities that might arise and to reclassify fixed assets as current assets.

### **5. Segmental information**

The CeNeS Directors are of the opinion that under IAS 14 – ‘Segmental Information’ the CeNeS Group has only one business segment, being drug development. In addition the CeNeS Directors are of the opinion that there is only one geographical segment, the UK.

## 6. Loss on ordinary activities before taxation

The following items have been included in arriving at the loss on ordinary activities before taxation:

	<i>3 months ended 31 March 2008 £'000</i>	<i>3 months ended 31 March 2007 £'000</i>
Depreciation of owned assets	3	3
Amortisation of licences	1	1
Operating lease rentals: land and buildings	118	112
Operating lease rentals: other	4	7

## 7. Taxation

The CeNeS Group submits a tax claim each year for Research and Development Tax Credits. A tax credit of £185,000 (3 months to 31 March 2007: £258,000) is recognised based on management's best estimates of the effective tax rate expected for the full financial year. The tax credit of £0.8 million estimated for the year ended 31 December 2007 has yet to be agreed with the HMRC.

## 8. Intangible assets

	<i>Licences £'000</i>	<i>Goodwill £'000</i>	<i>Total £'000</i>
<b>Cost</b>			
<b>As 1 January 2008 and at 31 March 2008</b>	<u>2,016</u>	<u>50,534</u>	<u>52,550</u>
<b>Amortisation and impairment</b>			
As at 1 January 2008	1,947	44,233	46,180
Amortisation for the period	<u>1</u>	<u>—</u>	<u>1</u>
<b>As at 31 March 2008</b>	<u>1,948</u>	<u>44,233</u>	<u>46,181</u>
<b>Net book value as at 31 March 2008</b>	<u>68</u>	<u>6,301</u>	<u>6,369</u>
Net book value as at 31 December 2007	<u>69</u>	<u>6,301</u>	<u>6,370</u>

## 9. Trade and other receivables – Non current assets

	<i>At 31 March 2008 £'000</i>	<i>At 31 December 2007 £'000</i>
Xention Limited loan note	375	375
Less: provision for impairment	<u>(227)</u>	<u>(227)</u>
	<u>148</u>	<u>148</u>

The loan note was issued by Xention Limited to CeNeS Limited in 2002 as part of its consideration for the acquisition of the Channelwork division from CeNeS Limited. The nominal value of the loan note is £375,000 and is receivable on 31 December 2009.

The fair value assigned to the loan notes is £148,000 to reflect the risk that the full value of the loan note may not be recoverable given the inherent high risk of small unquoted biotechnology companies.



## 10. Trade and other receivables

	<i>At 31 March 2008 £'000</i>	<i>At 31 December 2007 £'000</i>
Other receivables	113	84
Prepayments and accrued income	126	188
	<u>239</u>	<u>272</u>

## 11. Trade and other payables

	<i>At 31 March 2008 £'000</i>	<i>At 31 December 2007 £'000</i>
Trade payables	940	1,239
Other taxation and social security	47	48
Other payables	7	16
Accruals	315	453
	<u>1,309</u>	<u>1,756</u>

## 12. Provisions for liabilities and charges

	<i>At 31 March 2008 £'000</i>	<i>At 31 December 2007 £'000</i>
At 1 January	959	959
Utilised in period/year	(89)	(354)
Amortisation of discount	8	32
Additions to provision	81	322
<b>At 31 December 2007 and 31 March 2008</b>	<u>959</u>	<u>959</u>

The maturity of the provision at the period end was as follows:

	<i>At 31 March 2008 £'000</i>	<i>At 31 December 2007 £'000</i>
Amounts falling due:		
Within one year	321	321
After more than one year	638	638
	<u>959</u>	<u>959</u>

The CeNeS Group has reviewed and recalculated the onerous lease provision of £1.0 million (31 December 2007: £1.0 million) which reflects the expected liability relating to the leases of premises in Scotland that are no longer required by the CeNeS Group. The provision balance is based on the CeNeS Directors' current expectations for the time it will take to sublet the properties. Of this provision, £0.7 million (31 December 2007: £0.7 million) is due after more than one year and £0.3 million (31 December 2007: £0.3 million) is due within one year.

The fair values of future lease payments are based on cash flows discounted using a rate based on the market interest rate and the risk premium (31 March 2008: 10%; 31 December 2007: 10 per cent.).

### 13. Loss per ordinary share

The basic and diluted loss per share is based on a loss of £1.6 million (three months to 31 March 2007: £2.0 million) and the weighted average number of shares in issue during the period of 21,920,192 shares (3 months to 31 March 2007: 16,131,055).

### 14. Share capital

The share capital of CeNeS is shown below:

	<i>At 31 March 2008 Number</i>	<i>At 31 March 2008 £'000</i>	<i>At 31 December 2007 Number</i>	<i>At 31 December 2007 £'000</i>
<b>Authorised</b>				
Ordinary shares of 30p each	33,776,318	10,133	33,776,318	10,133
		<i>Number of ordinary 30p shares</i>	<i>Issued share capital £'000</i>	<i>Share capital to be issued £'000</i>
<b>Allotted, issued and fully paid</b>				
At 1 January and 31 March 2008		21,920,192	6,576	3,687

#### **Shares to be issued**

Following the reverse takeover of Core Group plc by CeNeS Limited in December 1999 there are 250,725 ordinary 30p shares to be issued as deferred consideration to holders of options over ordinary shares in CeNeS Limited. These were valued at approximately £13 per share at the date of the reverse takeover of Core Group plc by CeNeS Limited giving a value of £3,003,000 after deducting £371,000 receivable by CeNeS Limited on exercise of the options.

There are also 28,948 ordinary 30p shares to be issued as deferred consideration to holders of options over shares in Cambridge NeuroScience Inc. These were valued at approximately £19.85 per share at the date of the takeover of Cambridge NeuroScience Inc in December 2000 giving them a value of £390,000 after deducting £185,000 receivable by CeNeS on exercise of the options.

On 21 November 2003, CeNeS acquired the entire share capital of TheraSci Limited ("TheraSci"). A further allotment of 120,752 ordinary 30p shares, valued at £294,000, is due to GlaxoSmithKline plc subject to the achievement of a project milestone.

#### **Share based payments**

The total charge for the quarter relating to employee share based payment plans was £26,000 (quarter to 31 March 2007: £8,000) all of which related to equity-settled share based payment transactions. The fair value of options granted during the quarter was £nil (quarter to 31 March 2007: £nil).

### 15. Commitments, contingent liabilities and guarantees

CeNeS has a guarantee in relation to the lease arrangements for 3 Riverside Way, Irvine, entered into by CeNeS Drug Delivery Limited. The lease has a 25 year term, commencing 12 February 1998, with a break point at year 20. The annual amount payable is £168,000. This property is no longer required and CeNeS is actively seeking to sublet the property.

In September 1999, Core Technologies Limited concluded an agreement to take a lease of new, additional premises adjacent to the main site at Riverside Way, Irvine. The lease term is until March 2010 and the annual rental is £186,500. CeNeS is actively seeking to sublet the property.

CeNeS has reviewed and recalculated the onerous lease provision of £1.0 million (31 December 2007: £1.0 million) which reflects the expected liability relating to the leases of premises in Scotland that are no longer required by the CeNeS Group. Of this provision, £0.7 million (31 December 2007: £0.7 million) is due after more than one year and £0.3 million (31 December 2007: £0.3 million) is due within one year.

CeNeS has entered into cross guarantees within the CeNeS Group as part of its banking arrangements.

CeNeS has agreed to pay advisory fees of £400,000 upon the successful completion of the proposed acquisition of CeNeS by Paion.

#### **16. Related party disclosures**

During the quarter ended 31 March 2008 none of the CeNeS Directors subscribed for new ordinary shares of 30p each (3 months to 31 March 2007: nil).

The following fees and expenses were incurred during the period from the associated companies of the Non-executive Directors of the CeNeS Group as follows:

	<i>3 month ended 31 March 2008 £'000</i>	<i>3 months ended 31 March 2007 £'000</i>
Irwin Associates International (Mr T Ronald Irwin)	9	8
Johnson Partners (Dr Peter Johnson)	<u>9</u>	<u>8</u>

The balances due at the year end and included in creditors and accruals were as follows:

	<i>At 31 March 2008 £'000</i>	<i>At 31 December 2007 £'000</i>
Irwin Associates International (Mr T Ronald Irwin)	<u>20</u>	<u>13</u>

Alan Goodman, the Chairman of CeNeS, and Alan Smith, a Non-executive Director of CeNeS are also Directors of Avlar Bioventures Limited. One of the funds managed by Avlar Bioventures Limited holds 2,436,449 (31 December 2007: 2,436,449) CeNeS ordinary shares.

CeNeS Directors consider that there is no ultimate controlling party of CeNeS.

## **APPENDIX D**

### **Financial information on the Paion Group**

#### **PART I**

##### **Introduction**

The following Parts II to VI to this Appendix D set out financial information relating to the Paion Group for the fiscal years ended 31 December 2005, 2006 and 2007 and the three months ended 31 March 2008. The audited consolidated financial statements of Paion for the years ended 31 December 2005, 2006 and 2007 have been prepared in accordance with German auditing regulations and generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors) under International Financial Reporting Standards, as adopted by the EU, and the interpretations of the International Financial Reporting Interpretations Committee.

The financial information relating to the financial years ended 31 December 2005, 2006 and 2007 in Parts II, IV, V and VI has been extracted, without material adjustment, from the audited consolidated financial statements of Paion for those periods.

The financial information in Part C relating to the three months ended 31 March 2008 has been extracted, without material adjustment, from Paion's unaudited consolidated interim financial statements for that period, which were published on 29 April 2008.

**PART II**  
**Three-Year Overview**

**Consolidated Balance Sheet December 31, 2007, 2006 and 2005**

**Assets**

	<i>December 31 2007</i>	<i>December 31 2006 in EUR</i>	<i>December 31 2005*</i>
<b>Non-current assets</b>			
Intangible assets	462,349.84	524,246.44	514,203.61
Equipment	902,786.33	1,163,871.92	1,094,323.22
Long-term refund claims resulting from the assumption of development expenses	0.00	8,010,826.74	3,673,741.35
	<u>1,365,136.17</u>	<u>9,698,945.10</u>	<u>5,282,268.18</u>
<b>Current assets</b>			
Trade receivables	776,806.33	2,290,567.20	1,413,196.92
Prepaid expenses and other assets	498,934.20	871,707.98	11,086,605.12
Cash and cash equivalents	42,901,123.18	57,188,779.78	48,370,539.85
	<u>44,176,863.71</u>	<u>60,351,054.96</u>	<u>60,870,341.89</u>
<b>Total assets</b>	<u><u>45,541,999.88</u></u>	<u><u>70,050,000.06</u></u>	<u><u>66,152,610.07</u></u>

**Equity and liabilities**

	<i>December 31 2007</i>	<i>December 31 2006 in EUR</i>	<i>December 31 2005</i>
<b>Equity</b>			
Share capital	16,755,552.00	16,755,552.00	15,755,552.00
Capital reserve	85,737,273.03	85,032,116.76	75,925,289.91
Loss carryforward	(56,316,554.35)	(38,930,499.47)	(34,174,373.72)
Loss for the period	(10,512,054.28)	(17,386,054.88)	(4,756,125.75)
	<u>35,664,216.40</u>	<u>45,471,114.41</u>	<u>52,750,342.44</u>
<b>Non-current liabilities</b>			
Provisions	0.00	10,616,825.08	4,865,892.62
Financial liabilities	6,657,137.24	6,741,483.43	0.00
Finance lease liabilities	61,761.00	133,320.00	207,485.00
Deferred income	27,121.27	1,720,630.08	1,745,063.28
	<u>6,746,019.51</u>	<u>19,212,258.59</u>	<u>6,818,440.90</u>
<b>Current liabilities</b>			
Trade payables	2,294,817.61	4,508,927.03	4,408,391.84
Provisions	421,417.51	442,446.78	308,129.75
Current portion of finance lease liabilities	71,559.00	74,163.00	73,847.00
Other current liabilities	319,536.65	316,657.05	1,769,024.94
Current portion of deferred income	24,433.20	24,433.20	24,433.20
	<u>3,131,763.97</u>	<u>5,366,627.06</u>	<u>6,583,826.73</u>
<b>Total equity and liabilities</b>	<u><u>45,541,999.88</u></u>	<u><u>70,050,000.06</u></u>	<u><u>66,152,610.07</u></u>

\*The financial data in this Part II for the 2005 fiscal year takes into account changes in presentation that were made in the 2006 fiscal year for the current as well as the previous fiscal year. Therefore, the financial data in this Part II for the 2005 fiscal year varies from the data set out in Part VI below.

## Consolidated Income Statement 2007, 2006 and 2005

	2007	2006 <i>in EUR</i>	2005
Revenues	4,846,472.51	10,458,951.94	18,796,037.36
Cost of revenues	<u>(2,978,513.01)</u>	<u>(7,251,732.37)</u>	<u>(4,854,886.56)</u>
Gross profit	<u>1,867,959.50</u>	<u>3,207,219.57</u>	<u>13,941,150.80</u>
Research and development expenses	(9,814,009.42)	(16,486,558.17)	(13,627,205.01)
General and administrative expenses	(4,407,369.00)	(4,563,448.72)	(4,852,194.84)
Selling and marketing expenses	(559,570.00)	(1,088,225.45)	(1,370,255.82)
Other income (expenses), net	<u>289,334.51</u>	<u>149,199.08</u>	<u>93,910.65</u>
Operating expenses	<u>(14,491,613.91)</u>	<u>(21,989,033.26)</u>	<u>(19,755,745.02)</u>
Operating result	<u>(12,623,654.41)</u>	<u>(18,781,813.69)</u>	<u>(5,814,594.22)</u>
Financial income	4,549,187.50	2,042,188.53	1,073,935.29
Financial expenses	<u>(2,437,587.37)</u>	<u>(646,429.72)</u>	<u>(15,466.82)</u>
Financial result	<u>2,111,600.13</u>	<u>1,395,758.81</u>	<u>1,058,468.47</u>
Loss for the period before taxes	<u>(10,512,054.28)</u>	<u>(17,386,054.88)</u>	<u>(4,756,125.75)</u>
Income taxes	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>
Loss for the period	<u><u>(10,512,054.28)</u></u>	<u><u>(17,386,054.88)</u></u>	<u><u>(4,756,125.75)</u></u>
Earnings per share (basic)	(0.63)	(1.06)	(0.31)
Earnings per share (diluted)	(0.63)	(1.06)	(0.31)

## Consolidated Cash Flow Statement 2007, 2006 and 2005

	2007	2006 <i>in EUR</i>	2005*
Cash flows from operating activities:			
Profit/loss for the period	(10,512,054.28)	(17,386,054.88)	(4,756,125.75)
Reconciliation of loss for the period to cash flows from operating activities:			
Amortization/depreciation	522,441.84	364,245.40	410,678.20
Loss/profit from the disposal of non-current assets	4,360.86	8,419.74	212.00
Interest expenses and interest income	(2,111,600.13)	(1,395,758.81)	(1,058,468.47)
Release of investment grants	(24,433.20)	(24,433.20)	(24,443.20)
Release of deferred income	(1,669,075.61)	0.00	(89,372.57)
Expenses from stock option plans	705,156.27	1,115,100.16	843,359.40
Change in assets and liabilities which are not attributable to investing or financing activities:			
Long-term refund claims resulting from the assumption of development costs	6,065,907.88	(4,525,846.10)	(3,673,741.35)
Trade receivables	1,513,760.87	(877,370.28)	(963,228.74)
Prepaid expenses and other assets	511,387.54	402,141.68	(302,950.65)
Trade payables	(2,214,109.42)	100,535.19	1,551,055.46
Provisions	(8,061,802.86)	6,132,270.15	3,649,031.38
Other current liabilities	2,879.60	(259,874.57)	(307,468.42)
	<u>(15,267,180.64)</u>	<u>(16,346,625.52)</u>	<u>(4,721,462.71)</u>
Interest received	1,819,485.55	1,604,929.79	976,762.22
Net cash used in/from operating activities	<u>(13,447,695.09)</u>	<u>(14,741,695.73)</u>	<u>(3,744,700.49)</u>
Cash flows from investing activities:			
Cash paid for investments in intangible assets and equipment	(205,459.11)	(452,773.91)	(447,811.26)
Cash received from the sale of intangible assets and equipment	1,638.60	517.24	1,373,402.49
Net cash used in/from investing activities	<u>(203,820.51)</u>	<u>(452,256.67)</u>	<u>925,591.23</u>
Cash flows from financing activities:			
Capital increase	0.00	1,000,000.00	5,750,000.00
Contributions to the capital reserve	0.00	8,440,000.00	40,250,000.00
Payments in connection with the raising of capital	0.00	(448,273.31)	(4,648,864.78)
Borrowing	0.00	6,720,000.00	0.00
Capital repayment due to the settlement of options	0.00	(1,192,493.32)	(966,778.70)
Interest paid	(555,310.00)	(423,499.04)	0.00
Payment of finance lease liabilities	(80,831.00)	(83,542.00)	(83,538.00)
Net cash from financing activities	<u>(636,141.00)</u>	<u>14,012,192.33</u>	<u>40,300,818.52</u>
Change in cash and cash equivalents	<u>(14,287,656.60)</u>	<u>(1,181,760.07)</u>	<u>37,481,709.26</u>
Cash and cash equivalents at beginning of the period	<u>57,188,779.78</u>	<u>58,370,539.85</u>	<u>20,888,829.59</u>
Cash and cash equivalents at end of the period	<u><u>42,901,123.18</u></u>	<u><u>57,188,779.78</u></u>	<u><u>58,370,538.85</u></u>
Composition of cash and cash equivalents at the end of the period:			
Cash	42,901,123.18	57,188,779.78	48,370,539.85
Loan against promissory note	0.00	0.00	10,000,000.00

\*The financial data in this Part II for the 2005 fiscal year takes into account changes in presentation that were made in the 2006 fiscal year for the current as well as the previous fiscal year. Therefore, the financial data in this Part II for the 2005 fiscal year varies from the data set out in Part VI below.



## Consolidated Statement of Changes in Equity 2007, 2006 and 2005

	<i>Share capital EUR</i>	<i>Capital reserve EUR</i>	<i>Loss carryforward EUR</i>	<i>Equity EUR</i>
January 1, 2005	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	843,359.40	0.00	843,359.40
Loss for the period	0.00	0.00	(4,756,125.75)	(4,756,125.75)
December 31, 2005	<u>15,755,552.00</u>	<u>75,925,289.91</u>	<u>(38,930,499.47)</u>	<u>52,750,342.44</u>
Issue of shares	1,000,000.00	0.00	0.00	1,000,000.00
Contribution to the capital reserve	0.00	8,440,000.00	0.00	8,440,000.00
Cost of raising capital	0.00	(448,273.31)	0.00	(448,273.31)
Additional contribution to the capital reserve due to the issue of options	0.00	1,115,100.16	0.00	1,115,100.16
Loss for the period	0.00	0.00	(17,386,054.88)	(17,386,054.88)
December 31, 2006	<u>16,755,552.00</u>	<u>85,032,116.76</u>	<u>(56,316,554.35)</u>	<u>45,471,114.41</u>
Additional contribution to the capital reserve due to the issue of options	0.00	705,156.27	0.00	705,156.27
Loss for the period	0.00	0.00	(10,512,054.28)	(10,512,054.28)
December 31, 2007	<u><u>16,755,552.00</u></u>	<u><u>85,737,273.03</u></u>	<u><u>(66,828,608.63)</u></u>	<u><u>35,664,216.40</u></u>

## PART III

### Unaudited Consolidated Interim Financial Statements as of 31 March 2008

#### Consolidated Balance Sheet

##### Assets

	<i>March 31, 2008</i>	<i>December 31, 2007</i>
	<i>in EUR</i>	
<b>Non-current assets</b>		
Intangible assets	118,824.82	462,349.84
Equipment	873,250.54	902,786.33
	992,075.36	1,365,136.17
<b>Current assets</b>		
Trade receivables	704,472.23	776,806.33
Prepaid expenses and other assets	1,352,150.05	498,934.20
Cash and cash equivalents	48,577,689.49	42,901,123.18
	50,634,311.77	44,176,863.71
<b>Total assets</b>	51,626,387.13	45,541,999.88

##### Equity and liabilities

	<i>March 31, 2008</i>	<i>December 31, 2007</i>
	<i>in EUR</i>	
<b>Equity</b>		
Share capital	16,755,552.00	16,755,552.00
Capital reserve	85,823,015.23	85,737,273.03
Loss carryforward	-66,828,608.63	-56,316,554.35
Loss for the period	-1,177,829.10	-10,512,054.28
	34,572,129.50	35,664,216.40
<b>Non-current liabilities</b>		
Financial liabilities	6,669,917.77	6,657,137.24
Finance lease liabilities	43,439.00	61,761.00
Deferred income	6,202,831.17	27,121.27
	12,916,187.94	6,746,019.51
<b>Current liabilities</b>		
Trade payables	1,969,369.09	2,294,817.61
Provisions	289,051.58	421,417.51
Current portion of finance lease liabilities	72,247.00	71,559.00
Other current liabilities	328,423.38	319,536.65
Current portion of deferred income	1,478,978.64	24,433.20
	4,138,069.69	3,131,763.97
<b>Total equity and liabilities</b>	51,626,387.13	45,541,999.88

## Consolidated Income Statement

	<i>Januar 1- March 31, 2008</i>	<i>January 1- March 31, 2007</i>
	<i>in EUR</i>	
Revenues	1,651,216.28	1,294,195.33
Cost of revenues	-452,626.55	-1,248,526.95
Gross profit	<u>1,198,589.73</u>	<u>45,668.38</u>
Research and development expenses	-1,637,296.69	-3,351,609.15
General and administrative expenses	-1,034,840.51	-1,012,987.56
Selling and marketing expenses	-15,794.29	-207,760.80
Other income (expenses), net	<u>-20,821.28</u>	<u>19,981.78</u>
Operating expenses	<u>-2,708,752.77</u>	<u>-4,552,395.73</u>
Operating result	<u>-1,510,163.04</u>	<u>-4,506,727.35</u>
Financial income	484,405.35	496,853.12
Financial expenses	-152,071.41	-155,703.10
Financial result	<u>332,333.94</u>	<u>341,150.02</u>
Loss for the period before taxes	<u>-1,177,829.10</u>	<u>-4,165,577.33</u>
Income taxes	<u>0.00</u>	<u>0.00</u>
Loss for the period	<u><u>-1,177,829.10</u></u>	<u><u>-4,165,577.33</u></u>
Earnings per share (basic)	-0.07	-0.25
Earnings per share (diluted)	-0.07	-0.25

## Consolidated Cash Flow Statement

	<i>January 1- March 31, 2008 EUR</i>	<i>January 1- March 31, 2007 EUR</i>
Cash flows from operating activities:		
Net result for the period	-1,177,829.10	-4,165,577.33
Reconciliation of net profit (loss) for the period to cash flows from operating activities:		
Amortization/depreciation	82,423.37	102,050.18
Loss/Profits from the disposal of non-current assets	1,346.44	3,407.50
Interest expenses and interest income	-332,333.94	-341,150.02
Release of investment grants	-6,108.30	-6,106.30
Expenses from stock option plans	85,742.20	235,630.91
Change in assets and liabilities which are not attributable to investing or financing activities:		
Long-term refund claims resulting from the assumption of development costs	0.00	-1,042,145.93
Trade receivables	72,334.10	-1,438,509.97
Prepaid expenses and other assets	-804,830.29	107,194.93
Trade payables	-325,448.52	-505,369.48
Provisions	-132,365.93	1,338,012.71
Other current liabilities	9,574.73	118,423.98
Deferred income	7,636,375.64	0.00
	<u>5,108,880.40</u>	<u>-2,717,120.88</u>
Interest received	436,019.79	384,311.64
Net cash used in operating activities	<u>5,544,900.19</u>	<u>-2,332,809.24</u>
Cash flows from investing activities:		
Cash paid for investments in intangible assets and equipment	-31,250.05	-100,313.04
Cash received from the sale of intangible assets and equipment	320,529.05	0.00
Net cash used in investing activities	<u>289,279.00</u>	<u>-100,313.04</u>
Cash flows from financing activities:		
Interest paid	-139,290.88	-136,925.75
Payment of finance lease liabilities	-18,322.00	-20,884.00
Net cash used in financing activities	<u>-157,612.88</u>	<u>-157,809.75</u>
Change in cash and cash equivalents	5,676,566.31	-2,590,932.03
Cash and cash equivalents at beginning of the period	42,901,123.18	57,188,779.78
Cash and cash equivalents at end of the period	<u>48,577,689.49</u>	<u>54,597,847.75</u>
Composition of cash and cash equivalents at the end of the period:		
Cash	48,577,689.49	39,478,934.89
Marketable securities	0.00	15,118,912.86
	<u>48,577,689.49</u>	<u>54,597,847.75</u>

## Consolidated Statement of Changes in Equity

	<i>Share capital EUR</i>	<i>Capital reserve EUR</i>	<i>Loss carryforward EUR</i>	<i>Equity EUR</i>
December 31, 2006	<u>16,755,552.00</u>	<u>85,032,116.76</u>	<u>-56,316,554.35</u>	<u>45,471,114.41</u>
Issue of shares	0.00	0.00	0.00	0.00
Contribution to the capital reserve	0.00	0.00	0.00	0.00
Cost of raising capital	0.00	0.00	0.00	0.00
Additional contribution to the capital reserve due to the issue of options	0.00	235,630.91	0.00	235,630.91
Loss for the period	<u>0.00</u>	<u>0.00</u>	<u>-4,165,577.33</u>	<u>-4,165,577.33</u>
March 31, 2007	<u>16,755,552.00</u>	<u>85,267,747.67</u>	<u>-60,482,131.68</u>	<u>41,541,167.99</u>
Issue of shares	0.00	0.00	0.00	0.00
Contribution to the capital reserve	0.00	0.00	0.00	0.00
Cost of raising capital	0.00	0.00	0.00	0.00
Additional contribution to the capital reserve due to the issue of options	0.00	469,525.36	0.00	469,525.36
Loss for the period	<u>0.00</u>	<u>0.00</u>	<u>-6,346,476.95</u>	<u>-6,346,476.95</u>
December 31, 2007	<u>16,755,552.00</u>	<u>85,737,273.03</u>	<u>-66,828,608.63</u>	<u>35,664,216.40</u>
Issue of shares	0.00	0.00	0.00	0.00
Contribution to the capital reserve	0.00	0.00	0.00	0.00
Cost of raising capital	0.00	0.00	0.00	0.00
Additional contribution to the capital reserve due to the issue of options	0.00	85,742.20	0.00	85,742.20
Loss for the period	<u>0.00</u>	<u>0.00</u>	<u>-1,177,829.10</u>	<u>-1,177,829.10</u>
March 31, 2008	<u>16,755,552.00</u>	<u>85,823,015.23</u>	<u>-68,006,437.73</u>	<u>34,572,129.50</u>

## **Selected Explanatory Notes to the Unaudited Consolidated Interim Financial Statements as of 31 March 2008**

### **General**

The quarterly report of PAION AG includes interim consolidated financial statements and an interim group management report prepared in accordance with the provisions of Secs. 37x (3) and 37w (2) WpHG [“Wertpapierhandelsgesetz”: German Securities Trading Act] in conjunction with Sec. 37y WpHG. The consolidated financial statements were prepared in accordance with the provisions of 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.

### **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 31 March 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 these new or revised standards and interpretations will in some cases lead to additional disclosures in the next set of consolidated financial statements. Application of these standards and interpretations is not expected to have any effects on the Paion Group’s net assets, financial position and results of operations.

The provisions of IAS 34, “*Interim Financial Reporting*”, have been applied. The interim financial statements as of 31 March 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 31 March 2008 were the same as those used in the consolidated financial statements as of 31 December 2007.

### **Accounting Policies**

The accounting policies used in the interim consolidated financial statements as of 31 March 2008 were the same as those used in the consolidated financial statements as of 31 December 2007.

### **Licence Agreement Between PAION and Lundbeck**

With the licence agreement between PAION and Lundbeck, which was signed on 21 December 2007, Lundbeck now has the exclusive global rights for the development and marketing of Desmoteplase. This agreement was contingent on the successful completion of the patent review that was still ongoing on the date it was signed. On 29 January 2008, Lundbeck announced that the patent review had been completed and that the new licence agreement had taken effect without condition as of that day.

Under this agreement, Lundbeck has agreed to make the following payments:

- Payment of a non-refundable amount of EUR 8m in advance, on the date the agreement takes effect
- Assumption of all future costs, especially for clinical development, production development and approval

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

### **Discontinuation of Enecadin**

PAION decided to discontinue the clinical development of Enecadin, which is a neuroprotectant that was originally supposed to be used in connection with Desmoteplase. PAION made this decision based on scientific data which cast a shadow of doubt on the success of this type of medication.

There are no significant effects on the net assets, financial position and results of operations expected in the second quarter of 2008 in connection with the discontinuation of Enecadin.

### **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.



## PART IV

### Consolidated Financial Statements as of 31 December 2007

#### Consolidated Balance Sheet as of 31 December 2007

##### Assets

	Note	December 31, 2007	December 31, 2006
<i>in EUR</i>			
<b>Non-current assets</b>			
Intangible assets	1.	462,349.84	524,246.44
Equipment	2.	902,786.33	1,163,871.92
Long-term refund claims resulting from the assumption of development expenses	3.	0.00	8,010,826.74
		1,365,136.17	9,698,945.10
<b>Current assets</b>			
Trade receivables	4.	776,806.33	2,290,567.20
Prepaid expenses and other assets	5.	498,934.20	871,707.98
Cash and cash equivalents	6.	42,901,123.18	57,188,779.78
		44,176,863.71	60,351,054.96
<b>Total assets</b>		45,541,999.88	70,050,000.06

##### Equity and liabilities

		December 31, 2007	December 31, 2006
<i>in EUR</i>			
<b>Equity</b>			
Share capital	7.	16,755,552.00	16,755,552.00
Capital reserve		85,737,273.03	85,032,116.76
Loss carryforward		-56,316,554.35	-38,930,499.47
Loss for the period		-10,512,054.28	-17,386,054.88
		35,664,216.40	45,471,114.41
<b>Non-current liabilities</b>			
Provisions	8.	0.00	10,616,825.08
Financial liabilities	9.	6,657,137.24	6,741,483.43
Finance lease liabilities	10.	61,761.00	133,320.00
Deferred income	11.	27,121.27	1,720,630.08
		6,746,019.51	19,212,258.59
<b>Current liabilities</b>			
Trade payables	12.	2,294,817.61	4,508,927.03
Provisions	8.	421,417.51	442,446.78
Current portion of finance lease liabilities	10.	71,559.00	74,163.00
Other current liabilities	13.	319,536.65	316,657.05
Current portion of deferred income	11.	24,433.20	24,433.20
		3,131,763.97	5,366,627.06
<b>Total equity and liabilities</b>		45,541,999.88	70,050,000.06

## Consolidated Income Statement for the Fiscal Year 2007

	Note	2007	2006
		in EUR	
Revenues	14.	4,846,472.51	10,458,951.94
Cost of revenues		<u>-2,978,513.01</u>	<u>-7,251,732.37</u>
Gross profit		<u>1,867,959.50</u>	<u>3,207,219.57</u>
Research and development expenses		-9,814,009.42	-16,486,558.17
General and administrative expenses		-4,407,369.00	-4,563,448.72
Selling and marketing expenses		-559,570.00	-1,088,225.45
Other income (expenses), net	15.	<u>289,334.51</u>	<u>149,199.08</u>
Operating expenses		<u>-14,491,613.91</u>	<u>-21,989,033.26</u>
Operating result		<u>-12,623,654.41</u>	<u>-18,781,813.69</u>
Financial income	16.	4,549,187.50	2,042,188.53
Financial expenses	17.	<u>-2,437,587.37</u>	<u>-646,429.72</u>
Financial result		<u>2,111,600.13</u>	<u>1,395,758.81</u>
Loss for the period before taxes		<u>-10,512,054.28</u>	<u>-17,386,054.88</u>
Income taxes	18.	<u>0.00</u>	<u>0.00</u>
Loss for the period		<u><u>-10,512,054.28</u></u>	<u><u>-17,386,054.88</u></u>
Earnings per share (basic)	19.	-0.63	-1.06
Earnings per share (diluted)	19.	-0.63	-1.06

## Consolidated Cash Flow Statement for the Fiscal Year 2007

	2007 EUR	2006 EUR
Cash flows from operating activities:		
Net result for the period	-10,512,054.28	-17,386,054.88
Reconciliation of net result for the period to cash flows from operating activities:		
Amortization/depreciation	522,441.84	364,245.40
Profit/loss from the disposal of non-current assets	4,360.86	8,419.74
Interest expenses and interest income	-2,111,600.13	-1,395,758.81
Release of investment grants	-24,433.20	-24,433.20
Release of deferred income	-1,669,075.61	0.00
Expenses from stock option plans	705,156.27	1,115,100.16
Change in assets and liabilities which are not attributable to investing or financing activities:		
Long-term refund claims resulting from the assumption of development expenses	6,065,907.88	-4,525,846.10
Trade receivables	1,513,760.87	-877,370.28
Prepaid expenses and other assets	511,387.54	402,141.68
Trade payables	-2,214,109.42	100,535.19
Provisions	-8,061,802.86	6,132,270.15
Other current liabilities	2,879.60	-259,874.57
	<u>-15,267,180.64</u>	<u>-16,346,625.52</u>
Interest received	1,819,485.55	1,604,929.79
Net cash used in/from operating activities	<u>-13,447,695.09</u>	<u>-14,741,695.73</u>
Cash flows from investing activities:		
Cash paid for investments in intangible assets and equipment	-205,459.11	-452,773.91
Cash received from the sale of intangible assets and equipment	1,638.60	517.24
Net cash used in/from investing activities	<u>-203,820.51</u>	<u>-452,256.67</u>
Cash flows from financing activities:		
Capital increase	0.00	1,000,000.00
Contributions to the capital reserve	0.00	8,440,000.00
Payments in connection with the raising of capital	0.00	-448,273.31
Borrowing	0.00	6,720,000.00
Capital repayment due to the settlement of options	0.00	-1,192,493.32
Interest paid	-555,310.00	-423,499.04
Payments of finance lease liabilities	-80,831.00	-83,542.00
Net cash used in/from financing activities	<u>-636,141.00</u>	<u>14,012,192.33</u>
Change in cash and cash equivalents	-14,287,656.60	-1,181,760.07
Cash and cash equivalents at beginning of the period	57,188,779.78	58,370,539.85
Cash and cash equivalents at end of the period	<u>42,901,123.18</u>	<u>57,188,779.78</u>
Composition of cash and cash equivalents at the end of the period:		
Cash and cash equivalents	<u>42,901,123.18</u>	<u>57,188,779.78</u>

## Consolidated Statement of Changes in Equity for the Fiscal Year 2007

	<i>Share capital EUR</i>	<i>Capital reserve EUR</i>	<i>Loss carryforward EUR</i>	<i>Equity EUR</i>
December 31, 2005	15,755,552.00	75,925,289.91	-38,930,499.47	52,750,342.44
Issue of shares	1,000,000.00	0.00	0.00	1,000,000.00
Contribution to the capital reserve	0.00	8,440,000.00	0.00	8,440,000.00
Cost of raising capital	0.00	-448,273.31	0.00	-448,273.31
Additional contribution to the capital reserve due to the issue of options	0.00	1,115,100.16	0.00	1,115,100.16
Loss for the period	0.00	0.00	-17,386,054.88	-17,386,054.88
December 31, 2006	<u>16,755,552.00</u>	<u>85,032,116.76</u>	<u>-56,316,554.35</u>	<u>45,471,114.41</u>
Additional contribution to the capital reserve due to the issue of options	0.00	705,156.27	0.00	705,156.27
Loss for the period	0.00	0.00	-10,512,054.28	-10,512,054.28
December 31, 2007	<u><u>16,755,552.00</u></u>	<u><u>85,737,273.03</u></u>	<u><u>-66,828,608.63</u></u>	<u><u>35,664,216.40</u></u>

## Notes to the Consolidated Financial Statements for Fiscal Year 2007

### A. General

The consolidated financial statements comprise PAION AG as parent company registered at Martinstrasse 10-12, 52062 Aachen, Germany, and the wholly-owned subsidiary PAION Deutschland GmbH, Aachen, Germany, which is fully consolidated.

PAION AG acts as a holding company and renders various services for PAION Deutschland GmbH. PAION Deutschland GmbH, a bio-pharmaceutical company founded in 2000, aims to become a leading player in the development and marketing of innovative drugs for the treatment of stroke and other thrombotic diseases for which there is substantial unmet medical need.

PAION AG stock has been listed on Prime Standard of the regulated market of the Frankfurt Stock Exchange since February 2005, and is subject to extensive reporting obligations.

The consolidated financial statements as of 31 December 2007 and the group management report for fiscal year 2007 are due to be approved for publication at the supervisory board meeting on 3 March 2008.

### B. Basis of Accounting

The consolidated financial statements have been prepared in accordance with Sec. 315a HGB [“Handelsgesetzbuch”: German Commercial Code] and International Financial Reporting Standards (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 31 December 2007 and applied by PAION, were adopted by the European Commission for application in the EU. In accordance with IAS 1, assets and liabilities have been recognised and measured pursuant to the standards which were effective as of 31 December 2007.

The new and revised standards and interpretations listed below were applied for the first time in the fiscal year. Adoption of these standards and interpretations did not have any effect on the Group’s net assets, financial position and results of operations, but lead to additional disclosures.

- Amendment to IAS 1, “*Presentation of Financial Statements*”: The amendment sets out the disclosure requirements in relation to objectives, policies and processes for managing capital.
- IFRS 7, “*Financial Instruments: Disclosures*”: This new standard sets out the disclosure requirements for financial instruments and enables users to evaluate the significance of financial instruments for the Group’s financial position and performance and the nature and extent of risks arising from financial instruments.
- IFRIC 8 “*Scope of IFRS 2 Share-Based Payment*”: The interpretation requires IFRS 2 to be applied to all transactions in which an entity cannot identify some or all of the goods or services received. This applies in particular if the consideration for the issued equity instruments by the entity appears to be less than the fair value. Since PAION merely issued equity instruments to members of the management board and employees in the context of employee stock option programs, the application of this interpretation did not have any effect on the Group’s net assets, financial position and results of operations.
- IFRIC 9 “*Reassessment of Embedded Derivatives*”: In accordance with IFRIC 9, an entity must assess whether any embedded derivatives are created through a contract as a component of a hybrid instrument when it first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows. Since PAION does not have any embedded derivatives required to be separated from the host contract, this interpretation did not have any effect on the Group’s net assets, financial position and results of operations.

- IFRIC 10 “*Interim Reporting and Impairment*”: This interpretation states that an entity shall not reverse an impairment loss recognised in a previous interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost in a subsequent period. Since PAION made no such adjustments to impairment losses recognised, this interpretation did not have any effect on the Group’s net assets, financial position and results of operations.

The following standards and interpretations which have already been issued will be applied as soon as they become effective, provided they are adopted by the European Commission:

- Amendments to IAS 23, “*Borrowing Costs*”: In March 2007, the IASB published the revised IAS 23, which required borrowing costs attributable to a qualified asset to be capitalised. The revised standard becomes operative for reporting periods beginning on or after 1 January 2009.
- Amendments to IFRS 2, “*Share-Based Payment*”: In January 2008, the IASB published the revised IFRS 2. The amendments mainly serve to clarify the terms “vesting conditions” and “cancellations”. The revised standard becomes operative for reporting periods beginning on or after 1 January 2009.
- Amendments to IFRS 3, “*Business Combinations*”, and IAS 27, “*Consolidated and Separate Financial Statements*”: In January 2008, the IASB published the revised IFRS 3 and IAS 27. The amendments primarily relate to the balance sheet disclosure of minority interests and business combinations where less than 100% of the interests were acquired. The revised standard becomes operative for reporting periods beginning on or after 1 June 2009.
- IFRS 8, “*Operating Segments*”: In November 2006, the IASB published IFRS 8. This standard supersedes IAS 14, “*Segment Reporting*”, and brings the IASB’s standards into line with the US GAAP provisions of SFAS 131. In general, financial information must be reported on the basis of the internal reporting format used in assessing the operating segments (management approach). IFRS 8 becomes operative for reporting periods beginning on or after 1 January 2009.
- 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.
- IFRIC 12: In November 2006, the IFRIC published IFRIC 12, “*Service Concession Arrangements*”. IFRIC 12 clarifies application of existing IFRSs by public service concession operators with regard to the obligations and related rights in the service concession arrangements. IFRIC 12 is effective for reporting periods beginning on or after 1 January 2008.
- IFRIC 13: In June 2007, the IFRIC published IFRIC 13, “*Customer Loyalty Programs*”. The interpretation determines how customer loyalty programs operated by manufacturers and service providers are recognised. IFRIC 13 is effective for reporting periods beginning on or after 1 July 2008.
- IFRIC 14: In July 2007, IFRIC published IFRIC 14, IAS 19 “*The Limit on a Defined Benefit Asset, Minimum Funding Requirements and Their Interaction*”. Using general guidelines, IFRIC 14 regulates the measurement of a pension fund’s surplus which can be recognised as an asset pursuant to IAS 19, “*Employee Benefits*”, in accordance with the provisions of asset ceilings.

Application of these new or revised standards and interpretations will in some cases lead to additional disclosures in the next set of consolidated financial statements. Application of these standards and interpretations is not expected to have material effects on PAION's net assets, financial position and results of operations.

The consolidated financial statements were prepared in euros.

The income statement was prepared using the function of expense method. Research and development expenses are disclosed separately in the income statement due to their significance.

Under IAS 1, "*Presentation of Financial Statements*", non-current and current assets and non-current and current liabilities must be presented as separate classifications on the face of the balance sheet. Assets, liabilities and provisions due within one year are classified as current.

The consolidated financial statements do not contain any segment information as no reportable business or geographical segments could be identified. We currently assume that the new provisions of IFRS 8 will not result in segment reporting.

The preparation of 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 consolidation and accounting policies used in the prior year have been retained, making allowances for the new or changed standards and interpretations. Adoption of the new or revised standards and interpretations only lead to additional disclosure requirements, which were treated accordingly. There were no effects on the Group's net assets, financial position and results of operations.

### **C. Consolidation Principles**

The consolidated financial statements comprise PAION AG and its subsidiary PAION Deutschland GmbH. The financial statements of the two entities included in the consolidated financial statements are drawn up on the basis of uniform accounting policies. Receivables and liabilities, income and expenses, and profits from group transactions are eliminated.

### **D. Accounting Policies**

#### *Intangible Assets*

Purchased intangible assets are measured at cost. They are amortised over their useful lives using the straight-line method and assessed for impairment if there is an indication that the intangible assets may be impaired. The useful life of software is determined to be three years, while research and marketing rights for compounds are amortised over the term of the respective patent.

#### *Equipment*

Equipment is measured at cost less accumulated depreciation. Depreciation is calculated by applying the straight-line method over the estimated useful life of the assets, which normally ranges between three and twenty years. The Company tests assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset to the higher of its fair value less costs to sell and its value in use. If such assets are considered to be impaired, the impairment loss recognised is the amount by which the carrying amount of the assets exceeds the higher of fair value less costs to sell or value in use. If the grounds for impairment no longer exist, the assets are written up.

Leased equipment which satisfies certain criteria under IAS 17, "*Leases*", is recognised as an asset, while the present value of lease payments is recognised as a liability. Depreciation on leased assets is charged on a straight line basis over the term of the lease.



### *Long-Term Refund Claims Resulting From the Assumption of Development Expenses*

In the prior year, long-term refund claims from the assumption of development expenses from Lundbeck were recognised at present value, applying an interest rate of 3.8%. Due to the direct connection with the repayment obligation to Forest disclosed as a provision, these claims were recognised in accordance with IAS 37.53, “*Provisions, Contingent Liabilities and Contingent Assets*”.

### *Receivables and Other Assets*

Trade receivables and other assets are disclosed at amortised cost. Receivables denominated in foreign currency are translated at the closing rate. Exchange gains and losses are recognised in profit or loss.

### *Cash and Cash Equivalents*

Cash and cash equivalents comprise cash on hand, bank balances and short-term deposits with an original maturity of three months or less. They are measured at amortised cost.

### *Equity*

The costs directly associated with issuing equity are not expensed but directly deducted from equity.

### *Provisions*

Provisions are recognised when a present obligation (legal or constructive) exists as a result of a past event and when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions with a maturity of more than one year are recognised at present value.

### *Financial Liabilities*

Financial liabilities are measured at amortised cost using the effective interest method.

### *Trade Payables/Other Liabilities*

Trade payables and other liabilities are carried at the amount repayable. Liabilities denominated in foreign currency are translated at the closing rate. Exchange gains and losses are recognised in profit or loss.

### *Deferred Income*

Investment grants in connection with the acquisition of assets are recognised as deferred income in the balance sheet. The deferred investment grants are released in line with the depreciation/amortisation of the underlying assets. The amounts released are deducted from research and development expenses.

Non-repayable signing fees received in connection with outlicencing agreements are disclosed as deferred income and recognised in profit or loss as the respective milestones are achieved.

### *Revenues*

Revenues for the fiscal year are recognised when realised. Revenues are recognised when the owed service has been rendered, and the risks of ownership have been transferred and the amount of expected consideration can be measured reliably. Payments related to the sale or outlicencing of compounds or technological know-how are recognised in profit or loss when the services to be rendered on the basis of contractual regulations have been met in full.

### *Cost of Revenues*

Development expenses charged on are recognised as cost of revenues.

### *Research and Development Expenses*

Research expenses are expensed as incurred. Development expenses are recognised as an asset in accordance with IAS 38, “*Intangible Assets*”, depending on the possible outcome of the development activities and whether or not all of the criteria for recognition are met. These criteria are not currently met, such that development expenses are expensed as incurred.

### *Interest Income/Expenses*

Interest income and expenses are recognised in the period in which they are generated or incurred. Any necessary deferrals are calculated using the effective interest method.

### *Income Taxes/Deferred Taxes*

Deferred taxes are recognised according to IAS 12, “*Income Taxes*”. Deferred taxes are recognised by applying enacted statutory tax rates applicable to future years to temporary differences between the IFRS carrying amounts and the tax bases of existing assets and liabilities. In addition, deferred tax assets are recognised on tax loss carryforwards. The effect of a change in the enacted tax rates on deferred taxes is recorded in the period in which the change in enacted. No deferred tax assets are recognised, if it is probable that some or all of the deferred tax assets may not be recoverable.

### *Share-Based Payment Transactions*

Stock options are measured at fair value on the date on which they are granted. The fair value of the obligation is recognised as a personnel expense and as a simultaneous increase in equity over the vesting period. Obligations from stock appreciation rights are recognised as a provision and measured at fair value on the balance sheet date. Expenses are recognised as personnel expenses over the vesting period. The fair value is determined on the basis of internationally accepted valuation methods both for stock options and stock appreciation rights.

## **E. Accounting for Expenses Incurred in Connection With the Development of Desmoteplase**

The development of Desmoteplase and its financing was regulated under the licence agreements concluded between PAION, Forest Laboratories Ireland Limited, Clonshaugh, Ireland (hereinafter also referred to as “Forest”) and H. Lundbeck A/S, Valby-Kopenhagen, Denmark (hereinafter also referred to as “Lundbeck”). After the negative results of the Phase III clinical study (DIAS-2) carried out with Forest in the first half-year of 2007 was announced, Forest terminated the licence agreement with PAION in August 2007 and returned all rights from this licence agreement to PAION. Due to the termination, Forest is no longer obliged to finance the future development of Desmoteplase. It merely has to bear the follow-up costs relating to the DIAS-2 study for a six-month period after the termination.

In December 2007, PAION and Lundbeck concluded a new licence agreement for the development and marketing of Desmoteplase, which was contingent upon 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 new agreement, Lundbeck will take over the development and financing of Desmoteplase in future. For details of this new agreement, please see our comments in the group management report.

Since the provisions regarding rights and claims of PAION in the agreement with Forest and the original agreement with Lundbeck still significantly influenced the 2007 consolidated financial statements, the way they were accounted for before Forest’s termination is described below. For details of the agreement with Forest and the original agreement with Lundbeck, please see our comments in the consolidated financial statements of the prior year.

The development expenses incurred directly by PAION and to be reimbursed by Forest were recorded as revenue. PAION recognised a provision for the obligation to repay development

expenses reimbursed by Forest, which was agreed in the event of regulatory approval, by reducing revenues by 50% of the reimbursed expenses. Accordingly, revenues in any given period effectively included only approximately 50% of the Desmoteplase-related development expenses billed to Forest. 50% of the development expenses billed to Forest was accounted for as cost of revenues.

A provision was also recognised for the potential obligation to repay the development expenses incurred directly by Forest in the amount of the present value of 50% of the expenses incurred directly by Forest. This provision increased the research and development expenses disclosed by PAION accordingly.

The 20% premium on the overall repayment obligation was accounted for by recognising a provision in that amount and an increase in research and development expenses.

The following two cost categories were used in accounting for the claims against Lundbeck resulting from the assumption of development expenses:

1. Development expenses incurred directly by PAION but not charged on to Forest and to be reimbursed by Lundbeck.
2. Development expenses resulting from the repayment obligation to Forest:
  - (a) Development expenses incurred directly by PAION and charged on to Forest;
  - (b) Development expenses incurred directly by Forest.

Forest's termination did not impact the disclosure of the refund claims against Lundbeck from *cost category 1*, so that it remained the same until the balance sheet date. These refund claims were recognised as revenues while the related development expenses were recognised as cost of revenues. The costs were mainly current production development expenses. These claims against Lundbeck, which are due immediately, were recognised as trade receivables.

The refund claims against Lundbeck resulting from *cost category 2a* were recorded as revenues, whereas the corresponding development expenses were recognised as cost of revenues. PAION's refund claim against Lundbeck resulting from *cost category 2b* was recognised in profit or loss by being netted with the corresponding development expenses. The 20% premium payable on cost categories 2a and 2b were also included in the refund claim against Lundbeck.

The amount of the refund claims against Lundbeck resulting from cost categories 2a and 2b depended on the extent to which PAION exercises its future joint marketing options. The accounting treatment was based on the assumption that PAION would exercise all options; hence, the lowest possible refund claim against Lundbeck was recorded.

The refund claims against Lundbeck resulting from cost categories 2a and 2b would not have been due until Desmoteplase received regulatory approval in Europe and/or Japan. As they were due in more than one year, the refund claims were carried in the balance sheet as a non-current asset at their present value. In the consolidated cash flow statement, changes in these long-term refund claims were classified as a cash flow from operating activities because of their operating nature. Hence, they were stated in the same way as the changes in the long-term repayment obligation to Forest, which was also presented in the cash flows from operating activities.

Due to Forest's termination of the licence agreement, PAION's repayment obligation to Forest ceases to apply. The related provision was therefore reversed in the third quarter of 2007. The refund claim against Lundbeck directly related to this repayment obligation was also cancelled due to the lack of a reference value and was derecognised accordingly. With respect to the impact of these two license agreements and especially Forest's termination of the agreement on the consolidated financial statements, please refer to the additional disclosures on the respective balance sheet and income statement items.

## F. Notes to the Consolidated Balance Sheet

### (1) Intangible Assets

Intangible assets break down as follows:

	<i>Industrial rights and similar rights and assets in EUR</i>
Acquisition cost	
1 January 2006	830,555.00
Additions	84,749.82
Disposals	61,642.05
31 December 2006	<u>853,662.77</u>
Additions	92,995.90
Disposals	0.00
31 December 2007	<u><u>946,658.67</u></u>
Accumulated amortisation, depreciation and impairment losses	
1 January 2006	316,351.39
Additions	74,703.50
Disposals	61,638.56
31 December 2006	<u>329,416.33</u>
Additions	92,595.00
Impairment losses	62,297.50
Disposals	0.00
31 December 2007	<u><u>484,308.83</u></u>
Carrying amounts as of 31 December 2006	<u>524,246.44</u>
Carrying amounts as of 31 December 2007	<u><u>462,349.84</u></u>

Additions in fiscal year 2007 mainly relate to the acquisition of a document management system (EUR 62k) for the purpose of archiving the documentation on the clinical development of Desmoteplase and preparing the related documents for the regulatory authorities. Due to the postponement in the development of Desmoteplase and the fact that the future development is spearheaded by Lundbeck, the document management system is currently not being utilised. As of the balance sheet date, the system was therefore written down in full; the write-down was recorded under research and development expenses.

## (2) Equipment

Equipment developed as follows:

	<i>Plant and machinery</i>	<i>Other plant, factory and office equipment</i>	<i>Payments on account and assets under construction in EUR</i>	<i>Total</i>
Acquisition cost				
1 January 2006	802,724.58	1,515,880.83	69,287.79	2,387,893.20
Additions	110,908.27	170,858.16	86,257.66	368,024.09
Disposals	157,007.28	88,161.32	0.00	245,168.60
Reclassification	0.00	94,845.45	-94,845.45	0.00
31 December 2006	756,625.57	1,693,423.12	60,700.00	2,510,748.69
Additions	34,834.00	77,630.59	0.00	112,464.59
Disposals	4,292.36	138,816.75	0.00	143,109.11
Reclassification	0.00	60,700.00	-60,700.00	0.00
31 December 2007	787,167.21	1,692,936.96	0.00	2,480,104.17

### **Accumulated amortisation, depreciation and impairment losses**

1 January 2006	366,318.68	927,251.30	0.00	1,293,569.98
Additions	128,509.00	161,032.90	0.00	289,541.90
Disposals	156,987.28	79,247.83	0.00	236,235.11
31 December 2006	337,840.40	1,009,036.37	0.00	1,346,876.77
Additions	158,895.09	140,635.06	0.00	299,530.15
Impairment losses	0.00	68,020.17	0.00	68,020.17
Disposals	1,701.00	135,408.25	0.00	137,109.25
31 December 2007	495,034.49	1,082,283.35	0.00	1,577,317.84
Carrying amount as of 31 December 2006	418,785.17	684,386.75	60,700.00	1,163,871.92
Carrying amount as of 31 December 2007	292,132.72	610,653.61	0.00	902,786.33

Due to the staff reductions following the negative results of the DIAS-2 study, the lease for an office floor was terminated as of 31 December 2007. The leasehold improvements made on this floor at the beginning of the year were consequently written down as of the balance sheet date (EUR 68k).

Equipment includes assets of EUR 125k acquired through finance leases (prior year: EUR 198k); the gross value of these assets as of the balance sheet date came to EUR 358k (prior year: EUR 393k) and mainly relates to a bioprocess system for the production of Desmoteplase.

## (3) Long-Term Refund Claims Resulting From the Assumption of Development Expenses

The long-term refund claims from the assumption of development expenses disclosed in the prior year were due by the cooperation partner Lundbeck. These refund claims related directly to PAION's repayment obligations to the cooperation partner Forest. Since Forest terminated the cooperation agreement with PAION at the end of August 2007, all repayment obligations became void, making the related refund claims against Lundbeck obsolete. The derecognition of the refund claims against Lundbeck resulted in expenses of EUR 8,222k in fiscal year 2007, which were disclosed under research and development expenses.

## (4) Trade Receivables

Trade receivables for fiscal year 2007 and the prior year relate to refund claims for development expenses for Desmoteplase arising in connection with the license agreement with Forest and the original agreement with Lundbeck.

Trade receivables are non-interest bearing and are generally due in 30 days. As of 31 December, the age structure of trade receivables break down as follows:

	Total written down	Neither overdue nor	Overdue, but not written down		
			less than 30 days	30 to 60 days	61 to 90 days
			<i>in EUR k</i>		
2007	777	464	89	60	164
2006	2,291	2,291	0	0	0

(5) *Prepaid Expenses and Other Assets*

Prepaid expenses and other assets mainly include VAT refund claims of EUR 146k (prior year: EUR 385k), deferred interest claims of EUR 139k (prior year: EUR 187k), prepaid insurance premiums and rental payments of EUR 131k (prior year: EUR 182k).

(6) *Cash and Cash Equivalents*

Cash and cash equivalents are composed as follows:

	<i>31 December 2007</i>	<i>31 December 2006</i>
	<i>in EUR k</i>	
Short-term deposits	39,788	54,146
Banks balances and cash on hand	3,113	3,043
	<u>42,901</u>	<u>57,189</u>

Bank balances earn interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods of up to three months and earn interest at the respective short-term deposit rates.

(7) *Equity*

As of 31 December 2007, the share capital amounted to EUR 16,755,552.00 and is divided into 16,755,552 no-par value shares.

By resolution adopted by the annual general meeting on 10 May 2006, the management board was authorised to increase share capital on or prior to 10 May 2011, with the consent of the supervisory board, on one or more occasions, by up to an aggregate of EUR 7,850,000.00 through the issuance of up to 7,850,000 new no-par value bearer shares in return for cash contributions or contributions in kind (Authorized Capital 2004). Authorized Capital I is still fully available for issue.

By another resolution adopted by the annual general meeting on 10 May 2006, the management board was authorised to increase share capital on or before 10 May 2011, on one or more occasions by up to an aggregate amount of EUR 63,000,000.00 through the issuance of convertible or warrant-linked bonds with a maximum term of 20 years and grant the holders or creditors of bonds conversion or option rights to new shares in PAION AG with a proportionate share in share capital of up to an aggregate of EUR 6,300,000.00 (Conditional Capital I). Conditional Capital I has not yet been used up.

In addition, pursuant to a resolution adopted by the annual general meeting on 30 December 2004, the share capital of PAION AG was conditionally increased by an aggregate amount of up to EUR 1,000,000.00 by issuing a total of up to 1,000,000 new ordinary no-par bearer shares (Conditional Capital 2004 II). The conditional capital increase may be executed only to the extent that the holders of options granted by PAION AG in connection with the Stock Option Plan 2005 exercise their options. To service the Stock Option Plan 2005, the annual general meeting on 26 August 2005 resolved to conditionally increase PAION AG's share capital by up to another EUR 110,000.00 through the issuance of a maximum total of 110,000 new no-par value bearer shares (Conditional Capital III).



#### (8) Provisions

Provisions developed as follows:

	<i>31 December 2006</i>	<i>Utilisation</i>	<i>Release in EUR k</i>	<i>Addition</i>	<i>31 December 2007</i>
Premiums/management bonuses	374	368	0	353	359
Refund obligation to Forest	10,610	0	10,890	280	0
Other	75	0	13	0	62
	<u>11,059</u>	<u>368</u>	<u>10,903</u>	<u>633</u>	<u>421</u>

The provision recognised in the prior year for the repayment obligation to Forest for development expenses was reversed due to Forest's termination of the cooperation agreement in August 2007, as all of PAION's repayment obligations became obsolete. The derecognition of the provision resulted in income of EUR 10,890k in fiscal year 2007, which was disclosed under research and development expenses.

#### (9) Financial Liabilities

Financial liabilities relate to a subordinated loan of EUR 7,000,000 raised in April 2006. The subordinated loan was granted by HSBC Trinkaus & Burkhardt KGaA, Düsseldorf, Germany, and is part of the structured mezzanine financing scheme entitled "H.E.A.T. Mezzanine I-2006". In the interim, HSBC Trinkaus & Burkhardt KGaA transferred the subordinated loan to H.E.A.T Mezzanine S.A., Luxembourg. The bullet loan has a seven-year term and was paid out less the discount of EUR 280,000. The financial liability has a fixed interest rate of 7.933% p.a. and, as such, is not subject to an interest rate risk. Only a sustained ratings deterioration can result in an increase in the interest rate to 8.433%. The effective interest rate is 9.05% p.a. Interest payments are due on a quarterly basis.

#### (10) Finance Lease Liabilities

Liabilities due to lease contracts are recognised when the respective asset is recognised under assets (finance lease). They are recorded at their present value. Lease payments of EUR 138k (prior year: EUR 219k) are due to the lessor over the next few years. The interest included therein comes to EUR 5k (prior year: EUR 12k). The finance lease liabilities are presented according to their maturity as follows:

	<i>Lease payments</i>	<i>Interest portion included in EUR k</i>	<i>Lease liability</i>
2008	75	4	71
2009	63	1	62
	<u>138</u>	<u>5</u>	<u>133</u>

#### (11) Deferred Income

In the prior year, deferred income included a non-repayable signing fee which was due upon conclusion of the license agreement with Forest. Originally, it was intended to recognise the signing fee proportionally upon achieving respective milestones. Due to Forest's termination of the cooperation, the deferred signing fee of EUR 1,669k was reversed and recognised as revenues.

As of 31 December 2007, deferred income still included investment grants which PAION received from the Federal Ministry for Education and Research (Bundesministerium für Bildung und Forschung). The deferred investment grants are released in line with the



depreciation/amortisation of the underlying assets. The amounts released are deducted from research and development expenses (EUR 24k; prior year: EUR 24k). The portion of the grants which is not due within the next 12 months is disclosed under non-current liabilities (EUR 27k; prior year: EUR 52k).

(12) *Trade Payables*

As of 31 December 2007, trade payables amounted to EUR 2,295k (prior year: EUR 4,509k). They are non-interest bearing and are generally due in 30 days.

(13) *Other Current Liabilities*

Other current liabilities comprise the following items:

	<i>31 December 2007</i>	<i>31 December 2006</i>
	<i>in EUR k</i>	
Wage tax	121	145
Vacation entitlements	111	166
Other	88	6
	<u>320</u>	<u>317</u>

**G. Notes to the Consolidated Income Statement**

(14) *Revenues*

Revenues in fiscal year 2007 are attributable to the refund of development expenses by the cooperation partners Forest and Lundbeck (EUR 3,177k) and a deferred signing fee which was released due to Forest's termination of the cooperation (EUR 1,669k). Revenues in the prior year solely included the refund of development expenses by Forest and Lundbeck (EUR 10,459k).

(15) *Other Income (Expenses), Net*

This item mainly includes income for services provided in the area of clinical development and pharmacovigilance (EUR 174k) as well as other minor effects that cannot be allocated to other line items.

(16) *Financial Income*

Financial income breaks down as follows:

	<i>2007</i>	<i>2006</i>
	<i>in EUR k</i>	
Discounting of provisions	2,585	250
Interest income on the basis of amortized cost (bank balances and short-term deposits)	1,958	1,792
Discounting of non-current refund claims	6	0
	<u>4,549</u>	<u>2,042</u>

(17) *Financial Expenses*

Financial expenses comprise the following items:

	<i>2007</i>	<i>2006</i>
	<i>in EUR k</i>	
Discounting of non-current refund claims	1,951	189
Expenses on the basis of amortised costs (subordinated loan)	471	444
Unwinding of the discount for provisions	9	0
Finance lease expenses	7	10
Other	0	3
	<u>2,438</u>	<u>646</u>

#### (18) *Income Taxes/Deferred Taxes*

Tax losses have been incurred from the time of PAION Deutschland GmbH's formation in 2000 up to and including 2007. As of 31 December 2007, tax loss carryforwards came to some EUR 70m (prior year: EUR 60m). Under current German tax legislation, these tax losses can be carried forward indefinitely and netted against future income.

The combined income tax rate of 39.77% applied in the past will decrease to 31.41% from 2008 onward due to the German business tax reform. Of this new tax rate comprises corporate income tax of 15%, the solidarity surcharge, which itself constitutes 5.5% of the corporate income tax, and trade tax on income levied at 15.58%.

Applying the combined income tax rate pursuant to the 2008 German business tax reform, deferred tax assets on tax loss carryforwards amounted to EUR 22m as of 31 December 2007 (prior year: EUR 24m, calculated on the basis of the old tax rate). Debit differences between the tax base and the IFRS carrying amount as of 31 December 2007 result in deferred tax assets of EUR 1k (prior year: EUR 320k).

Further losses are expected for the years to come and, as such, it is not yet considered likely that the deferred tax assets will be realised. In accordance with IAS 12.34, "Income Taxes", the deferred tax assets on loss carryforwards and the surplus deferred tax assets on temporary differences were thus not recognised.

The reconciliation of the expected income tax and the current tax expense is shown below applying a tax rate of 39.77 %:

	2007	2006
	<i>in EUR k</i>	
Loss for the period	-10,512	-17,386
Expected tax expense (+)/income (-)	-4,181	-6,914
Non-recognition of deferred taxes on temporary differences	-319	35
Non-recognition of deferred taxes on tax losses of the fiscal year	4,125	6,586
Costs in connection with capital increases	0	-178
Expenses of stock options	280	443
Other	95	28
Current income tax expense	<u>0</u>	<u>0</u>

#### (19) *Earnings per Share*

Earnings per share are calculated in accordance with IAS 33, "Earnings per Share", by dividing the net result of the year by the weighted average number of shares outstanding. The underlying weighted average number of ordinary shares outstanding is calculated as follows:

	2007	2006
Shares outstanding on 1 January	16,755,552	15,755,552
Capital increase in April 2006	0	716,667
Weighted average number of ordinary shares	<u>16,755,552</u>	<u>16,472,219</u>

Basic and diluted earnings per share are calculated on the basis of the following figures:

	2007	2006
Net result of the year in EUR	-10,512,054.28	-17,386,054.88
Weighted average number of ordinary shares for basic earnings per share	16,755,552	16,472,219
Weighted average number of ordinary shares for diluted earnings per share	16,755,552	16,472,219
<b>Earnings per share (in EUR):</b>		
<b>Basic</b>	<b>-0.63</b>	<b>-1.06</b>
<b>Diluted</b>	<b>-0.63</b>	<b>-1.06</b>

The outstanding stock options in the fiscal year and also in the prior year did not dilute the earnings per share.

## H. Notes to the Consolidated Cash Flow Statement

The consolidated cash flow statement shows how the cash and cash equivalents of PAION have changed during the course of the fiscal year due to inflows and outflows of funds. In accordance with IAS 7, "Cash Flow Statements", a distinction is made between cash flows from operating, investing and financing activities. Cash and cash equivalents disclosed in the consolidated cash flow statement include cash, bank balances and short-term deposits with a maturity of up to three months based on the date of investment.

## I. Other Notes

### *Stock Option Plan 2005*

On 30 December 2004, the annual general meeting of PAION AG approved a stock option plan for management board members and employees of PAION. Under the stock option plan, of the total of 1,102,888 stock options, 496,300 stock options can be granted to management board members and 606,588 to employees. One stock option entitles the holder to subscribe to one share from the dedicated "Conditional Capital 2004 II" and "Conditional Capital III". The stock options have a ten-year term and can only be exercised after a vesting period. The vesting period begins on the issue date and ends, for 50% of the stock options issued, two years after the issue date; for 25% of the stock options issued, the vesting period ends three years, and for the other 25%, four years, after the issue date. Options can only be exercised when the stock price on the exercise date has increased by a cumulative 5% each year since their issue.

Development of the stock options granted:

	<i>No. of stock options</i>	<i>Weighted average exercise price in EUR</i>
Outstanding stock options as of 1 January 2006	891,227	8.00
Granted	11,615	9.55
Expired	-30,926	8.00
Outstanding stock options as of 31 December 2006	871,916	8.02
Granted	94,847	8.00
Expired	-82,506	8.00
Outstanding stock options as of 31 December 2007	<u>884,257</u>	<u>8.02</u>

No stock options were exercised in fiscal year 2007. On 31 December 2007, 424,698 of the outstanding stock options had vested after the expiry of the vesting period. However, the appreciation in value necessary to exercise was not achieved by the balance sheet date. The weighted average remaining term of these stock options was 7.3 years as of the balance sheet date. The exercise prices of the outstanding stock options range from EUR 8.00 to EUR 9.55.

The stock options were accounted for in accordance with IFRS 2, "Share-Based Payment". The fair value of the stock options on the date of issue was calculated using the Black/Scholes option pricing model and is being recognised in profit or loss as personnel expenses over the vesting period of two to four years. The fair value of the stock options issued in fiscal year 2007 was calculated on the basis of an exercise price of EUR 8.00 per option and a stock price of EUR 8.00 on the issue date. The term of the options until exercise was assumed to be three to five years and a risk-free interest rate of 4.2% was used. The anticipated volatility was assumed to be 47.77%. Dividends were not taken into account. Furthermore, annual employee turnover was presumed to be 6.5%. On the basis of these parameters and assumptions, the fair values for the stock options issued in 2007 vary between EUR 2.87 and EUR 3.52, depending on the underlying term. In fiscal year 2007, personnel expenses of EUR 705k (prior year: EUR 1,115k) were recognised for the stock options issued, while, at the same time, the capital reserve was increased accordingly.

### *Employee Participation Plan 2006*

The management board of PAION AG, with the consent of the supervisory board, launched an employee participation plan granting stock appreciation rights. Under this Employee Participation Plan 2006, 252,000 stock appreciation rights from the total 560,000 can be issued to management board members, while the other 308,000 stock appreciation rights can be issued to employees of the PAION Group. A stock appreciation right entitles the holder to receive a sum of money based on the PAION AG share price. The maximum amount payable on a stock appreciation right is limited to 100% of the exercise price. The stock appreciation rights have a ten-year term and can only be exercised after a vesting period of two years. Stock appreciation rights can only be exercised when the stock price on the exercise date has increased by a cumulative 5% each year since their issue.

Development of the stock appreciation rights granted:

	<i>No. of stock appreciation rights</i>	<i>Weighted average exercise price in EUR</i>
Stock appreciation rights outstanding on 1 January 2006	0	0.00
Granted	209,150	7.89
Expired	0	0.00
Stock appreciation rights outstanding on 31 December 2006	209,150	7.89
Granted	0	0.00
Expired	-51,400	7.89
Stock appreciation rights outstanding on 31 December 2007	<u>157,750</u>	<u>7.89</u>

Due to the current vesting period, of the stock appreciation rights granted could be exercised as of 31 December 2007. The weighted average remaining term of these stock appreciation rights was nine years as of the balance sheet date. The exercise price of the outstanding stock appreciation rights is EUR 7.89.

The obligations from these stock appreciation rights are measured at fair value as of the balance sheet date in accordance with the provisions of IFRS 2 "*Share-Based Payment*". The fair value was calculated using the Black/Scholes option pricing model. An exercise price of EUR 7.89, a stock price of EUR 1.97 as of the balance sheet date, a term of the stock appreciation rights of three years beginning at the grant date, a risk-free interest rate of 4.3%, and an annual employee turnover of 10% were used for the calculation. Dividends were not taken into account. Given the historical volatility of the shares in PAION AG, the anticipated volatility was assumed to be 93.9%. In order to account for the necessary cumulative increase in stock price and the value limits, separate option values were set for these parameters which were combined with the value of the actual exercise options. On the basis of these parameters and assumptions, the fair value of the stock appreciation rights granted was EUR 0.20 as of 31 December 2007. The payment obligations from this employee participation plan led to personnel expenses of EUR 7k (prior year: EUR 6k) in fiscal year 2007. A corresponding provision of EUR 13k (prior year: EUR 6k) was recognised.

### *Other Financial Obligations/Contingent Liabilities*

PAION has rented office and research premises, as well as motor vehicles and some of its factory and office equipment. The lease agreements for office and research premises provide for an automatic extension of the relevant agreement provided that it is not terminated within a particular time period before the expiry of the agreement. The future minimum lease obligations under these lease agreements are as follows:

	31 December 2007 EUR k	31 December 2006 EUR k
2008	403	350
2009	311	307
2010	298	297
2011	171	171
Total	<u>1,183</u>	<u>1,125</u>

The rental and lease expenses under these agreements came to EUR 499k in fiscal year 2007 (prior year: EUR 456k).

In addition, PAION is obligated to make payments under various license and purchase agreements pursuant to which PAION acquired the rights to certain patents. Upon the occurrence of certain events, PAION will be required to make milestone payments in an aggregate amount of up to approximately EUR 16m (which is partially payable in USD) to the contracting partners with respect to licenses for Desmoteplase, Enecadin and Solulin. PAION also agreed to pay royalties based on future net sales of Desmoteplase, Solulin and Enecadin.

#### *Employees and Personnel Expenses*

In fiscal year 2007, PAION employed an average of 75 people (prior year: 77). Of these 75 employees, 55 worked in research and development and 20 in administration and sales. Due to the negative results of the DIAS-2 study, PAION adapted its personnel structure mid-2007. As of 31 December 2007, the number of employees fell to 53 (prior year: 81).

The following personnel expenses were incurred in fiscal years 2007 and 2006:

	2007 in EUR k	2006
Salaries	6,402	6,364
Social security	714	761
	<u>7,116</u>	<u>7,125</u>

The above personnel expenses include costs of granting options under the stock option plan and the participation plan of EUR 712k (prior year: EUR 1,121k).

#### *Related Parties*

Transactions with related parties must be disclosed pursuant to IAS 24, "Related Parties". The management and supervisory boards as well as shareholders qualify as related parties within the meaning of IAS 24.9. With regard to the remuneration of the members of the management and supervisory boards, reference is made to the statements under "Members of the Management Board," and "Members of the Supervisory Board" in this section.

Apart from the above, there are no significant related parties.

#### *Financial Risk Management Objectives and Policies*

The objective of PAION's business activities is currently the production development and clinical development of various substances. No revenues have yet been generated from product sales, with high expenses being incurred as forecast. PAION aims to advance the substances through the clinical development and regulatory approval process and secure the short and medium-term funding for these activities. Funding is chiefly secured by means of equity and development cooperations in the course of which the cooperation partners make milestone payments and bear development expenses directly or indirectly. The ability to raise further equity or receive milestone payments from cooperation partners depends largely on the positive progress in the clinical development of each substance. The Group's capital structure is of minor significance. PAION's management has therefore set its focus on managing and monitoring the individual development projects, liquidity and future liquidity needs.

Financial liabilities comprise a subordinated loan, finance leases and trade payables. In addition, PAION has various financial assets such as trade receivables as well as bank balances and short-term deposits. Financial assets and liabilities relate directly to PAION's business activities or financing of current operations.

PAION has not used derivative financial instruments either in the reporting or in the prior fiscal year.

PAION is exposed to the following risks arising from financial instruments:

PAION is not currently exposed to any notable *foreign currency risk*. Development expenses are charged on and financial investments made in euros. The trade payables which are denominated in a foreign currency are of secondary importance.

All of the trade receivables result from development expenses charged on to Forest and Lundbeck. In spite of this concentration, PAION considers the *credit risk* to be low in view of the credit standing of its two cooperation partners. Bank balances and short-term deposits are held at two major German banks and a saving bank. Various credit protection criteria are applied in selecting short-term investments (e.g. rating, capital guarantee, protection by the Deposit Protection Fund). Given the selection criteria applied and the ongoing monitoring of its investments, PAION does not believe that these activities involve a credit risk. The amounts shown in the balance sheet are the maximum credit risk.

Liquidity is monitored and managed using an enterprise planning tool for short, medium and long-term planning which has been customised for PAION. *Liquidity risks* are identified at an early stage by simulating various scenarios and using sensitivity analyses. Current liquidity is recorded and monitored on a daily basis.

The interest accruing on the bank balances and short-term deposits depend on the development of the market rates. PAION is therefore exposed to an interest rate risk in regard to these items. A 50 basis point reduction in the interest rates in fiscal year 2007 would therefore have resulted in a EUR 250k (prior year: EUR 289k) decrease in the consolidated result. The fixed interest subordinated loan is only subject to an interest rate risk in the event of a sustained ratings deterioration. In such case, the interest rate could rise by 50 basis points to 8.433%. This risk could materialise in fiscal year 2008 at the earliest.

### *Financial Instruments*

The following table shows the carrying amount and fair value of financial instruments disclosed in the consolidated financial statements.

		Net carrying amount		Fair value	
		31 December 2007	31 December 2006	31 December 2007	31 December 2006
<i>in EUR k</i>					
<i>Financial assets:</i>					
Cash and cash equivalents	(1)	42,901	57,189	42,901	57,189
Trade receivables	(1)	777	2,291	777	2,291
Other assets	(1)	353	487	353	487
<i>Financial liabilities:</i>					
Fixed interest subordinated loan	(2)	6,657	6,741	6,893	7,022
Liabilities from finance leases	(3)	133	207	133	208
Trade payables	(2)	2,295	4,509	2,295	4,509
Other liabilities	(2)	199	172	199	172

Measurement category according to IAS 39:

(1) Loans and receivables.

(2) Liabilities recognised at amortised cost

(3) Measurement according to IAS 17



Cash and cash equivalents, trade receivables, other assets, trade payables and other liabilities are all short-term. Thus, the carrying amounts as of the balance sheet date correspond with the fair value. The fair value for the fixed interest subordinated loan was measured at the present value using the term structure of interest rates applicable on the balance sheet date for payments in connection with this liability.

#### *Members of the Management Board*

The members of the management board are:

- Dr Wolfgang Söhngen, CEO, Chairman
- Alexander Vos, COO, Deputy Chairman
- Dr Mariola Söhngen, CMO
- Bernhard Hofer, CFO

In fiscal year 2007, the total remuneration paid to management board members was EUR 1,088,004. As of 31 December 2007, a total of 496,300 stock options (fair value on the date of issue: EUR 1,764,347) and 100,000 stock appreciation rights (fair value as of 31 December 2007: EUR 20,000) had been issued to management board members. For further information on the remuneration of the management board, please see our explanations under “Compensation Report” in the group management report.

The Company’s management board members are also the general managers of PAION Deutschland GmbH and work full time for the Company and for PAION Deutschland GmbH.

As of 31 December 2007, Dr Mariola Söhngen held 645,543 shares and Dr Wolfgang Söhngen 579,241 shares in PAION AG. The amounts disclosed each contain a portion consisting of 6,197 shares of PAION AG held by Dres. Söhngen Beteiligungs GmbH & Co. KG; in which Dr Mariola Söhngen and Dr Wolfgang Söhngen have interests as general partner and limited partner respectively, each with a 50% share.

As of 31 December 2007, of the other members of the management board held shares in PAION AG.

#### *Members of the Supervisory Board*

- Dr Walter Wenninger, Leverkusen, Germany, chairman, businessman

Other supervisory board or similar positions:

- Axiogenesis AG, Cologne, Germany
- EPIDAUROS Biotechnologie AG, Bernried, Germany
- NOXXON Pharma AG, Berlin, Germany, chairman of the supervisory board
- Santaris Pharma A/S, Horsholm, Denmark
- Prof. Dr Erich Schlick, Otterstadt, Germany, deputy chairman (since 20 June 2007); partner at Wellington Partners Venture Capital GmbH, Munich, Germany

Other supervisory board or similar positions:

- BMDSys GmbH, Jena, Germany
- -Immatics GmbH, Tübingen, Germany
- Sensimed AG, Lausanne, Switzerland, chairman of the supervisory board
- Administrative board member of the Central Institute for Mental Health, Mannheim, Germany



- Dr Jörg Spiekerkötter, Kleinmachnow, Germany; CFO of Conergy AG, Hamburg, Germany  
(Member of the supervisory board since 20 June 2007)
  - Dr Franz Wirtz, Stolberg, Germany, deputy chairman, businessman  
(Resigned on 20 June 2007)
- Other supervisory board or similar positions:
- DASGIP AG, Jülich, Germany
  - QIAGEN N.V., Venlo, Netherlands

The members of the supervisory board received remuneration of EUR 108,000 for fiscal year 2007. For further information on the remuneration of the supervisory board, please see our explanations under “Compensation Report” in the group management report.

As of 31 December 2007, of the members of the supervisory board held shares in PAION AG.

#### *Auditors*

At the annual general meeting on 20 June 2007, Ernst & Young AG, Wirtschaftsprüfungsgesellschaft Steuerberatungsgesellschaft, Cologne, Germany, was appointed as auditor for the individual and consolidated financial statements for fiscal year 2007. The auditor received or will invoice the following fees for services rendered to PAION AG and its subsidiary PAION Deutschland GmbH in fiscal year 2007 and the prior year:

	2007	2006
	<i>in EUR k</i>	
Audit	52	56
Tax advisory	2	8
Other services	20	21
	74	85
	74	85

Other services mainly relate to fees for the review of the quarterly financial statements.

#### *Corporate Governance*

The supervisory board and management board of PAION AG declare that they are committed to responsible and transparent management and control focused on long-term added value.

The Company complies, for the most part, with the recommendations set forth in the most recent version of the German Corporate Governance Code dated 14 June 2007. On 16 November 2007, the supervisory board and the management board issued the declaration of compliance with the Corporate Governance Code pursuant to Sec. 161 AktG [“Aktengesetz”: German Stock Corporation Act]. This declaration of compliance is published on PAION AG’s website ([www.paion.de](http://www.paion.de)).

#### *Events Occurring After the Balance Sheet Date*

By notice dated 29 January 2008, PAION’s cooperation partner Lundbeck announced that the licence agreement concluded on 21 December 2007 had taken effect as of that date after the patent review had been completed.

## PART V

### Consolidated Financial Statements as of 31 December 2006

#### Consolidated Balance Sheet as of 31 December 2006

##### Assets

	<i>Note</i>	<i>December 31, 2006</i>	<i>December 31, 2005</i>
<i>in EUR</i>			
<b>Non-current assets</b>			
Intangible assets	1.	524,246.44	514,203.61
Equipment	2.	1,163,871.92	1,094,323.22
Long-term refund claims resulting from the assumption of development expenses	3.	8,010,826.74	3,673,741.35
		9,698,945.10	5,282,268.18
<b>Current assets</b>			
Trade receivables	4.	2,290,567.20	1,413,196.92
Prepaid expenses and other assets	5.	871,707.98	11,086,605.12
Cash and cash equivalents	6.	57,188,779.78	48,370,539.85
		60,351,054.96	60,870,341.89
<b>Total assets</b>		70,050,000.06	66,152,610.07

##### Equity and liabilities

	<i>Note</i>	<i>December 31, 2006</i>	<i>December 31, 2005</i>
<i>in EUR</i>			
<b>Equity</b>			
Share capital	7.	16,755,552.00	15,755,552.00
Capital reserve		85,032,116.76	75,925,289.91
Loss carryforward		-38,930,499.47	-34,174,373.72
Loss for the period		-17,386,054.88	-4,756,125.75
		45,471,114.41	52,750,342.44
<b>Non-current liabilities</b>			
Provisions	8.	10,616,825.08	4,865,892.62
Financial liabilities	9.	6,741,483.43	0.00
Finance lease liabilities	10.	133,320.00	207,485.00
Deferred income	11.	1,720,630.08	1,745,063.28
		19,212,258.59	6,818,440.90
<b>Current liabilities</b>			
Trade payables		4,508,927.03	4,408,391.84
Provisions	8.	442,446.78	308,129.75
Current portion of finance lease liabilities	10.	74,163.00	73,847.00
Other current liabilities	12.	316,657.05	1,769,024.94
Current portion of deferred income	11.	24,433.20	24,433.20
		5,366,627.06	6,583,826.73
<b>Total equity and liabilities</b>		70,050,000.06	66,152,610.07

## Consolidated Income Statement for the Fiscal Year 2006

	Note	2006 in EUR	2005
Revenues	13.	10,458,951.94	18,796,037.36
Cost of revenues		<u>-7,251,732.37</u>	<u>-4,854,886.56</u>
Gross profit		<u>3,207,219.57</u>	<u>13,941,150.80</u>
Research and development expenses		-16,486,558.17	-13,627,205.01
General and administrative expenses		-4,563,448.72	-4,852,194.84
Selling and marketing expenses		-1,088,225.45	-1,370,255.82
Other income (expenses), net	14.	<u>149,199.08</u>	<u>93,910.65</u>
Operating expenses		<u>-21,989,033.26</u>	<u>-19,755,745.02</u>
Operating result		<u>-18,781,813.69</u>	<u>-5,814,594.22</u>
Financial income		2,042,188.53	1,073,935.29
Financial expenses		<u>-646,429.72</u>	<u>-15,466.82</u>
Financial result		<u>1,395,758.81</u>	<u>1,058,468.47</u>
Loss for the period before taxes		<u>-17,386,054.88</u>	<u>-4,756,125.75</u>
Income taxes	15.	<u>0.00</u>	<u>0.00</u>
Loss for the period		<u><u>-17,386,054.88</u></u>	<u><u>-4,756,125.75</u></u>
Earnings per share (basic)	16.	-1.06	-0.31
Earnings per share (diluted)	16.	-1.06	-0.31

## Consolidated Cash Flow Statement for the Fiscal Year 2006

	2006 EUR	2005 EUR
Cash flows from operating activities:		
Profit/loss for the period	-17,386,054.88	-4,756,125.75
Reconciliation of loss for the period to cash flows from operating activities:		
Amortization/depreciation	364,245.40	410,678.20
Loss/profit from the disposal of non-current assets	8,419.74	212.00
Interest expenses and interest income	-1,395,758.81	-1,058,468.47
Release of investment grants	-24,433.20	-24,443.20
Release of deferred income	0.00	-89,372.57
Expenses from stock option plans	1,115,100.16	843,359.40
Change in assets and liabilities which are not attributable to investing or financing activities:		
Long-term refund claims resulting from the assumption of development costs	-4,525,846.10	-3,673,741.35
Trade receivables	-877,370.28	-963,228.74
Prepaid expenses and other assets	402,141.68	-302,950.65
Trade payables	100,535.19	1,551,055.46
Provisions	6,132,270.15	3,649,031.38
Other current liabilities	-259,874.57	-307,468.42
	<u>-16,346,625.52</u>	<u>-4,721,462.71</u>
Interest received	1,604,929.79	976,762.22
Net cash used in/from operating activities	<u>-14,741,695.73</u>	<u>-3,744,700.49</u>
Cash flows from investing activities:		
Cash paid for investments in intangible assets and equipment	-452,773.91	-447,811.26
Cash received from the sale of intangible assets and equipment	517.24	1,373,402.49
Net cash used in/from investing activities	<u>-452,256.67</u>	<u>925,591.23</u>
Cash flows from financing activities:		
Capital increase	1,000,000.00	5,750,000.00
Contributions to the capital reserve	8,440,000.00	40,250,000.00
Payments in connection with the raising of capital	-448,273.31	-4,648,864.78
Borrowing	6,720,000.00	0.00
Capital repayment due to the settlement of options	-1,192,493.32	-966,778.70
Interest paid	-423,499.04	0.00
Payment of finance lease liabilities	-83,542.00	-83,538.00
Net cash from financing activities	<u>14,012,192.33</u>	<u>40,300,818.52</u>
Change in cash and cash equivalents	-1,181,760.07	37,481,709.26
Cash and cash equivalents at beginning of the period	58,370,539.85	20,888,829.59
Cash and cash equivalents at end of the period	<u>57,188,779.78</u>	<u>58,370,538.85</u>
<i>Composition of cash and cash equivalents at the end of the period:</i>		
Cash	57,188,779.78	48,370,539.85
Loan against promissory note	0.00	10,000,000.00
	<u>57,188,779.78</u>	<u>58,370,539.85</u>

## Consolidated Statement of Changes in Equity for the Fiscal Year 2006

	<i>Share capital EUR</i>	<i>Capital reserve EUR</i>	<i>Loss carryforward EUR</i>	<i>Equity EUR</i>
December 31, 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	843,359.40	0.00	843,359.40
Loss for the period	0.00	0.00	-4,756,125.75	-4,756,125.75
December 31, 2005	<u>15,755,552.00</u>	<u>75,925,289.91</u>	<u>-38,930,499.47</u>	<u>52,750,342.44</u>
Issue of shares	1,000,000.00	0.00	0.00	1,000,000.00
Contribution to the capital reserve	0.00	8,440,000.00	0.00	8,440,000.00
Cost of raising capital	0.00	-448,273.31	0.00	-448,273.31
Additional contribution to the capital reserve due to the issue of options	0.00	1,115,100.16	0.00	1,115,100.16
Loss for the period	0.00	0.00	-17,386,054.88	-17,386,054.88
December 31, 2006	<u><u>16,755,552.00</u></u>	<u><u>85,032,116.76</u></u>	<u><u>-56,316,554.35</u></u>	<u><u>45,471,114.41</u></u>

## Notes to the Consolidated Financial Statements for Fiscal Year 2006

### A. General Information

The PAION consolidated financial statements comprise PAION AG as parent company registered at Martinstrasse 10-12, 52062 Aachen, Germany, and the wholly-owned subsidiary PAION Deutschland GmbH, Aachen, Germany, which is fully consolidated.

PAION AG acts as a holding company and renders various services for PAION Deutschland GmbH. PAION Deutschland GmbH, a bio-pharmaceutical company founded in 2000, aims to become a leading player in the development and marketing of innovative drugs for the treatment of stroke and other thrombotic diseases for which there is substantial unmet medical need.

PAION AG stock has been traded on the Official Market of the Frankfurt Stock Exchange in the Prime Standard segment with extensive reporting obligations since February 2005.

The consolidated financial statements as of December 31, 2006 and the group management report for fiscal year 2006 are due to be approved for publication at the supervisory board meeting on March 16, 2007.

### B. Basis of Accounting

The consolidated financial statements have been prepared in accordance with Sec. 315a (1) HGB [“Handelsgesetzbuch”: German Commercial Code] and International Financial Reporting Standards (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 December 31, 2006 and applied by PAION, were adopted by the European Commission for application in the EU. In accordance with IFRS 1, assets and liabilities have been recognised and measured pursuant to the IFRSs which were mandatory as of December 31, 2006.

The following standards and interpretations which have already been issued will be applied as soon as they become effective, provided they are adopted by the European Commission:

- IFRS 7: In August 2005, the IASB published IFRS 7, “*Financial Instruments — Disclosures*”, which redefines the disclosure requirements for financial instruments. IFRS 7 must be applied for reporting periods beginning on or after January 1, 2007 and supersedes the disclosure requirements of IAS 32, “*Financial Instruments — Disclosure and Presentation*”.
- IAS 1: In August 2005, the IASB issued an amendment to IAS 1, “*Presentation of Financial Statements*”. The amendment sets out the disclosure requirements in relation to objectives, policies and processes for managing capital. The requirements are mandatory for reporting periods beginning on or after January 1, 2007.
- IFRS 8: In November 2006, the IASB published IFRS 8, “*Operating Segments*”. This standard supersedes IAS 14, “*Segment Reporting*”, and brings the IASB’s standards into line with the US GAAP provisions of SFAS 131. In general, financial information must be reported on the basis of the internal reporting format used in assessing the operating segments (management approach). Adoption of IFRS 8 is mandatory for reporting periods beginning on or after January 1, 2009.
- 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 mandatory for reporting periods beginning on or after March 1, 2007.

- IFRIC 12: In December 2006, the IFRIC published IFRIC 12, “*Service Concession Arrangements*”. IFRIC 12 clarifies application of existing IFRSs by public service concession operators with regard to the obligations and related rights in the service concession arrangements. Adoption of IFRIC 12 is mandatory for fiscal years beginning on or after January 1, 2008.

Application of these new or revised standards and interpretations will in some cases lead to additional disclosures in the next consolidated financial statements. Application of these standards and interpretations is not expected to have a material effect on PAION's financial position and financial performance.

The consolidated financial statements were prepared in euros.

The income statement was prepared using the function of expense method. Research and development expenses are disclosed separately in the income statement due to their significance.

Under IAS 1, “*Presentation of Financial Statements*”, non-current and current assets and non-current and current liabilities must be presented as separate classifications on the face of the balance sheet. Assets, liabilities and provisions due within one year are classified as current.

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

The preparation of consolidated 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 these estimates.

The consolidation principles and accounting policies used in the prior year have been retained, making allowances for the new or changed standards and interpretations. Application of the new or amended standards and interpretations did not have any repercussions.

### **C. Consolidation Policies**

The consolidated financial statements comprise PAION AG and its subsidiary PAION Deutschland GmbH. The financial statements of the two entities included in the consolidated financial statements are drawn up on the basis of uniform accounting policies. Receivables and liabilities, income and expenses, and profits resulting from group transactions are eliminated.

### **D. Accounting Policies**

#### *Intangible Assets*

Purchased intangible assets are measured at cost. Amortisation of intangible assets is calculated by applying the straight-line method over the useful life of the assets. The useful life of software is determined to be three years, while research and marketing rights for compounds are amortised over the term of the respective patent.

#### *Equipment*

Equipment is measured at cost less accumulated depreciation. Depreciation is calculated by applying the straight-line method over the estimated useful life of the assets, which normally ranges between three and twenty years. The Company reviews assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset to the higher of its fair value less cost to sell and its value in use. If such assets are considered to be impaired, the impairment loss recognised is the amount by which the carrying amount of the assets exceeds the higher of fair value less cost to sell or value in use. If the reasons for impairment no longer exist, the assets are written up.



Leased equipment which satisfies certain criteria under IAS 17, "Leases", is recognised as an asset, while the present value of lease payments is recognised as a liability. Depreciation is charged straight-line on leased assets over the term of the lease.

#### *Long-Term Refund Claims Resulting From the Assumption of Development Expenses*

Long-term refund claims from the assumption of development expenses from Lundbeck are recognised at present value applying an interest rate of 3.8% (prior year: 2.9%). Due to the direct connection with the repayment obligation to Forest disclosed as a provision, these claims are recognised in accordance with IAS 37.53, "Provisions, Contingent Liabilities and Contingent Assets".

#### *Receivables and Other Assets*

Trade receivables and other assets are disclosed at amortised cost. The loan against promissory note carried under other assets in the prior year was classified as a held-to-maturity financial instrument and also recognised at amortised cost. Receivables denominated in foreign currency are translated at the closing rate. Exchange gains and losses are recognised in profit or loss.

#### *Cash and Cash Equivalents*

Cash and cash equivalents include cash on hand and bank balances with a residual term of up to three months. They are measured at amortised cost.

#### *Equity*

The costs directly associated with issuing equity are not expensed but directly deducted from equity.

#### *Provisions*

Provisions are recognised when a present obligation (legal or constructive) exists as a result of a past event and when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions with a maturity of more than one year are recognised at present value.

#### *Financial Liabilities*

Financial liabilities are measured at amortised cost using the effective interest method.

#### *Trade Payables/Other Liabilities*

Trade payables and other liabilities are carried at the amount repayable. Liabilities denominated in foreign currency are translated at the closing rate. Exchange gains and losses are recognised in profit or loss.

#### *Deferred Income*

Investment grants in connection with the acquisition of assets are recognised as deferred income in the balance sheet. The deferred investment grants are released in line with the depreciation/amortisation of the underlying assets. The amounts released are deducted from research and development expenses.

Non-repayable signing fees received in connection with outlicensing agreements are disclosed as deferred income and recognised in profit or loss as the respective milestones are achieved.

#### *Revenues*

Revenues for the fiscal year are recognised when realised. Revenues are recognised when the owed service has been rendered, and the risks of ownership have been transferred and the amount of expected consideration can be measured reliably. Payments related to the sale or outlicensing of compounds or technological know\*\*softhyph\*\*how are recognised in profit or loss when the services to be rendered on the basis of contractual regulations have been met in full.

### *Cost of Revenues*

The consideration paid by PAION for development and marketing rights is recognised as cost of revenues, when and to the extent that revenues are simultaneously generated through the outlicensing. The cost of revenues also contains allocated development costs.

### *Research and Development Expenses*

Research expenses are expensed as incurred. Development expenses are recognised as an asset in accordance with IAS 38, “*Intangible Assets*”, depending on the possible outcome of the development activities and whether or not all of the criteria for recognition are met. These criteria are not currently met, such that development expenses are expensed as incurred.

### *Public Subsidies*

Subsidies that directly relate to expenses incurred in connection with research and development activities are recognised as a reduction of research and development expenses. In fiscal year 2006, no public subsidies were netted with research and development expenses (prior year: EUR 1.9m).

### *Interest Income/Expenses*

Interest income and expenses are recognised in the period in which generated or incurred. Any necessary deferrals are calculated using the effective interest method.

### *Income Taxes/Deferred Taxes*

Deferred taxes are recognised according to IAS 12, “*Income Taxes*”. Deferred taxes are recognised by applying enacted statutory tax rates applicable to future years to temporary differences between the IFRS carrying amounts and the tax bases of existing assets and liabilities. In addition, deferred tax assets are recognised on tax loss carryforwards. The effect of a change in the enacted tax rates on deferred taxes is recorded in the period in which the change in enacted. No deferred tax assets are recognised, if it is probable that some portion or all of the deferred tax assets may not be recoverable.

### *Share-Based Payment Transactions*

Stock options are measured at fair value on the date on which they are granted. The fair value of the obligation is recognised as a personnel expense and as a simultaneous increase in equity over the vesting period. Obligations from stock appreciation rights are recognised as a provision and are measured at fair value on the balance sheet date. Expenses are recognised as personnel expenses over the vesting period. The fair value is determined on the basis of internationally accepted valuation methods both for stock options and stock appreciation rights.

## **E. Outlicensing Agreements**

### 1. *License Agreement With Forest Laboratories Ireland Limited, Clonshaugh, Ireland*

On June 30, 2004, PAION Deutschland GmbH concluded a license agreement with Forest Laboratories Ireland Limited, Clonshaugh, Ireland (hereinafter referred to as “Forest”), a subsidiary of Forest Laboratories, Inc., New York City, NY, USA. The agreement grants Forest an exclusive license with respect to Desmoteplase for the US and Canadian markets. The agreement assumes that the United States and Canada on the one hand, and Europe and Japan on the other, each represent 50% of the global market for Desmoteplase. In return, Forest agreed to make upfront payments and milestone payments totalling USD 62m to PAION, USD 22m of which was paid in 2004, and to initially assume the expenses for the joint clinical development of Desmoteplase for the treatment of stroke. If PAION obtains regulatory approval for Desmoteplase in Europe and/or Japan, it will repay up to 50% (35% attributable to the European market and 15% to Japan) of the costs borne directly or indirectly by Forest plus a premium of 20% as well as interest on the costs to be refunded. PAION has the right to offset this repayment obligation to Forest against future royalty payments from Forest to PAION.

If the FDA grants regulatory approval for the marketing of Desmoteplase, Forest will be required to use all commercially reasonable efforts to market the drug in the United States and Canada. PAION will receive royalties based on its net revenues from Desmoteplase in the US and Canadian markets. Net royalties, i.e. less the royalties which PAION has to pay to Schering, the original licensor, will be a double-digit percentage.

Until approval of Desmoteplase for the indication stroke is granted in the US, Forest will be required to make milestone payments totalling USD 40m in the future when contractually defined events occur.

## 2. *License Agreement With H. Lundbeck A/S, Valby-Copenhagen, Denmark*

On July 11, 2005, PAION Deutschland GmbH concluded a license agreement for the further development and marketing of Desmoteplase with Lundbeck. This agreement grants Lundbeck an exclusive license to develop and market Desmoteplase for the European and Japanese market, as well as for all other countries except for the United States and Canada, for which Forest had already been granted a license. PAION has co-promotion options to market the drug in major European countries. Under this agreement, Lundbeck has agreed to make the following payments:

- Assumption of part of the past and future development expenses, including the obligations to repay development expenses borne directly and indirectly by Forest in the event of regulatory approval for Desmoteplase in Europe and/or Japan
- One-time payment for access to PAION's know-how
- Milestone payments until regulatory approval
- Payment of revenue-based royalties or profit shares

Upon signing the agreement, Lundbeck made a one-time, non-refundable payment of EUR 15m for access to PAION's know-how. The milestone payments will fall due in the course of the further development of Desmoteplase in the indication ischemic stroke and amount to up to EUR 50m. The total amount of the milestone payments to be made by Lundbeck will be reduced depending on the number of countries for which PAION exercises its co-promotion options.

In those countries in which Lundbeck has exclusive market access, PAION will receive revenue-based royalties of a double-digit percentage (after deduction of the royalties which PAION has to pay to the original licensor, Schering Aktiengesellschaft, Berlin).

In countries in which PAION can share marketing of the drug, PAION will receive a 50% share of profits if it exercises its option. In this case PAION must assume half of the repayment obligation to Forest attributable to these countries, which will simultaneously result in a corresponding reduction of the refund claims against Lundbeck from the assumption of development expenses. PAION must decide whether or not to exercise its option by the close of clinical development.

## 3. *Accounting for Expenses Incurred in Connection With the Development of Desmoteplase*

Owing to the cooperation agreements concluded with Forest and Lundbeck, the development of Desmoteplase is now performed and financed jointly by three companies. PAION and its partners share differently in the individual development stages and the respective financing. The accounting treatment for PAION's claims and obligations resulting from the agreements is set out below.

The development expenses incurred directly by PAION and to be reimbursed by Forest are recorded as revenue. PAION recognises a provision for the obligation to repay development expenses reimbursed by Forest, which would arise in the event of regulatory approval, by reducing revenues by 50% of the reimbursed expenses. Accordingly, revenues in any given period effectively include only approximately 50% of the Desmoteplase-related development expenses billed to Forest. 50% of the development expenses billed to Forest are accounted for as cost of revenues.

A provision is also recognised for the potential obligation to repay the development expenses incurred directly by Forest in the amount of the present value of 50% of the expenses incurred directly by Forest. This provision increases accordingly the research and development expenses disclosed by PAION. The 20% premium on the repayment obligation is accounted for by recognising a provision in that amount and an increase in research and development expenses.

The following two cost categories are used in accounting for the claims against Lundbeck resulting from the assumption of development expenses:

1. Development expenses incurred directly by PAION but not charged on to Forest and to be reimbursed by Lundbeck.
2. Development expenses resulting from the repayment obligation to Forest:
  - (a) Development expenses incurred directly by PAION and charged on to Forest;
  - (b) Development expenses incurred directly by Forest.

The refund claims against Lundbeck resulting from *cost category 1* are recorded as revenues, whereas the corresponding development expenses are recognised as cost of revenues. The expenses are mainly current production development expenses.

These claims against Lundbeck, which are due immediately, are recognised as trade receivables.

The refund claims against Lundbeck resulting from *cost category 2a* are recorded as revenues, whereas the corresponding development expenses are recognised as cost of revenues. PAION's refund claim against Lundbeck resulting from *cost category 2b* is recognised in profit or loss by being netted with the corresponding development expenses. The 20% premium payable to Forest on cost categories 2a and 2b is also refunded by Lundbeck. This claim is recognised in profit or loss by being netted with the corresponding development expenses.

The amount of the refund claims against Lundbeck resulting from cost categories 2a and 2b depends on the extent to which PAION exercises its co-promotion options. The current accounting treatment is based on the assumption that PAION will exercise all options; hence, the lowest possible refund claim against Lundbeck is recorded. If PAION decides not to exercise its co-promotion options, the refund claim against Lundbeck will be equal to the aggregate repayment obligation to Forest.

The refund claims against Lundbeck resulting from cost categories 2a and 2b will not be due until Desmoteplase receives regulatory approval in Europe and/or Japan. As they are due in more than one year, the refund claims are carried in the balance sheet as a non-current asset at their present value. In the consolidated cash flow statement, changes in these long-term refund claims are, because of their operating nature, classified as a cash flow from operating activities. Hence, they are stated in the same way as the changes in the long-term repayment obligation to Forest, which is also presented in the cash flows from operating activities.

With respect to the impact of these two license agreements with Forest on the consolidated financial statements, reference is made to the additional disclosures on the respective balance sheet and income statement captions. As of December 31, 2006, the long-term refund claims from the assumption of development expenses against Lundbeck amounted to EUR 8.0m (prior year: EUR 3.7m) and the repayment obligation to Forest to EUR 10.6m (prior year: EUR 4.9m).

In August 2006, PAION and Lundbeck concluded an agreement on a second Phase III study on Desmoteplase. As part of this agreement, PAION agreed to assume a significant portion of the funding of this study. Subject to certain conditions, costs borne by PAION may in future be reimbursed fully or in part by Lundbeck and/or Forest. These potential refund claims represent contingent assets which may not be recognised in the balance sheet according to IAS 37.31, "Provisions, Contingent Liabilities and Contingent Assets".

## F. Notes to the Consolidated Balance Sheet

### (1) Intangible Assets

Intangible assets break down as follows:

	<i>Industrial property rights and similar rights and assets in EUR</i>
<b>Acquisition cost</b>	
January 1, 2005	2,275,593.44
Additions	93,384.56
Disposals	1,538,423.00
December 31, 2005	<u>830,555.00</u>
Additions	84,749.82
Disposals	61,642.05
December 31, 2006	<u><u>853,662.77</u></u>
<b>Accumulated amortisation</b>	
January 1, 2005	336,124.40
Additions	146,447.50
Disposals	166,220.51
December 31, 2005	<u>316,351.39</u>
Additions	74,703.50
Disposals	61,638.56
December 31, 2006	<u><u>329,416.33</u></u>
Carrying amounts as of December 31, 2005	<u><u>514,203.61</u></u>
Carrying amounts as of December 31, 2006	<u><u>524,246.44</u></u>

The additions in fiscal year 2006 relate mainly to software licenses acquired for a consideration. In the prior year, the capitalised global development and marketing rights for Desmoteplase were reduced proportionately to account for the outlicensing to Lundbeck and, net of accumulated amortisation, were recorded as an expense (EUR 1.4m). As of December 31, 2006, intangible assets mainly comprised the remaining share of the development and marketing rights for Desmoteplase of EUR 0.4m.

## (2) Equipment

Equipment developed as follows:

	<i>Plant and machinery</i>	<i>Other equipment, factory and office equipment</i>	<i>Payments on account and assets under construction in EUR</i>	<i>Total</i>
Acquisition cost				
January 1, 2005	660,198.72	1,471,015.84	0.00	2,131,214.56
Additions	142,525.86	142,612.06	69,287.79	354,425.71
Disposals	0.00	97,747.07	0.00	97,747.07
December 31, 2005	802,724.58	1,515,880.83	69,287.79	2,387,893.20
Additions	110,908.27	170,858.16	86,257.66	368,024.09
Disposals	157,007.28	88,161.32	0.00	245,168.60
Reclassification	0.00	94,845.45	-94,845.45	0.00
December 31, 2006	756,625.57	1,693,423.12	60,700.00	2,510,748.69
<b>Accumulated depreciation</b>				
January 1, 2005	272,147.68	853,527.66	0.00	1,125,675.34
Additions	94,171.00	170,059.70	0.00	264,230.70
Disposals	0.00	96,336.06	0.00	96,336.06
December 31, 2005	366,318.68	927,251.30	0.00	1,293,569.98
Additions	128,509.00	161,032.90	0.00	289,541.90
Disposals	156,987.28	79,247.83	0.00	236,235.11
December 31, 2006	337,840.40	1,009,036.37	0.00	1,346,876.77
Carrying amounts as of				
December 31, 2005	436,405.90	588,629.53	69,287.79	1,094,323.22
Carrying amounts as of				
December 31, 2006	418,785.17	684,386.75	60,700.00	1,163,871.92

The payments on account and assets under construction mainly relate to leasehold improvements.

Equipment includes assets of EUR 198k acquired through finance leases (prior year: EUR 273k); the gross value of these assets as of the balance sheet date came to EUR 393k (prior year: EUR 393k) and mainly relates to a bioprocess system for the production of Desmoteplase.

## (3) Long-Term Refund Claims Resulting From the Assumption of Development Expenses

The long-term refund claims resulting from the assumption of development expenses are against Lundbeck and will be payable when Desmoteplase is given regulatory approval in Europe and/or Japan.

## (4) Trade Receivables

Trade receivables relate to reimbursements for development expenses for Desmoteplase in connection with the license agreements with Forest and Lundbeck.

## (5) Prepaid Expenses and Other Assets

Prepaid expenses and other assets mainly include VAT refund claims of EUR 385k (prior year: EUR 620k), deferred interest claims of EUR 187k (prior year: EUR 97k), prepaid insurance premiums and rental payments of EUR 182k (prior year: EUR 199k) and tax on investment income of EUR 36k (prior year: EUR 132k). The prior-year figure included a loan against promissory note of EUR 10,000k held as a short-term investment and which was redeemed in January 2006.



## (6) *Cash and Cash Equivalents*

The cash and cash equivalents include cash on hand and bank balances with a maturity of up to three months, based on the date of investment.

## (7) *Equity*

### *Capital increase*

On April 5, 2006, the management board of PAION AG, with the consent of the supervisory board, resolved to increase the share capital through the issuance of 1,000,000 new no-par value bearer shares, each with a notional value of EUR 1.00, utilising part of the "Authorised Capital 2004". Share capital thus rose by EUR 1,000,000 from EUR 15,755,552 to EUR 16,755,552. On April 5, 2006, the supervisory board, in accordance with the authorisation granted to it by the shareholder meeting, resolved to amend the articles of incorporation with regard to this capital increase of EUR 1,000,000.00. The new shares were issued in a private placement at a price of EUR 9.44 each to US and European institutional investors, under exclusion of the shareholders' subscription right. PAION generated a cash flow of EUR 9,440,000 from this capital increase. EUR 1,000,000 of this was transferred to subscribed capital and the remainder of EUR 8,440,000 to the capital reserve. The capital increase was entered in the commercial register on April 13, 2006 and the shares were admitted to trading on the Frankfurt Stock Exchange on April 24, 2006.

Costs of EUR 448k were incurred in connection with the capital increase. These costs were offset against the capital reserve. Income taxes were not included in offsetting as there was no direct tax advantage. Reference is made to the statements in Section G. under (15) "Income Taxes/Deferred Taxes".

As of December 31, 2006, the share capital amounted to EUR 16,755,552.00 and is divided into 16,755,552 no-par value shares. The capital reserve amounted to EUR 85,032,117 as of December 31, 2006.

### *Authorised and Conditional Capital*

By virtue of a resolution adopted by the shareholder meeting on May 10, 2006, the management board was authorised to increase share capital on or prior to May 10, 2011, with the consent of the supervisory board, on one or more occasions, by up to an aggregate of EUR 7,850,000.00 through the issuance of up to 7,850,000 new no\*\*softhyph\*\*par value bearer shares in return for cash contributions or contributions in kind (Authorised Capital I). The "Authorised Capital I" is still fully available for issue. In addition, pursuant to a resolution adopted by the shareholder meeting on May 10, 2006, the unused "Authorised Capital 2004" was cancelled.

By virtue of another resolution adopted by the shareholder meeting on May 10, 2006, the management board was authorised to issue on or before May 10, 2011, on one or more occasions bearer and/or registered and/or convertible warrant bonds with a maximum term of 20 years and grant the holders or creditors of bonds conversion rights or options to new shares in PAION AG with a share in share capital of up to an aggregate of EUR 6,300,000.00 (Conditional Capital I). The "Conditional Capital I" has not yet been used up. The shareholder meeting on May 10, 2006 also resolved to cancel "Conditional Capital 2004 I".

Pursuant to a resolution adopted by the shareholder meeting on December 30, 2004, the share capital of PAION AG was conditionally increased by an aggregate amount of up to EUR 1,000,000.00 through the issuance of an aggregate of up to 1,000,000 new no-par value bearer shares (Conditional Capital 2004 II). The conditional capital increase may be executed only to the extent that the holders of options granted by PAION AG in connection with the Stock Option Plan 2005 exercise their options. To service the Stock Option Plan 2005, the shareholder meeting on August 26, 2005 resolved to conditionally increase PAION AG's share capital by up to another EUR 110,000.00 through the issuance of a maximum total of 110,000 new no-par value bearer shares (Conditional Capital III).



#### (8) Provisions

Provisions developed as follows:

	December 31, 2005	Utilisation	Reversal in EUR k	Allocation	December 31, 2006
Refund obligation to Forest	4,866	0	0	5,744	10,610
Premiums/bonus management	236	235	0	373	374
Other	71	0	0	4	75
	<u>5,173</u>	<u>235</u>	<u>0</u>	<u>6,121</u>	<u>11,059</u>

The provision for the *refund obligation to Forest* relates to the obligation to refund 50% (35% for Europe and 15% for Japan) of the development expenses borne directly and indirectly by Forest plus a premium of 20% arising in the event of regulatory approval for Desmoteplase in Europe and/or Japan. This provision is shown in the balance sheet under "Non-current liabilities". For more information, reference is made to the statements in Section E. "Outlicensing Agreements".

Liabilities from financial statement costs and audit fees, employer's liability insurance contributions and consulting fees, which were disclosed as provisions in the prior year, were disclosed as trade payables as of the balance sheet date. The amount to be recognised for these liabilities as of December 31, 2006 was EUR 248k (prior year: EUR 152k). For the sake of clarity, the prior-year figures were adjusted accordingly in the consolidated balance sheet.

#### (9) Financial Liabilities

Financial liabilities relate to a subordinated loan of EUR 7,000,000 raised in April 2006. The subordinated loan was granted by HSBC Trinkaus & Burkhardt KGaA, Düsseldorf, Germany, and is part of the structured mezzanine financing scheme entitled "H.E.A.T Mezzanine I-2006". In the interim, HSBC Trinkaus & Burkhardt KGaA transferred the subordinated loan to H.E.A.T Mezzanine S.A., Luxembourg. The bullet loan has a seven-year term and was paid out less the debt discount of EUR 280,000. The financial liability has a fixed interest rate of 8.333% and, as such, is not subject to an interest rate risk. The effective interest rate amounts to 9.11 %. Interest payments are due on a quarterly basis.

#### (10) Finance Lease Liabilities

Liabilities due to lease contracts are recognised when the respective asset is recognised as an asset (finance lease). They are recorded at their present value. Lease payments of EUR 219k (prior year: EUR 303k) are due to the lessor over the next few years. The interest included therein comes to EUR 12k (prior year: EUR 22k). The finance lease liabilities are presented according to their maturity as follows:

	Lease payments	Interest portion included in EUR k	Lease liability
2007	81	7	74
2008	75	4	71
2009	63	1	62
	<u>219</u>	<u>12</u>	<u>207</u>

#### (11) Deferred Income

Deferred income includes a non-repayable signing fee which fell due upon conclusion of the license agreement with Forest. The signing fee is recognised in profit or loss upon achievement of the relevant milestones. EUR 1,669k of the signing fee had not yet been recognised in profit or loss as of December 31, 2006 and was disclosed in the balance sheet under "Non-current liabilities".

Deferred income also includes an investment grant which PAION received from the Federal Ministry of Education and Research. The deferred investment grants are released in line with the depreciation/amortisation of the underlying assets. The amounts released are deducted from research and development expenses. The portion of the grants which is not due within the next 12 months is disclosed under non-current liabilities (EUR 52k; prior year: EUR 76k).

(12) *Other Current Liabilities*

Other current liabilities comprise the following items:

	<i>December 31, 2006</i>	<i>December 31, 2005</i>
	<i>in EUR k</i>	
Vacation entitlements	166	167
Wage tax	145	118
Obligation from the termination of a stock option plan	0	1,200
Obligation from a rent rescission agreement	0	130
Social security contributions	0	62
Other	6	92
	<u>317</u>	<u>1,769</u>

Obligations from outstanding vacation entitlements, which were disclosed under accrued liabilities in the prior year, were reclassified as other current liabilities as of the balance sheet date (EUR 166k; prior year: EUR 167k). For the sake of clarity, the prior year figure was adjusted accordingly in the consolidated balance sheet.

**G. Notes to the Consolidated Income Statement**

(13) *Revenues*

Revenues for fiscal year 2006 of EUR 10,459k stem exclusively from the two cooperation partners' refunds of development expenses. Revenues in the prior year included a payment from Lundbeck for access to PAION's know-how (EUR 15,000k) and the refund of development expenses by Forest and Lundbeck (EUR 3,707k). In addition, a portion of the signing fees paid by Forest (EUR 89k) were released to income in the prior year.

(14) *Other Income (Expenses), Net*

This item mainly includes income from derecognised liabilities (EUR 82k) as well as other minor effects that cannot be allocated to other line items.

(15) *Income Taxes/Deferred Taxes*

Tax losses have been incurred from the time of PAION Deutschland GmbH's formation in 2000 up to and including 2006. As of December 31, 2006, tax loss carryforwards came to some EUR 60m (prior year: EUR 43m). Under current German tax legislation, these tax losses can be carried forward indefinitely and netted against future income. However, the changes in the shareholder structure of PAION Deutschland GmbH and the capital increases in this connection in recent years could limit the amount of loss carryforwards utilisable under current tax law.

The combined income tax rate for fiscal year 2006 remained as in the prior year at 39.77%, 25% of which related to corporate income tax and the solidarity surcharge, which itself constitutes 5.5% of the corporate income tax, and trade tax on income levied at 445%. Applying the combined income tax rate, deferred tax assets amounted to EUR 24m as of December 31, 2006 (prior year: EUR 17m). Debit differences between the tax base and the IFRS carrying amount as of December 31, 2006 result in deferred tax assets of EUR 325k (prior year: 284k).

Further losses are expected for the years to come and, as such, it is not considered likely that the deferred tax assets will be realised. In accordance with IAS 12.34, "*Income Taxes*", the deferred tax assets were thus not recognised.

In fiscal year 2006, as in the prior year, costs directly related to capital increases were not expensed but netted directly against the capital reserve. Due to the loss situation and the non-recognition of all deferred tax assets, these costs of raising capital are deducted from the capital reserve without taking income taxes into account.

The reconciliation of the expected income tax and the current tax expense is shown below applying a tax rate of 39.77%:

	2006	2005
	<i>in EUR k</i>	
Profit (loss) for the period	-17,386	-4,756
Expected tax expense (+)/income(-)	-6,914	-1,891
Non-recognition of deferred taxes on temporary differences	35	115
Non-recognition of deferred taxes on tax losses of the fiscal year	6,586	2,942
Costs in connection with capital increases	-178	-1,534
Costs of stock options	443	335
Other	28	33
Current tax expense	<u>0</u>	<u>0</u>

#### (16) *Earnings per Share*

Earnings per share are calculated under IAS 33, "*Earnings per Share*", by dividing profit (loss) by the weighted average number of shares outstanding.

The underlying weighted average number of ordinary shares outstanding is calculated as follows:

	2006	2005
Shares outstanding on January 1	15,755,552	10,005,552
Capital increase in February 2005	0	5,118,055
Capital increase in April 2006	716,667	0
Weighted average number of ordinary shares	<u>16,472,219</u>	<u>15,123,607</u>

Basic and diluted earnings per share are calculated on the basis of the following figures:

	2006	2005
Profit (loss) in EUR	-17,386,054.88	-4,756,125.75
Weighted average number of ordinary shares for basic earnings per share	16,472,219	15,123,607
Weighted average number of ordinary shares for diluted earnings per share	16,472,219	15,123,607
Earnings per share (in EUR):		
Basic	-1.06	-0.31
Diluted	-1.06	-0.31

The outstanding stock options did not dilute the earnings per share in the fiscal year and the prior year.

## H. Notes to the Consolidated Cash Flow Statement

The consolidated cash flow statement shows how the cash and cash equivalents of PAION have changed during the course of the fiscal year due to inflows and outflows of funds. In accordance with IAS 7, "*Cash Flow Statements*", a distinction is made between cash flows from operating, investing and financing activities. The cash and cash equivalents disclosed in the consolidated cash flow statement include cash and bank balances with a maturity of up to three months, based on the date of investment.

## I. Other Notes

### *Stock Option Plan 2005*

On December 30, 2004, the shareholder meeting of PAION AG approved a stock option plan for management board members and employees of PAION. Under the stock option plan, of the total of 1,102,888 stock options, 496,300 stock options can be granted to management board members and 606,588 to employees. One stock option entitles the holder to subscribe to one share from the dedicated "Conditional Capital 2004 II" and "Conditional Capital III". The stock options have a ten-year term and can only be exercised after a vesting period. The vesting period begins on the issue date and ends, for 50% of the stock options issued, two years after the issue date; for 25% of the stock options issued, the vesting period ends three years, and for the other 25%, four years, after the issue date. Options can only be exercised when the stock price on the exercise date has increased by a cumulative 5% each year since their issue.

Development of the stock option claims granted:

	<i>No. of stock options</i>	<i>Weighted average – exercise price in EUR</i>
Outstanding stock options as of January 1, 2005	0	0.00
Granted	949,305	8.00
Expired	58,078	8.00
Outstanding stock options as of December 31, 2005	891,227	8.00
Granted	11,615	9.55
Expired	30,926	8.00
Outstanding stock options as of December 31, 2006	<u>871,916</u>	<u>8.02</u>

Since the vesting period had not yet expired, none of the stock options which were outstanding as of December 31, 2006 were able to be exercised in 2006. The weighted average remaining term of these stock options was 8.2 years as of the balance sheet date. The exercise prices of the outstanding stock options range from EUR 8.00 to EUR 9.55.

The stock options were accounted for in accordance with IFRS 2, "Share-Based Payment". The fair value of the stock options on the date of issue was calculated using the Black/Scholes option pricing model and is being recognised in profit or loss as personnel expenses over the vesting period of two to four years. The fair value of the stock options issued in fiscal year 2006 was calculated on the basis of an exercise price of EUR 9.55 per option and a stock price of EUR 9.85 on the issue date. The term of the options until exercise was assumed to be three to five years. Depending on the term, a risk-free interest rate of 3.5% to 4.5% was used. The anticipated volatility was assumed to be 27.81 %. This is a weighted volatility which takes into account the volatility available for PAION and the volatility of three stock market indices. Dividends were not taken into account. Furthermore, annual employee turnover was presumed to be 7.5%. On the basis of these parameters and assumptions, the fair values for the stock options issued vary between EUR 2.41 and EUR 3.28, depending on the underlying term. In fiscal year 2006, personnel expenses of EUR 1,115k were recognised for the stock options issued, and the capital reserve was increased accordingly at the same time.

### *Employee Stock Compensation Plan 2006*

The management board of PAION AG, with the consent of the supervisory board, launched an employee stock compensation plan granting stock appreciation rights. Under this Employee Stock Compensation Plan 2006, 252,000 stock appreciation rights from the total 560,000 can be issued to management board, while the other 308,000 stock appreciation rights can be issued to employees of the PAION Group. A stock appreciation right entitles the holder to receive a sum of money based on the PAION AG share price. The maximum amount payable on a stock appreciation right is limited to 100% of the exercise price. The stock appreciation rights have a ten-year term and can only be exercised after a vesting period of two years. Stock appreciation

rights can only be exercised when the stock price on the exercise date has increased by a cumulative 5% each year since their issue. As of December 31, 2006, a total of 209,150 stock appreciation rights had been issued to management board members and employees.

The obligations from these stock appreciation rights were measured at fair value as of the balance sheet date in accordance with the provisions of IFRS 2, "*Share-Based Payment*". The fair value was calculated using the Black/Scholes option pricing model. An exercise price of EUR 7.89, a stock price of EUR 8.25 as of the balance sheet date, a term of three years for the stock appreciation rights, a risk-free interest rate of 3.8%, and an annual employee turnover of 6.5% were used for the calculation. Dividends were not taken into account. Given the historical volatility of the shares in PAION AG, the anticipated volatility was assumed to be 49.37%.

In order to account for the necessary cumulative increase of the stock price and the value limits, separate option values were set for these parameters which were combined with the value of the actual exercise options.

On the basis of these parameters and assumptions, the fair value of the stock appreciation rights granted was EUR 1.71 as of the balance sheet date. The payment obligations from this employee stock compensation plan led to personnel expenses of EUR 6k in fiscal year 2006 and a provision of the same amount as of December 31, 2006.

### **Related Parties**

Transactions with related parties must be disclosed pursuant to IAS 24, "*Related Parties*". The management and supervisory boards as well as shareholders qualify as related parties within the meaning of IAS 24.9. With regard to the remuneration of the members of the management and supervisory boards, reference is made to the statements under "Members of the Management Board," and "Members of the Supervisory Board" in this section.

Apart from the above, there are no significant related parties.

### *Financial Instruments*

The financial instruments held by PAION on the balance sheet date were mainly cash and cash equivalents, short-term investments, trade receivables and payables and financial liabilities. PAION does not currently use derivative financial instruments.

Due to the short maturities of the short-term investments and the trade receivables and payables, the carrying amounts are identical to the fair values. The fair value of the financial liabilities was EUR 7,003k as of December 31, 2006 and was measured at the present value using the term structure of interest rates applicable for payments in connection with these liabilities.

PAION is not currently exposed to any notable *foreign currency risk*. Development expenses are charged on and financial investments made in euros. The trade payables which are denominated in a foreign currency are of secondary importance. When specific milestones are reached, PAION will receive further payments from its cooperation partners, some of which will be payable in US dollars. The Company regularly reviews whether or not currency hedges are appropriate.

All of the trade receivables result from development expenses charged on to Forest and Lundbeck. The long-term refund claims resulting from development expenses are against Lundbeck. In spite of this concentration, PAION considers the *credit risk* to be low in view of the credit standing of its two cooperation partners. The cash and cash equivalents and short-term investments are with two major German banks and the savings bank Sparkasse Aachen. Various credit protection criteria are applied in selecting short-term investments (e.g. rating, capital guarantee, protection by the Deposit Protection Fund). Given the selection criteria applied and the ongoing monitoring of its investments, PAION does not believe that these activities involve a credit risk. The amounts shown in the balance sheet are the maximum credit risk.

Liquidity is monitored and managed using an enterprise planning tool for both short and long-term planning which has been customised for PAION. *Liquidity risks* are identified at an early stage by simulating various scenarios and using sensitivity analyses. Current liquidity is recorded and monitored on a daily basis.

On the balance sheet date, PAION did not hold any positions that were subject to a direct *interest rate risk*.

#### *Employees and Personnel Expenses*

PAION increased headcount substantially in fiscal year 2006, employing an average of 77 employees in 2006 (prior year: 64 employees). Of the 77 employees, 54 work in research in development, 19 in administration, and 4 in sales. Another general manager was appointed to the management of PAION Deutschland GmbH in September 2006. PD Dr. Stephan Wnendt has many years of management experience in biopharmaceutical product development in Europe and the US and is responsible for production, quality assurance, project management and preclinical issues at PAION.

The following personnel expenses were incurred in fiscal years 2006 and 2005:

	<i>2006</i>	<i>2005</i>
	<i>in EUR k</i>	
Salaries	6,364	5,323
Social security	761	637
	<u>7,125</u>	<u>5,960</u>

The above personnel expenses include costs of granting options under the stock option plan of EUR 1,121 k (prior year: EUR 843k).

#### *Other Financial Obligations/Contingent Liabilities*

PAION has rented office and research premises, as well as motor vehicles and some of its factory and office equipment. The future minimum lease obligations under these lease agreements are as follows:

	<i>December 31,</i>	<i>December 31,</i>
	<i>2006</i>	<i>2005</i>
	<i>EUR k</i>	
2007	474	400
2008	350	286
2009	307	277
2010	297	276
2011	171	159
Total	<u>1,599</u>	<u>1,398</u>

The rental and lease expenses under these agreements came to EUR 456k in fiscal year 2006 (prior year: EUR 419k).

In addition, PAION is obligated to make payments under various license and purchase agreements pursuant to which PAION acquired the rights to certain patents. Upon the occurrence of certain events, PAION will be required to make milestone payments in an aggregate amount of up to approximately EUR 16m (which are partially payable in USD) to the contracting partners with respect to licenses for Desmoteplase, Enecadin and Solulin. PAION also agreed to pay royalties based on its future net sales of Desmoteplase, Solulin and Enecadin.



### *Members of the Management Board*

The members of the management board are:

- Dr. Wolfgang Söhngen, CEO, Chairman
- Alexander Vos, COO, Deputy Chairman
- Dr. Mariola Söhngen, CMO
- Bernhard Hofer, CFO

In fiscal year 2006, the total remuneration paid to management board members was EUR 1,047k. In addition, the management board members received non-monetary benefits in the form of company cars. As of December 31, 2006, a total of 496,300 stock options (fair value: EUR 1,764,347) and 100,000 stock appreciation rights (fair value: EUR 171,000) had been issued to management board members. For further information on the remuneration of the management board, we refer to the explanations under 'Compensation Report' in the group management report.

PAION AG's management board members are also general managers of PAION Deutschland GmbH and work full-time for PAION AG and for PAION Deutschland GmbH.

As of December 31, 2006, Dr. Wolfgang Söhngen and Dr. Mariola Söhngen held 579,241 and 645,543 shares, respectively, in PAION AG, including 6,197 shares held by Dres. Söhngen Beteiligungs GmbH & Co. KG, in which Dr. Wolfgang Söhngen and Dr. Mariola Söhngen each hold 50% through Dres. Söhngen Beteiligungs GmbH as general partner and as limited partners.

### *Members of the Supervisory Board:*

The members of the supervisory board are:

- Dr. Walter Wenninger, Leverkusen, Germany, Chairman, businessman

Other supervisory board or similar positions:

- Arrow Therapeutics Ltd., London, UK
  - Axiogenesis AG, Cologne, Germany
  - EPIDAUROS Biotechnologie AG, Bernried, Germany
  - Verlags- und Medien Aktiengesellschaft (VEMAG), Cologne, Germany
  - Dr. Franz Wirtz, Stolberg, Germany, Deputy Chairman, businessman
- Other supervisory board or similar positions:
- DASGIP AG, Jülich, Germany
  - QIAGEN N.V., Venlo, Netherlands.
  - Prof. Dr. Erich Schlick, Otterstadt, Germany, partner at Wellington Partners Venture Capital GmbH, Munich, Germany

Other supervisory board or similar positions:

- Elara Pharmaceuticals GmbH, Heidelberg, Germany, (from October 1, 2006 to December 31, 2006),
- Administrative board member of the Central Institute of Mental Health, Mannheim, Germany

The members of the supervisory board received remuneration of EUR 103,500 for fiscal year 2006. For further information on the remuneration of the supervisory board, we refer to the explanations under 'Compensation Report' in the group management report.

Dr. Franz Wirtz GmbH, which is wholly owned by Dr. Wirtz, held 194,073 shares in PAION AG as of December 31, 2006. In addition, Dr. Wirtz holds a 10% interest in Dr. Franz Wirtz Vermögensverwaltungs GbR, which, as of December 31, 2006, held a further 140,056 PAION AG shares.



### *Auditors*

At the shareholder meeting on May 10, 2006, Ernst & Young AG, Wirtschaftsprüfungsgesellschaft, Cologne, Germany, was appointed as auditor for the annual and consolidated financial statements for fiscal year 2006. The auditor received or will invoice the following fees for services rendered to PAION AG and its subsidiary PAION Deutschland GmbH in fiscal year 2006:

- Audits: EUR 55,800
- Tax advisory: EUR 8,345
- Other services: EUR 20,550

Other services mainly relate to fees for the review of the quarterly financial statements.

### *Corporate Governance*

The supervisory board and management board of PAION AG declare that they are committed to responsible and transparent management and control focused on long-term added value.

The Company complies, for the most part, with the recommendations set forth in the most recent version of the German Corporate Governance Code dated June 12, 2006. On December 11, 2006, the supervisory board and the management board issued the declaration of compliance with the Corporate Governance Code pursuant to Sec. 161 AktG [“Aktengesetz”: German Stock Corporation Act]. This declaration of compliance is published on PAION AG’s website ([www.paion.de](http://www.paion.de)).

## PART VI

### Consolidated Financial Statements as of 31 December 2005

#### Consolidated balance sheet as of 31 December 2005

##### Assets

	<i>Note</i>	<i>31 December 2005</i>	<i>31 December 2004</i>
		<i>in EUR</i>	
<b>Non-current assets</b>			
Intangible assets	1.	514,203.61	1,939,469.04
Equipment	2.	1,094,323.22	1,005,539.22
Long-term refund claims resulting from the assumption of development costs	3.	3,673,741.35	0.00
		5,282,268.18	2,945,008.26
<b>Current assets</b>			
Trade receivables	4.	1,413,196.92	449,968.18
Prepaid expenses and other assets	5.	11,086,605.12	1,386,487.80
Cash and cash equivalents	6.	48,370,539.85	20,888,829.59
		60,870,341.89	22,725,285.57
<b>Total assets</b>		66,152,610.07	25,670,293.83

##### Equity and liabilities

	<i>Note</i>	<i>31 December 2005</i>	<i>31 December 2004</i>
		<i>in EUR</i>	
<b>Equity</b>			
Share capital	7.	15,755,552.00	10,005,552.00
Capital reserve		75,925,289.91	39,480,795.29
Loss carryforward		-34,174,373.72	-34,350,454.31
Net loss for the period/Net profit for the period		-4,756,125.75	176,080.59
		52,750,342.44	15,311,973.57
<b>Non-current liabilities</b>			
Finance lease liabilities	8.	207,485.00	281,331.00
Provisions	9.	4,865,892.62	1,935,702.38
Deferred income	10.	1,745,063.28	1,858,869.05
		6,818,440.90	4,075,902.43
<b>Current liabilities</b>			
Current portion of finance lease liabilities	8.	73,847.00	70,930.00
Trade payables		4,257,091.84	2,706,036.38
Provisions	9.	459,429.75	2,311,330.95
Accrued liabilities		166,488.77	110,530.00
Other current liabilities	11.	1,602,536.17	1,059,147.30
Current portion of deferred income	10.	24,433.20	24,443.20
		6,583,826.73	6,282,417.83
<b>Total equity and liabilities</b>		66,152,610.07	25,670,293.83

## Consolidated income statement for the Fiscal Year 2005

	<i>Note</i>	<i>2005</i>	<i>2004</i>
		<i>in EUR</i>	
Revenues	12.	18,796,037.36	16,952,217.47
Cost of revenues		-4,854,886.56	-2,438,792.38
Gross profit		<u>13,941,150.80</u>	<u>14,513,425.09</u>
Operating expenses			
Research and development expenses		-13,627,205.01	-7,976,422.59
General and administrative expenses		-4,852,194.84	-5,708,189.15
Selling and marketing expenses		-1,370,255.82	-647,121.00
Other income (expenses), net	13.	93,910.65	-268,797.42
		<u>-19,755,745.02</u>	<u>-14,600,530.16</u>
Operating result		<u>-5,814,594.22</u>	<u>-87,105.07</u>
Financial result	14.	1,058,468.47	263,185.66
Net Loss/Profit for the period before taxes		<u>-4,756,125.75</u>	<u>176,080.59</u>
Income taxes	15.	0.00	0.00
Net loss for the period/Net profit for the period		<u><u>-4,756,125.75</u></u>	<u><u>176,080.59</u></u>
Earnings per share (undiluted)	16.	-0.31	0.02
Earnings per share (diluted)	16.	-0.31	0.02

## Consolidated cash flow statement for the Fiscal Year 2005

	2005 <i>in EUR</i>	2004
Cash flows from operating activities:		
Net result for the period	-4,756,125.75	176,080.59
Reconciliation of net profit (loss) for the period to cash flows from operating activities:		
Amortization/depreciation	410,678.20	354,070.22
Write-ups	0.00	-198,201.36
Loss/Profits from the disposal of non-current assets	212.00	-3,050.95
Interest paid on finance leases	12,609.00	6,780.00
Release of investment grants	-24,443.20	-6,108.30
Release of deferred income	-89,372.57	0.00
Expenses from stock option plans	843,359.40	803,000.00
Effects from the business combination of PAION AG and PAION Deutschland GmbH	0.00	-1,027.85
Change in assets and liabilities which are not attributable to investing or financing activities:		
Long-term refund claims resulting from the assumption of development costs	-3,673,741.35	0.00
Trade receivables	-963,228.74	-449,968.18
Prepaid expenses and other assets	-400,117.32	-432,493.12
Trade payables	1,551,055.46	1,566,236.27
Provisions	3,651,883.80	949,997.76
Other current liabilities	-307,468.42	473,852.65
Deferred income	0.00	1,758,458.18
Net cash from operating activities	<u>-3,744,699.49</u>	<u>4,997,625.91</u>
Cash flows from investing activities:		
Cash paid for investments in intangible assets and equipment	-447,811.26	-1,721,480.44
Cash received from the sale of intangible assets and equipment	1,373,402.49	277,096.60
Net cash used in investing activities	<u>925,591.23</u>	<u>-1,444,383.84</u>
Cash flows from financing activities:		
Capital increase	5,750,000.00	73,150.00
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	-1,165,266.11
Payment of finance lease liabilities	-83,538.00	-39,379.00
Net cash used in financing activities	<u>40,300,818.52</u>	<u>8,882,069.63</u>
Change in cash and cash equivalents	37,481,710.26	12,435,311.70
Cash and cash equivalents at beginning of the period	<u>20,888,829.59</u>	<u>8,453,517.89</u>
Cash and cash equivalents at end of the period	<u><u>58,370,539.85</u></u>	<u><u>20,888,829.59</u></u>
<i>Composition of cash and cash equivalents at the end of the period:</i>		
Cash	48,370,539.85	20,888,829.59
Loan against promissory note	10,000,000.00	0.00
Cash and cash equivalents at end of the period	<u><u>58,370,539.85</u></u>	<u><u>20,888,829.59</u></u>

## Consolidated statement of changes in equity for the Fiscal Year 2005

	<i>Share capital EUR</i>	<i>Capital reserve EUR</i>	<i>Loss carryforward EUR</i>	<i>Equity EUR</i>
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
Effect from the business combination of PAION AG and PAION				
Deutschland GmbH Contribution to the capital reserve	9,827,052.00	-9,778,079.85	0.00	48,972.15
Cost of raising capital	0.00	10,288,564.74	0.00	10,288,564.74
Additional contribution to the capital reserve due to the issue of options	0.00	-275,000.00	0.00	-275,000.00
Decrease in the capital reserve due to the settlement of options	0.00	803,000.00	0.00	803,000.00
Net profit for the period	0.00	-3,332,044.83	0.00	-3,332,044.83
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	843,359.40	0.00	843,359.40
Net loss for the period	0.00	0.00	-4,756,125.75	-4,756,125.75
31 December 2005	15,755,552.00	75,925,289.91	-38,930,499.47	52,750,342.44

\* The comparative figures for 31 December 2003 relate to PAION Deutschland GmbH.

## Consolidated Notes for the Fiscal Year 2005

### A. 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, Germany, on the basis of full consolidation.

PAION AG acts as a holding company and renders various services for PAION Deutschland GmbH. PAION Deutschland GmbH, a bio-pharmaceutical company founded in 2000, aims to become a leading player in the development and marketing of innovative drugs for the treatment of stroke and other thrombotic diseases for which there is substantial unmet medical need. PAION plans to build an integrated drug portfolio using a "search and development" approach. As part of this approach, PAION will seek to identify promising new compounds with potential in the treatment of stroke and other thrombotic diseases, license or otherwise acquire them and advance them through the clinical development and regulatory approval process. Where appropriate, particularly during the late stages of the clinical development and approval process and the marketing of PAION's drug candidates, collaboration with experienced partners will be sought.

On February 9, 2005, PAION AG's shares were admitted to trading on the Official Market Segment of the Frankfurt Stock Exchange and to the Prime Standard, the subsegment of the Official Market Segment with additional post-admission obligations. Trading commenced on February 11, 2005. 5,000,000 shares were initially placed as part of the equity launch. An additional 750,000 shares were placed due to the Greenshoe option which was exercised in full. Total gross issue proceeds of EUR 46m were realised.

### B. Basis of Accounting

In accordance with Sec. 315a HGB ["Handelsgesetzbuch": German Commercial Code] and Article 4 of the European Parliaments and Council Directive (EC) No. 1606/2002, the consolidated financial statements were prepared in compliance with IFRSs. New standards adopted by the International Accounting Standards Board (IASB), London, UK, are already applied as soon as they become effective. The provision of IFRS 2 "*Share-Based Payment*" were voluntarily applied in the prior-year financial statements. The provisions contained in various IFRSs that have not yet been transposed into European law by the European Union as well as the IFRSs which are not yet come into effect had no effect on the consolidated financial statements. The supervisory board authorised the accompanying consolidated financial statements for publication on March 13, 2006.

Since 2002, the designation "IFRSs" has been used to denote all of the accounting standards promulgated by the IASB, and thus replaces the designation "IASs" (International Accounting Standards). Accounting standards published by the IASB before the change in name continue to be referred to as IASs.

The consolidated financial statements were prepared in euros.

The income statement was prepared using the function of expense method. Research and development expenses are disclosed separately in the income statement due to their significance.

Under IAS 1, "*Presentation of Financial Statements*", non-current and current assets and non-current and current liabilities must be presented as separate classifications on the face of the balance sheet. Assets, liabilities and provisions due within one year are classified as current.

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

The preparation of consolidated 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 these estimates.

### **C. Consolidation Policies**

PAION AG was founded on June 2, 2004. In 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. The contribution of all shares in PAION Deutschland GmbH to PAION AG in return for shares in PAION AG was recognised in accordance with IFRS 3, "*Business Combinations*". The transaction satisfied the criteria for recognition as a reverse acquisition (IFRS 3.21) as the shareholders of PAION Deutschland GmbH have been given the power to govern the financing and operating policies of PAION AG owing to the issue of shares in PAION AG as consideration for the contribution in kind. Pursuant to IFRS 3, following the reverse acquisition, the consolidated financial statements as of December 31, 2004 had to be published under the name of the legal parent (PAION AG). However, the financial statements followed on from the financial statements of the legal subsidiary (PAION Deutschland GmbH) such that:

- the assets and liabilities of PAION Deutschland GmbH were recognised and measured in the consolidated financial statements at their pre-combination carrying amounts;
- the loss carryforwards and other equity balances recognised in the consolidated financial statements corresponded to the loss carryforwards and other equity balances of the legal subsidiary immediately before the business combination;
- the amount recognised as equity in the consolidated financial statements was determined by adding the costs of the business combination to the equity of PAION Deutschland GmbH immediately before the business combination; however, the equity structure appearing in the consolidated financial statements (i.e. the number and type of equity instruments issued) reflected the equity structure of PAION AG, including the shares issued by PAION AG to effect the combination;
- the comparative information for 2003 presented in the consolidated financial statements as of December 31, 2004 related to PAION Deutschland GmbH.

Intercompany transactions are eliminated. Receivables and liabilities between consolidated entities are offset as are intercompany income and expenses.

### **D. Accounting Policies**

#### *Intangible Assets*

Purchased intangible assets are measured at cost. Amortization of intangible assets is calculated by applying the straight-line method over the useful life of the assets. The useful life of software is determined to be three years, while research and marketing rights for compounds are amortised over the term of the respective patent.

#### *Equipment*

Equipment is recognised at cost less accumulated depreciation. Depreciation is calculated by applying the straight-line method over the estimated useful life of the assets, which normally ranges between three and thirteen years. Low-value assets are fully expensed in the year of acquisition. The Company reviews assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset to the higher of its fair value less cost to sell and its value in use. If such assets are considered to be impaired, the impairment loss recognised is the amount by which the carrying amount of the assets exceeds the higher of fair value less cost to sell or value in use. If the reasons for an impairment loss cease to apply, write-ups are performed.



Leased equipment which satisfies certain criteria under IAS 17, "Leases", is recognised as an asset, while the present value of lease payments is recognised as a liability. Depreciation is charged straight line on leased assets over the term of the lease.

#### *Long-Term Refund Claims Resulting From the Assumption of Development Costs*

The long-term refund claims resulting from the assumption of development costs by Lundbeck are carried at present value which is calculated by using an interest rate of 2.9%. The accounting of these claims is made in accordance with IAS 37.53, "Provisions, Contingent Liabilities and Contingent Assets" because of the direct interrelation to the refund obligation to Forest which is considered as provision in the financial statements.

#### *Receivables and Other Assets*

Trade receivables and other assets are shown at amortised cost. The loan against promissory note which is presented in the balance sheet under other assets was classified as held-to-maturity investment and is also carried at amortised cost. Receivables denominated in foreign currency are translated at the closing rate. Exchange gains and losses are recognised in profit and loss.

#### *Equity*

The costs directly associated with issued equity are not expensed but directly deducted from equity.

The granting of options (equity instruments) is recognised as an expense and as an increase in equity on the basis of fair value measurement. Planning changes, in particular the settlement of claims through cash compensation, are accounted for as a capital repayment.

#### *Provisions*

Provisions are recognised when a present obligation (legal or constructive) exists as a result of a past event and when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions with a maturity of more than one year are recognised at present value.

#### *Liabilities*

Trade payables and other liabilities are carried at the amount repayable. Liabilities denominated in foreign currency are translated at the closing rate. Exchange gains and losses are recognised in profit and loss.

#### *Deferred Income*

Investment grants in connection with the acquisition of assets are recognised as deferred income in the balance sheet. The deferred investment grants are released in line with the depreciation/amortization of the underlying assets. The amounts released are deducted from research and development expenses.

Non-repayable signing fees received which relate to license agreements are disclosed as deferred income and recognised in profit and loss when the respective milestones are achieved.

#### *Revenues*

Revenues for the fiscal year are recognised when realised. Revenues are recognised when the owed service has been rendered, and the risks of ownership have been transferred and the amount of expected consideration can be measured reliably. Payments related to the sale or outlicensing of compounds or technological know-how are recognised in profit and loss when the services to be rendered on the basis of contractual regulations have been met in full.

#### *Cost of Revenues*

The consideration paid for development and marketing rights are recognised as cost of revenues at the time of outlicensing in the amount outlicensed. The cost of revenues also contains allocated development costs.

### *Research and Development Expenses*

Research expenses are expensed as incurred. Development expenses are recognised as an asset in accordance with IAS 38, “*Intangible Assets*”, depending on the possible outcome of the development activities and whether or not all of the criteria for recognition are met. These criteria are not currently met, such that development expenses are expensed as incurred.

### *Public Subsidies*

Subsidies that directly relate to expenses incurred in connection with research and development activities are recognised as a reduction of research and development expenses. In fiscal year 2005, public subsidies of EUR 1.9m were netted with research and development expenses.

### *Interest Income*

Interest income is recognised as an income in the period in which it is generated. Any necessary deferrals are calculated using the effective interest method.

### *Income Taxes/Deferred Taxes*

Deferred taxes are recognized according to IAS 12, “*Income Taxes*”. They are accounted for using the liability method. Deferred taxes are recognised by applying enacted statutory tax rates applicable to future years to temporary differences between the IFRS carrying amounts and the tax bases of existing assets and liabilities. In addition, deferred tax assets are recognised on tax loss carryforwards. The effect of a change in the enacted tax rates on deferred taxes is recorded in the period in which the change is enacted. No deferred tax assets are recognised, if it is probable that some portion or all of the deferred tax assets will not be recoverable.

## **E. Outlicensing Agreements**

### **1. License Agreement With Forest Laboratories Ireland Limited, Clonshaugh, Ireland**

On June 30, 2004, PAION Deutschland GmbH concluded a license agreement with Forest Laboratories Ireland Limited, Clonshaugh, Ireland (hereinafter referred to as “Forest”), a subsidiary of Forest Laboratories, Inc., New York City, NY, USA. The agreement grants Forest an exclusive license with respect to Desmoteplase for the US and Canadian markets. The agreement assumes that the United States and Canada on the one hand, and Europe and Japan on the other, each represent 50% of the global market for Desmoteplase. In return, Forest agreed to make upfront payments and milestone payments totaling USD 62m to PAION, USD 22m of which was already paid in 2004, and to initially assume essentially all future expenses incurred by PAION in connection with the clinical development of Desmoteplase for the treatment of stroke. Consistent with the assumption with regard to the split of the global market for Desmoteplase, PAION has agreed that, if it obtains regulatory approval for Desmoteplase in Europe and/or Japan, it will repay up to 50% of the costs borne directly or indirectly by Forest plus a premium of 20% as well as interest on the costs to be repaid.

PAION has the right to offset the amounts owed to Forest against future royalty payments from Forest to PAION. If the U.S. Food and Drug Administration (FDA) grants regulatory approval for the marketing of Desmoteplase, Forest will be required to use commercially reasonable efforts to market the drug in the United States and Canada and to pay PAION royalties based on its net sales of Desmoteplase in the US and Canadian markets.

### **2. License Agreement with H. Lundbeck A/S, Valby-Copenhagen, Denmark**

On July 11, 2005, PAION Deutschland GmbH concluded a license agreement for the further development and marketing of Desmoteplase with Lundbeck. This agreement grants Lundbeck an exclusive license to develop and market Desmoteplase for the European and Japanese market, as well as for all other countries except for the USA and Canada, for which Forest had already been granted a license. PAION has the option to co-promote the drug in major European countries. Under this agreement, Lundbeck has agreed to provide the following:

- Assumption of part of the past and future development costs, including the obligation to repay development costs borne directly and indirectly by Forest in the event of regulatory approval for Desmoteplase in Europe and/or Japan
- One-time payment for access to PAION's know-how
- Milestone payments until regulatory approval
- Payment of revenue-based royalties or profit shares

Upon signing the agreement, Lundbeck made the one-time, non-refundable payment of EUR 15m for access to PAION's know-how. The milestone payments will become due in the course of the further development of Desmoteplase in the indication ischaemic stroke and amount to up to EUR 50m. The total amount of the milestone payments will depend on the extent to which PAION exercises its co-promotion options, which PAION has for major European markets.

In those countries in which Lundbeck has exclusive market access, PAION will receive revenue-based royalties with a double-digit percentage rate, net of the royalties which PAION has to pay to Schering. In countries in which PAION can share marketing of the drug, PAION will receive a 50% share of profits if it exercises its option.

The amount of the portion of past and future development costs to be borne by Lundbeck also depends on the extent to which PAION exercises its co-promotion options. If it exercises all of its options, and if Desmoteplase receives regulatory approval in Europe and Japan, PAION could have to cover up to 18% of the joint development costs. PAION must decide whether or not to exercise its option by the close of clinical development.

### **3. Accounting for the Outlicensing Agreements**

In accordance with IAS 18, "*Revenue*", milestone payments related to the license agreements with Forest and Lundbeck are recorded as revenue when the respective milestones are achieved. Furthermore, royalties on future net revenues resulting from the license agreements with Forest and Lundbeck are recorded as revenue when the respective revenues are generated. The non-refundable upfront payments received by PAION under the agreement with Forest are recorded as deferred income and recognised as revenue in proportion to the future milestone payments to be made to PAION.

The reimbursement of development expenses incurred directly by PAION is also recorded as revenue while the corresponding development expenses are accounted for as cost of revenues.

PAION recognises a provision for the obligation to repay costs reimbursed by Forest which would arise in the event of regulatory approval by reducing revenues by the net present value of 50% of the reimbursed costs. Accordingly, our revenues in any given period effectively include only approximately 50% of the Desmoteplase-related development expenses billed to Forest. A provision is also recognised for the potential obligation to repay the costs incurred directly by Forest in the amount of the present value of 50% of the costs incurred directly by Forest. This provision increases accordingly the research and development expenses stated by PAION. The 20% premium on the overall repayment obligation is accounted for by recognising a provision in that amount and an increase in research and development expenses.

In accounting for the claims against Lundbeck resulting from the assumption of development costs it is necessary to differentiate between the following two cost categories:

1. Development costs incurred directly by PAION but not charged on to Forest.
2. Development costs resulting from the repayment obligation to Forest:
  - (a) Development costs incurred directly by PAION and charged on to Forest;
  - (b) Development costs incurred directly by Forest.

The refund claims against Lundbeck resulting from *cost category 1* are recorded as revenue, whereas the corresponding development costs are recognised as cost of revenues. The costs are mainly current production development costs. These claims against Lundbeck, which are due immediately, are recognised as trade receivables.

The refund claims against Lundbeck resulting from *cost category 2a* are recorded as revenue, whereas the corresponding development costs are recognised as cost of revenues. PAION's refund claim against Lundbeck resulting from *cost category 2b* is recognised in profit and loss by being netted with the corresponding development costs. The 20% premium payable to Forest on cost categories 2a and 2b is also refunded by Lundbeck. This claim is recognized in profit and loss by being netted with the corresponding development costs.

The amount of the refund claims against Lundbeck resulting from cost categories 2a and 2b depends on the extent to which PAION exercises its co-promotion options. The current accounting treatment is based on the assumption that PAION will exercise all options; hence, the lowest possible refund claim against Lundbeck is recorded. If PAION decides not to exercise its co-promotion options, the cost refund claim against Lundbeck will be equal to the aggregate repayment obligation to Forest.

The refund claims against Lundbeck resulting from cost categories 2a and 2b will not be due until Desmoteplase receives regulatory approval in Europe and/or Japan. As they are due in more than one year, the refund claims are carried in the balance sheet as a non-current asset at their present value. In the consolidated cash flow statement, changes in these long-term refund claims are, because of their operating nature, classified as a cash flow from operating activities, and not as a cash flow from investing activities. Hence, they are stated in the same way as the changes in the long-term repayment obligation to Forest, which is also presented in the cash flows from operating activities.

With respect to the impact of these two license agreements with Forest on the consolidated financial statements, reference is made to the additional disclosures on the respective balance sheet and income statement captions.

## F. Notes to the Consolidated Balance Sheet

### (1) Intangible Assets

Intangible assets break down as follows:

	<i>Industrial property rights and similar rights and assets in EUR</i>
Cost	
January 1, 2004	937,643.39
Additions	1,637,950.05
Disposals	300,000.00
December 31, 2004	2,275,593.44
Additions	93,384.55
Disposals	1,538,423.00
December 31, 2005	830,554.99
Accumulated amortization	
January 1, 2004	206,042.89
Additions	157,003.50
Disposals	26,921.99
December 31, 2004	336,124.40
Additions	146,447.50
Disposals	166,220.52
December 31, 2005	316,351.38
Carrying amounts as of December 31, 2004	1,939,469.04
Carrying amounts as of December 31, 2005	514,203.61

In the prior year, EUR 3.2m was paid for the global development and marketing rights for Desmoteplase. EUR 1.6m thereof was recognised as an asset and the remaining 50% expensed due to the outlicensing of Desmoteplase to Forest based on the assumption that the outlicensed area of the United States and Canada accounts for 50% of the global market for Desmoteplase. 50% of the payments of EUR 0.7m made in 2003 for the global development and marketing rights for Desmoteplase were, to the extent that they related to the United States and Canada, also expensed in fiscal year 2004 net of accumulated amortization (EUR 0.3m). In fiscal year 2005, the capitalised global development and marketing rights for Desmoteplase were reduced proportionately to allow for the outlicensing to Lundbeck and, net of accumulated amortization, and were recorded as an expense (EUR 1.4m). As of December 31, 2005, intangible assets mainly comprise the remaining share of the development and marketing rights for Desmoteplase of EUR 0.4m.

## (2) Equipment

Equipment developed as follows:

	<i>Technical equipment and machines</i>	<i>Other equipment, factory and office equipment in EUR</i>	<i>Payments on account and assets under construction</i>	<i>Total</i>
Cost				
January 1, 2004	274,113.68	1,468,633.14	0.00	1,742,746.82
Additions	386,085.04	55,580.35	0.00	441,665.39
Disposals	0.00	53,197.65	0.00	53,197.65
December 31, 2004	660,198.72	1,471,015.84	0.00	2,131,214.56
Additions	142,525.86	142,612.06	69,287.79	354,425.71
Disposals	0.00	97,747.07	0.00	97,747.07
December 31, 2005	802,724.58	1,515,880.83	69,287.79	2,387,893.20
Accumulated depreciation				
January 1, 2004	198,735.68	980,304.31	0.00	1,179,039.99
Additions	73,412.00	123,654.72	0.00	197,066.72
Disposals	0.00	52,230.01	0.00	52,230.01
Write-ups	0.00	198,201.36	0.00	198,201.36
December 31, 2004	272,147.68	853,527.66	0.00	1,125,675.34
Additions	94,171.00	170,059.70	0.00	264,230.70
Disposals	0.00	96,336.06	0.00	96,336.06
December 31, 2005	366,318.68	927,251.30	0.00	1,293,569.98
Carrying amounts as of December 31, 2004	388,051.04	617,488.18	0.00	1,005,539.22
Carrying amounts as of December 31, 2005	436,405.90	588,629.53	69,287.79	1,094,323.22

The payments on account and assets under construction relate mainly to leasehold improvements.

Equipment includes assets of EUR 273k acquired through finance leases (prior year: EUR 348k); the gross value of these assets as of the balance sheet date come to EUR 393k (prior year: EUR 410k) and mainly relates to a bioprocess-system for the production of Desmoteplase.

## (3) Long-Term Refund Claims Resulting From the Assumption of Development Costs

The long-term refund claims resulting from the assumption of development costs are against Lundbeck and will be payable when Desmoteplase is given regulatory approval in Europe and/or Japan.

## (4) Trade Receivables

Trade receivables relate to reimbursements for development expenses for Desmoteplase in connection with the license agreements with Forest and Lundbeck.

## (5) Prepaid Expenses and Other Assets

Prepaid expenses and other assets mainly comprise a loan against promissory note for EUR 10,000k held as a short-term investment and which brought 2.2% interest. The loan was redeemed in January 2006. This item also contains advance payments of VAT of EUR 620k (prior year: EUR 254k), tax on investment income of EUR 132k (prior year: EUR 109k) and prepaid insurance premiums and rent (EUR 199k; prior year: EUR 177k). The prior year figure



also included prepaid fees connected with the capital increase within the IPO (EUR 792k). These fees were offset against the increase in equity resulting from the IPO as costs of raising capital.

#### (6) *Cash and Cash Equivalents*

The cash and cash equivalents contain cash on hand and bank balances with a maturity of up to three months, based on the date of investment.

#### (7) *Equity*

##### *Capital Increase in Connection with the IPO*

On January 21, 2005, the general shareholders' meeting resolved in preparation for the IPO of PAION AG to increase the capital stock of EUR 10,005,552.00 by an aggregate amount of up to EUR 5,000,000.00 in return for a cash contribution through the issuance of an aggregate of up to 5,000,000 new ordinary no-par value bearer shares, each with a notional share in the capital stock of EUR 1.00. On February 9, 2005, the supervisory board, in accordance with the authorisation granted to it by the general shareholders' meeting, resolved to amend the articles of incorporation with regard to the capital increase of EUR 5,000,000.00 implemented in connection with the IPO.

In addition, the management board, with the consent of the supervisory board, resolved on February 9, 2005 to increase the capital stock from EUR 15,005,552.00 by an aggregate amount of up to EUR 750,000.00 from Authorised Capital 2004 in return for a cash contribution to an aggregate of EUR 15,755,552.00 through the issuance of up to 750,000 new ordinary no-par value bearer shares, each with a notional value of EUR 1.00. A Greenshoe option was agreed with the underwriter UBS Limited, London, UK, in connection with the IPO. UBS Limited notified the Company on February 21, 2005 that the Greenshoe option had been exercised in full.

Hence, a total of 5,750,000 new shares were placed in the IPO. The issue generated proceeds of EUR 46m, of which EUR 5,750k was allocated to subscribed capital and EUR 40,250k to the capital reserve. Costs of EUR 4,649k were incurred for consultants (prior year: EUR 275k) in connection with the capital increase. These costs were offset against the capital reserve. Income taxes were not included in offsetting as there was no direct tax advantage. Reference is made to the statements in G. under (15) "Income Taxes/Deferred Taxes".

As of December 31, 2005, the capital stock amounts to EUR 15,755,552.00 and is divided into 15,755,552 no-par shares.

##### *Authorised and Conditional Capital*

By virtue of a resolution adopted by the general shareholders' meeting on December 30, 2004, the management board was authorised to increase the capital stock on or prior to December 30, 2009, with the consent of the supervisory board, on one or more occasions, by up to an aggregate of EUR 5,000,000.00 through the issuance of up to 5,000,000 new ordinary no-par value bearer shares in return for cash contributions or contributions in kind (Authorised Capital 2004). 750,000 no-par shares were issued from this authorised capital in order to enable full exercise of the Greenshoe option in connection with the IPO; this meant that another 4,250,000 no-par shares can still be issued from the "Authorised Capital 2004".

By virtue of another resolution adopted by the general shareholders' meeting on December 30, 2004, the management board was authorised to increase capital stock on or before December 30, 2009, on one or more occasions by up to an aggregate amount of EUR 40,000,000.00 through the issuance of convertible or warrant-linked bonds with a maximum term of 20 years and grant the holders or creditors of bonds conversion or option rights to new shares in PAION AG with a proportionate share in capital stock of up to an aggregate of EUR 4,000,000.00 (Conditional Capital 2004 I). The Conditional Capital 2004 I has not yet been used up.

In addition, pursuant to a resolution adopted by the general shareholders' meeting on December 30, 2004, the capital stock of PAION AG was conditionally increased by an aggregate amount of up to EUR 1,000,000.00 through the issuance of an aggregate of up to



1,000,000 new ordinary no-par bearer shares (Conditional Capital 2004 II). The conditional capital increase may be executed only to the extent that the holders of option rights granted by PAION AG in connection with the Stock Option Plan 2005 exercise their option rights. To service the Stock Option Plan 2005, the general shareholders' meeting on August 26, 2005 resolved to conditionally increase PAION AG's capital stock by up to another EUR 110,000.00 through the issuance of a maximum total of 110,000 new no-par bearer shares (Conditional Capital III).

#### *Stock Option Plan for Employees and External Consultants*

In prior years, PAION Deutschland GmbH introduced stock option plan for employees as well as for external consultants which grant "phantom shares" in PAION Deutschland GmbH. As of the end of fiscal year 2004, management resolved to terminate the stock option plan and to settle all outstanding subscription rights through cash payments. Appropriate agreements were concluded with the employees and consultants participating in the plan. In order to calculate the settlement, the eligible claims were converted into phantom shares of PAION AG. Settlement is to be made in three instalments. The first and second tranches were paid out in 2004 and 2005. The third tranche of EUR 1.2m was due in February 2006 and thus correspond to the amount shown as other liability as of December 31, 2005. The cash settlement of the subscription rights is accounted for as a repurchase of an equity interest, i.e. as a reduction of the capital reserve. The capital reserve was thus reduced by EUR 3.3m as of December 31, 2004.

#### *Stock Option Plan 2005*

On December 30, 2004, the general shareholders' meeting of PAION AG approved a stock option plan for management board members and employees of PAION. Under the stock option plan, of the total of 1,102,888 stock options, 496,300 stock options can be granted to management board members and 606,588 to employees. One stock option entitles the holder to subscribe to one share from the dedicated Conditional Capital 2004 II and Conditional Capital III. The stock options have a ten-year term and can only be exercised after a vesting period. The vesting period begins on the issue date and ends, for 50% of the stock options issued, two years after the issue date; for 25% of the stock options issued, the vesting period ends three years, and for the other 25%, four years, after the issue date. Options can only be exercised when the stock price on the exercise date has increased by a cumulative 5% each year since their issue.

On March 10, 2005, 496,300 stock options were issued to members of the management board under the stock option plan, and 453,005 were issued to employees. The exercise price was fixed at EUR 8.00 per option. As of December 31, 2005, a total of 891,227 stock options have been granted to management board members and employees. As the vesting period is still running, no options were exercised in the fiscal year.

The stock options were accounted for in accordance with IFRS 2 "*Share-Based Payment*". The fair value of the stock options on the date of issue was calculated using the Black/Scholes option pricing model and is being recognised in profit and loss as personnel expenses over the vesting period of two to four years. The fair values of the stock options issued are calculated on the basis of an exercise price of EUR 8.00 per option and a stock price of EUR 8.80 on the issue date. The term of the options until exercise was assumed to be three to five years. Depending on the term, a risk-free interest rate of 3.0% to 3.5% was used. The anticipated volatility was assumed to be 44.88%. As PAION AG's shares had only been listed on the Frankfurt stock exchange for a short time at the date of calculating the fair value, a weighted volatility was determined on the basis of the volatility available for PAION and the volatility of three stock market indices. Dividends were not taken into account. Furthermore, a fluctuation of employees was considered with an annual rate of 7.5%. On the basis of these parameters and assumptions, the fair values for the stock options issued vary between EUR 3.23 and EUR 4.08, depending on the underlying term. In fiscal year 2005, personnel expenses of EUR 843k were recognised for the stock options issued, while, at the same time, the capital reserve was increased accordingly.

#### (8) Finance Lease Liabilities

Liabilities due to lease contracts are recognised when the respective asset is recognised as an asset (finance lease). They are recorded at their present value. Lease payments of EUR 303k (prior year: EUR 387k) are due to the lessor over the next few years. The portion of the interest cost included is EUR 22k. The finance lease liabilities are presented according to their maturity as follows:

	<i>Lease payments</i>	<i>Interest portion included in EUR k</i>	<i>Lease liability</i>
2006	84	10	74
2007	81	7	74
2008	75	4	71
2009	63	1	62
	<u>303</u>	<u>22</u>	<u>281</u>

#### (9) Provisions

Provisions developed as follows:

	<i>December 31, 2004</i>	<i>Utilisation</i>	<i>Reversal</i>	<i>Allocation in EUR k</i>	<i>Reclassi- fication</i>	<i>December 31, 2005</i>
Refund obligation to Forest	736	0	21	4,151	0	4,866
Bonuses	60	60	0	236	0	236
Financial statement costs and audit fees	65	64	1	97	0	97
Employer's liability insurance	28	25	3	35	0	35
Consulting fees	1,195	1,161	34	20	0	20
Contingent losses from pending transactions	221	48	46	3	130	0
Obligation from the termination of a stock option plan	1,874	674	0	0	1,200	0
Other	68	0	0	3	0	71
	<u>4,247</u>	<u>2,032</u>	<u>105</u>	<u>4,545</u>	<u>1,330</u>	<u>5,325</u>

The provision for the *refund obligation to Forest* relates to the obligation to refund 50% of the development costs borne directly and indirectly by Forest plus a premium of 20% arising in the event of regulatory approval for Desmoteplase in Europe and/or Japan. This provision is shown in the balance sheet under "non-current liabilities". For more information, reference is made to the statements under "E. Outlicensing Agreements".

For information on the provision for *obligations from the termination of a stock option plan*, please see our comments in "F. (7) Equity". As the amount of these obligations could finally determined in February 2006, a reclassification to 'other liabilities' was made at the cut-off date.

The *provision for contingent losses from pending transactions* was recognised for leased office spaces which are no longer used. A rescission agreement was concluded with effect from December 31, 2005. The outstanding payment obligations was reclassified to 'other liabilities' at the cut-off date.

The provision for *consulting fees* recognised in the prior year mainly covered costs related to the IPO on February 11, 2005. As these costs are offset against the capital increase from the IPO, these costs were initially reported under other assets as of the prior year's balance sheet date.

#### (10) Deferred Income

Deferred income includes a non-refundable signing fee which fell due upon conclusion of the license agreement with Forest. The signing fee is recognised in profit and loss upon the achievement of the relevant milestones. In fiscal year 2005, a portion of EUR 89k was

recognised as income because the indication pulmonary embolism has been shelved for the time being and the related milestones will no longer apply when releasing the signing fee to profit and loss. The remainder of EUR 1,669k is stated in the balance sheet under “non-current liabilities”.

Deferred income also includes an investment grant which PAION received from the Federal Ministry for Education and Research. The deferred investment grants are released in line with the depreciation/amortization of the underlying assets. The amounts released are deducted from research and development expenses. The portion of the grants which is not due within the next 12 months is disclosed under non-current liabilities (EUR 76k).

(11) *Other Current Liabilities*

Other current liabilities comprise the following items:

	<i>December 31, 2005</i>	<i>December 31, 2004</i>
	<i>in EUR k</i>	
Obligation from the termination of a stock option plan	1,200	293
Obligation from a lease rescission agreement	130	0
Wage tax	118	548
Social security contributions	62	118
Other	92	100
	<u>1,602</u>	<u>1,059</u>

**G. Notes to the Consolidated Income Statement**

(12) *Revenues*

*Revenues* in fiscal year 2005 were the result of a payment from Lundbeck for gaining access to PAION’s know-how (EUR 15,000k) and the reimbursement of development costs by Forest and Lundbeck (EUR 3,707k). In addition, a partial release to income of the signing fees paid by Forest (EUR 89k) was recognised. In the prior year, revenues were generated exclusively from the licensing agreement with Forest and EUR 15,592k related to the transfer of know-how, EUR 703k related to the partial recognition of signing fees, and EUR 657k related to the reimbursement of development costs.

(13) *Other Income (Expenses), Net*

This item mainly includes exchange gains (EUR 58k), reversals of provisions (EUR 21k) and exchange losses (EUR 19k) as well as other minor effects that cannot be allocated to other line items.

(14) *Financial Result*

The financial result breaks down as follows:

	<i>2005</i>	<i>2004</i>
	<i>in EUR k</i>	
Interest income	1,073	274
Interest expenses	-15	-11
	<u>1,058</u>	<u>263</u>

(15) *Income Taxes/Deferred Taxes*

Tax losses have been incurred from the time of PAION Deutschland GmbH’s formation in 2000 up to and including 2005. As of December 31, 2005, tax loss carryforwards came to some EUR 43m (prior year: EUR 36m). Under current German tax legislation, these tax losses can be carried forward indefinitely and netted against future income. However, the changes in the shareholder structure of PAION Deutschland GmbH in recent years could limit the amount of loss carryforwards utilizable under current tax law.

Applying corporate income tax and the solidarity surcharge at a combined rate of 21.57% (taking into account the deductibility of the trade tax; prior year: 21.80%) as well as a local trade tax rate of 18.20% (prior year: 17.36%), deferred tax assets amounted to EUR 17,288k as of December 31, 2005 (prior year: EUR 14,118k). Debit differences between the tax base and the IFRS carrying amount as of December 31, 2005 result in additional deferred tax assets of EUR 284k (prior year: 169k). The change in the tax rate is due to an increase in the municipal factor for trade tax from 420% to 445%.

Further losses are expected for the years to come and, as such, it is not considered likely that the deferred tax assets will be realised. In accordance with IAS 12.34, "Income Taxes", the deferred tax assets were not recognised.

In fiscal year 2005 as in the prior year, costs directly related to capital increases were not expensed but netted directly against the capital reserve. Due to the loss situation and the non-recognition of all deferred tax assets, these costs of raising capital are deducted from the capital reserve without taking income taxes into account.

The reconciliation of the expected income taxes and the current tax expense is shown below applying a tax rate of 39.77% (prior year: 39.16%):

	2005	2004
	<i>in EUR k</i>	
Net profit (loss) for the period	-4,756	176
Expected tax expense (+)/income (-)	-1,891	69
Non-recognition of deferred taxes on temporary differences	115	-111
Non-recognition of deferred taxes on tax losses of the fiscal year	2,942	1,452
Costs in connection with capital increases	-1,534	-418
Costs of stock options	335	0
Costs of the stock option plan	0	314
Reduction in the capital reserve due to the settlement of the stock option plan	0	-1,305
Other	33	-1
Current tax expense	<u>0</u>	<u>0</u>

#### (16) Earnings per Share

Earnings per share are calculated in accordance with IAS 33, "Earnings per Share", by dividing net profit (loss) by the weighted average number of shares outstanding during fiscal years 2005 and 2004, respectively. Against the background of the business combination of PAION AG and PAION Deutschland GmbH during fiscal year 2004, the weighted average number of shares outstanding in 2004 was calculated in accordance with the provisions of IFRS 3, "Business Combinations", as follows:

- for the period from January 1, 2004 to the date of the business combination, based on the number of shares outstanding of PAION AG, which are deemed to be the number of shares issued by PAION AG to the shareholders of PAION Deutschland GmbH;
- for the date after the business combination, based on the actual number of shares outstanding.

The underlying weighted average number of ordinary shares outstanding is calculated as follows:

	2005	2004
Shares outstanding on January 1	10,005,552	8,703,078
Capital increase in February	5,118,055	0
Capital increase in May	0	803,369
Business combination in September	0	1,744
Weighted average number of ordinary shares	15,123,607	9,508,191

Basic and diluted earnings per share are calculated on the basis of the following figures:

	December 31 2005	December 31 2004
Net profit (loss) in EUR	-4,756,125.75	176,080.59
Weighted average number of ordinary shares for basic earnings per share	15,123,607	9,508,191
Dilutive shares from a stock option plan	0	7,610
Weighted average number of ordinary shares for diluted earnings per share	15,123,607	9,515,801
Earnings per share (in EUR):		
Basic	-0.31	0.02
Diluted	-0.31	0.02

The stock options issued in fiscal year 2005 did not dilute the earnings per share.

## H. Notes to the Consolidated Cash Flow Statement

The consolidated cash flow statement shows how the cash and cash equivalents of PAION have changed during the course of the fiscal year due to inflows and outflows of funds. In accordance with IAS 7, “*Cash Flow Statements*”, a distinction is made between cash flows from operating, investing and financing activities. The cash and cash equivalents disclosed in the consolidated cash flow statement include cash on hand and bank balances with a maturity of up to three months, based on the date of investment. Furthermore, the loan against promissory note, used as a short-term investment and shown in the balance sheet under “other assets” was classified as cash and cash equivalents because the invested funds were returned in January 2006.

## I. Other Notes

### *Related Parties*

Transactions with related parties must be disclosed pursuant to IAS 24, “*Related Parties*”. The management and supervisory boards as well as shareholders qualify as related parties within the meaning of IAS 24.9. With regard to the remuneration of the members of the management and supervisory boards, reference is made to the statements under “Members of the Management Board”, and “Members of the Supervisory Board” in this section.

In fiscal year 2005, Blättchen & Partner AG provided consulting services to PAION AG in connection with the IPO and the general shareholders’ meeting. Prof. Dr. Wolfgang Blättchen is a member of the management board of Blättchen & Partner AG and was also, during part of the fiscal year, a member of the supervisory board of PAION AG. The fees paid to Blättchen & Partner AG in the fiscal year amounted to EUR 237k plus travel and out-of-pocket expenses.

Apart from the above, there are no significant related parties.

### *Financial Instruments*

The financial instruments held by PAION on the balance sheet date are mainly cash and cash equivalents, short-term investments, trade receivables and payables, and refund claims resulting from the assumption of development costs. PAION does not currently use derivative financial instruments.

Due to the short maturities of the short-term investments and the trade receivables and payables, the book values are identical to the fair values. The long-term refund claims resulting from the assumption of development costs are carried at present value; for this financial instrument there is, therefore, no difference between book and fair value.

PAION is not currently exposed to any notable *foreign currency risk*. Development costs are charged and financial investments made in euros. The trade payables which are denominated in a foreign currency are of secondary importance. When specific milestones are reached, PAION will receive further payments from its cooperation partners, some of which will be payable in US dollars. The Company regularly reviews whether or not a currency hedge is appropriate.

All of the trade receivables result from development costs charged on to Forest and Lundbeck. The long-term refund claims resulting from development costs are against Lundbeck. In spite of this concentration, PAION considers the *credit risk* to be low in view of the credit standing of its two cooperation partners. The cash and cash equivalents and short-term investments are with two major German banks and the savings bank Sparkasse Aachen. Various credit protection criteria are applied in selecting short-term investments (e.g. rating, capital guarantee, protection by the Deposit Protection Fund). Given the selection criteria applied and the ongoing monitoring of its investments, PAION does not believe that these activities involve a credit risk. The amounts shown in the balance sheet are the maximum credit risk.

Liquidity is monitored and controlled using an enterprise planning tool for both short and long-term planning which has been customised for PAION. *Liquidity risks* are identified at an early stage by simulating various scenarios and using sensitivity analyses. Current liquidity is recorded and monitored on a daily basis.

On the balance sheet date, PAION did not hold any positions that were subject to an *interest rate risk*.

#### *Employees and Personnel Expenses*

In fiscal year 2005, PAION employed an average of 64 people (prior year: 49). An average of 41 persons were employed in research and development in the fiscal year, 19 were employed in administration, and 4 in sales and marketing. The following personnel expenses were incurred in fiscal years 2005 and 2004:

	2005	2004
	<i>in EUR k</i>	
Salaries	5,323	3,671
Social security	637	507
	<u>5,960</u>	<u>4,178</u>

The above personnel expenses include costs of issuing options under the stock option plan of EUR 843k (prior year: EUR 278k).

#### *Other Financial Obligations/Contingent Liabilities*

PAION has rented office and research premises, as well as motor vehicles and some of its factory and office equipment. The fu\*\*softhyph\*\*ture minimum lease obligations required under these lease agreements are as follows:

	<i>EUR k</i>
2006	441
2007	400
2008	286
2009	277
Thereafter	435
Total	<u>1,839</u>



The rental and lease expenses under these agreements came to EUR 419k in fiscal year 2005 (prior year: EUR 394k).

In addition, PAION is obligated to make payments under various license and purchase agreements pursuant to which PAION acquired the rights to certain patents. Upon the occurrence of certain events, PAION will be required to make milestone payments in an aggregate amount of up to approximately EUR 15.7m (which is partially payable in USD) to the contracting partners with respect to licenses for Desmoteplase, Enecadin and Solulin. PAION also agreed to pay royalties based on its future net sales of Desmoteplase, Solulin and Enecadin.

#### Members of the Management Board

The members of the management board are:

- Dr. Wolfgang Söhngen, CEO, Chairman
- Alexander Vos, COO, Deputy Chairman
- Dr. Mariola Söhngen, CMO
- Bernhard Hofer, CFO

The remuneration paid to management board members comprises a fixed annual compensation, a variable bonus and a long-term performance-based compensation component in the form of stock options. The variable bonus depends on the achievement of financial and strategic corporate targets and personal goals which are defined by the supervisory board in conjunction with the management board at the beginning of each fiscal year. The level of target achievement and the related amount of the variable compensation is assessed and determined by the supervisory board at the end of each year. The members of the management board received stock options from the stock option plan approved at the general shareholders' meeting on December 30, 2004. The number of shares to be allocated to the management board was fixed by the supervisory board immediately after the IPO. By the vesting period of two to four years until the possible exercise of the stock options, they are designed to act as a long-term incentive to enhance the Company's value. The stock options had an issue price of EUR 8.00 per option. In addition, the management board members receive fringe benefits in the form of company cars and allowances for insurance policies. Based on the agreements with the members of management, the compensation structure for fiscal year 2005 is as follows:

	<i>Fixed compensation EUR</i>	<i>Variable compensation EUR</i>	<i>Other compensation EUR</i>	<i>Stock options No.</i>	<i>Stock options fair value* EUR</i>
Dr. Wolfgang Söhngen	200,000	50,000	19,223	138,964	389,162
Alexander Vos	200,000	50,000	3,264	138,964	389,162
Dr. Mariola Söhngen	190,000	50,000	13,531	109,186	305,770
Bernhard Hofer	120,000	30,000	4,446	109,186	305,770

\* fair value on the issue date calculated with the Black/Scholes option pricing model

As of December 31, 2005, Dr. Wolfgang Söhngen and Dr. Mariola Söhngen held 602,241 and 672,543 shares, respectively, in PAION AG, including 6,197 shares held by Dres. Söhngen Beteiligungs GmbH & Co. KG, in which Dr. Wolfgang Söhngen and Dr. Mariola Söhngen each hold 50% through Dres. Söhngen Beteiligungs GmbH as general partner and as limited partners. In fiscal year 2005, Dr. Wolfgang Söhngen transferred 67,500 shares to his children as a gift.

The Company's management board members are also the general managers of PAION Deutschland GmbH and work full time for the Company and for PAION Deutschland GmbH.



*Members of the Supervisory Board:*

The members of the supervisory board are:

- Dr. Walter Wenninger, Leverkusen, Germany, Chairman, businessman

Other supervisory board or similar positions:

- EPIDAUROS Biotechnologie AG, Bernried, Germany
- Verlags- und Medien Aktiengesellschaft (VEMAG), Cologne, Germany
- Arrow Therapeutics Ltd., London, UK

- Dr. Franz Wirtz, Stolberg, Germany, Deputy Chairman, businessman

Other supervisory board or similar positions:

- DASGIP AG, Jülich, Germany
- QIAGEN N.V., Venlo, Netherlands.

- Prof. Dr. Erich Schlick, Otterstadt, Germany, partner at Wellington Partners Venture Capital GmbH, Munich, Germany

Member of the supervisory board from January 1 to May 25, 2005 and since October 1, 2005

Other supervisory board or similar positions:

- Administrative board member of the Central Institute of Mental Health, Mannheim, Germany

- Prof. Dr. Wolfgang Blättchen, Leonberg, Germany, management consultant

Member of the supervisory board from May 25, 2005 to September 30, 2005, since October 1, 2005, substitute member for Prof. Dr. Erich Schlick

Other supervisory board or similar positions:

- AIXTRON AG, Aachen, Germany
- APCOA Parking AG, Leinfelden-Echterdingen, Germany
- GARDENA AG, Ulm, Germany
- HAUBROK AG, Düsseldorf, Germany
- HORVÁRTH AG, Stuttgart, Germany
- MARC O'POLO AG, Stephanskirchen, Germany
- tec2b AG, Stuttgart, Germany

The members of the supervisory board received the following remuneration for fiscal year 2005:

- |                                 |               |
|---------------------------------|---------------|
| – Dr. Walter Wenninger:         | EUR 52,000.00 |
| – Dr. Franz Wirtz:              | EUR 39,000.00 |
| – Prof. Dr. Erich Schlick:      | EUR 17,698.63 |
| – Prof. Dr. Wolfgang Blättchen: | EUR 8,301.37  |

The remuneration comprises basic compensation and per-meeting fees. The members of the supervisory board do not receive performance-based remuneration. In addition, in fiscal year 2005, the members of the supervisory board also received the remuneration fixed at the general shareholders' meeting on August 26, 2005 for their work in the abbreviated fiscal year from June 2 to December 31, 2004:

- |                            |               |
|----------------------------|---------------|
| – Dr. Walter Wenninger:    | EUR 21,935.45 |
| – Dr. Franz Wirtz:         | EUR 21,522.90 |
| – Prof. Dr. Erich Schlick: | EUR 12,416.67 |

Dr. Franz Wirtz GmbH, which is wholly owned by Dr. Wirtz, held 194,073 shares in PAION AG as of December 31, 2005. In addition, Dr. Wirtz holds a 10% interest in Dr. Franz Wirtz Vermögensverwaltungs GbR, which, as of December 31, 2005, held a further 140,056 PAION AG shares.

#### *Auditors*

At the general shareholders' meeting on August 26, 2005, Ernst & Young AG, Wirtschaftsprüfungsgesellschaft, Cologne, Germany, was appointed as auditor for the annual and consolidated financial statements for fiscal year 2005. The auditor received the following fees for services rendered to PAION AG and its subsidiary PAION Deutschland GmbH in fiscal year 2005:

– Audit:	EUR 35,000
– Tax advisory:	EUR 19,566
– Other services:	EUR 102,350

Other services mainly relate to work performed in connection with the issuance of comfort letters for the IPO.

#### *Corporate Governance*

The supervisory board and management board of PAION AG declare that they are committed to responsible and transparent management and control focussed on long-term added value.

The Company complies, for the most part, with the recommendations set forth in the most recent version of the German Corporate Governance Code dated June 2, 2005. On December 14, 2005, the supervisory board and the management board issued the declaration of compliance with the Corporate Governance Code pursuant to Sec. 161 AktG [“Aktengesetz”: German Stock Corporation Act] This declaration of compliance is published on PAION AG's website ([www.paion.de](http://www.paion.de)).

## APPENDIX E

### Additional Information

#### 1. Responsibility

- 1.1 The CeNeS Directors, whose names are set out in paragraph 2.1 below, accept responsibility for the information contained in this document, except for the information for which responsibility is taken by the Paion Directors. Save as aforesaid, to the best of the knowledge and belief of the CeNeS Directors (who have taken all reasonable care to ensure that such is the case), the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information.
- 1.2 The Paion Directors, whose names are set out in paragraph 2.2 below, accept responsibility for the information contained in this document relating to each member of the Paion Group, the Paion Directors and each of them and members of their immediate families, related trusts and any persons connected with them including, specifically, the financial information set out in Appendix D and the information contained in the following sections:
- (A) Part 1, paragraph 5 (Management and Employees);
  - (B) Part 2, paragraphs 5 (Information on Paion), 6 (Background to and reasons for the Acquisition), 7 (Current trading and prospects), 8 (Financial effects of the Acquisition), 11 (Irrevocable Undertakings and Letter of Intent), 12 (Paion Prospectus), 13 (Management and employees), 17 (Cancellation of trading of CeNeS Shares on AIM), 18 (Admission) and 21 (DIs and Settlement); and
  - (C) Appendix E, paragraphs 2 (Directors), 4.4 and 4.5 (Disclosure of Interests and Dealings), 7.1 (Material Contracts) and 8 (Other Information),
- in each case, insofar as each paragraph relates to Paion, the Paion Directors or any other member of the Paion Group and/or the Enlarged Group or any of their officers, directors and/or employees.
- 1.3 To the best of the knowledge and belief of the Paion Directors (who have taken all reasonable care to ensure that such is the case), the information contained herein for which they are responsible is in accordance with the facts and does not omit anything likely to affect the import of such information.
- 1.4 Neither Capita IRG Trustees Limited nor Capita Trust Company Limited make any representations or recommendations whatsoever regarding this document and accept no responsibility or liability for any information contained herein. Capita IRG Trustees Limited and Capita Trust Company Limited owe no duty to any holder of CeNeS Shares.

#### 2. Directors

- 2.1 The CeNeS Directors and their respective functions are as follows:

<i>Name</i>	<i>Position held</i>
Alan Goodman	Chairman
Neil Clark	Chief Executive
Tony Osborne	Finance Director and Company Secretary
Ronald Irwin	Non-Executive Director
Dr Peter Johnson	Non-Executive Director
Alan Smith	Non-Executive Director

CeNeS's registered office is at Riverside Way, Riverside Business Park, Irvine KA11 5DJ, Scotland.

- 2.2 The Paion Directors and their respective functions are as follows:

<i>Name</i>	<i>Position held</i>
Dr Wolfgang Söhnngen	Chief Executive Officer and chairman of the management board
Dr Mariola Söhnngen	Chief Medical Officer
Bernhard Hofer	Chief Financial Officer
Alexander Vos	Chief Operating Officer

The business address of each of the Paion Directors is Martinstrasse 10-12, 52062 Aachen, Germany which is also Paion's principal place of business.

### 3. Concert Parties

For the purposes of Rule 24.2(d)(iii) of the Code, no persons are acting in concert with Paion or CeNeS other than:

- (A) in the case of CeNeS:
  - (i) its financial adviser, Nomura Code; and
  - (ii) the CeNeS Directors; and
- (B) in the case of Paion:
  - (i) its financial adviser, Landsbanki; and
  - (ii) the Paion Directors.

### 4. Disclosure of interests and dealings

#### 4.1 Definitions for the purposes of paragraph 4

- (A) **“acting in concert”** has the meaning attributed to it in the Code;
- (B) an **“Associate”** means, in relation to CeNeS:
  - (1) the subsidiaries and associated companies of CeNeS and companies of which any such subsidiaries or associated companies are associated companies (each a **“Relevant Company”**) (for this purpose, ownership or control of 20 per cent. or more of the equity share capital of a company is regarded as the test of associated company status);
  - (2) connected advisers to CeNeS or any Relevant Company and persons controlling, controlled by or under the same control of any such connected advisers; and
  - (3) the CeNeS Directors and the directors of any Relevant Company (in each case, together with their close relatives and related trusts);
- (C) **“connected adviser”** has the meaning attributed to it in the Code;
- (D) **“Connected Person”** means in relation to any person, a person whose interest in shares is one in which the first mentioned person is also taken to be interested pursuant to Part 22 of the Companies Act 2006;
- (E) **“control”** means a holding, or aggregate holdings, of shares in the capital of a company carrying 30 per cent. or more of the voting rights of such company, irrespective of whether the holding or holdings give de facto control;
- (F) **“dealing or dealt”** includes the following:
  - (1) acquiring or disposing of Relevant Securities, the right (whether conditional or absolute) to exercise or direct the exercise of the voting rights allocated to Relevant Securities or general control of Relevant Securities;
  - (2) taking, granting, acquiring, disposing of, entering into, closing out, terminating, exercising (by either party) or verifying an option in respect of any Relevant Securities;
  - (3) subscribing or agreeing to subscribe for Relevant Securities (whether in respect of new or existing securities);
  - (4) exercising or converting any Relevant Securities carrying conversion or subscription rights;

- (5) acquiring, disposing of, entering into, closing out, exercising (by either party) of any rights under, or varying of, a derivative referenced directly or indirectly, to Relevant Securities;
  - (6) entering into, terminating or varying the terms of any agreement to purchase or sell Relevant Securities; and
  - (7) any other action resulting, or which may result, in an increase or decrease in the number of Relevant Securities in which a person is interested or in respect of which he has a Short Position;
- (G) **“derivative”** includes any financial product whose value in whole or in part is determined, directly or indirectly, by reference to the price of an underlying security but which does not include the possibility of delivery of such underlying securities;
  - (H) **“Disclosure Date”** means 30 April 2008, being the latest practicable date prior to the publication of this document;
  - (I) **“Disclosure Period”** means the period commencing on 5 February 2007 (being the date 12 months prior to the commencement of the Offer Period) and ending on the Disclosure Date;
  - (J) an **“Exempt Fund Manager”** means a person who manages investment accounts on a discretionary basis and is recognised by the Panel as an exempt fund manager for the purposes of the Code;
  - (K) an **“Exempt Principal Trader”** means a person who is recognised by the Panel as an exempt principal trader for the purposes of the Code;
  - (L) being **“interested”** in Relevant Securities includes where a person (otherwise than through a Short Position):
    - (1) owns Relevant Securities;
    - (2) has the right (whether conditional or absolute) to exercise or direct the exercise of the voting rights attaching to Relevant Securities or has general control over them;
    - (3) by virtue of an agreement to purchase, option or derivative, has the right or option to acquire Relevant Securities or to call for their delivery or is under an obligation to take delivery of them, whether the right, option or obligation is conditional or absolute and whether it is in the money or otherwise; or
    - (4) is party to any derivative whose value is determined by reference to their price and which results, or may result, in his having a long position in them;
  - (M) **“Paragraph 1 Associate”** means, in relation to CeNeS, a company which is an Associate of CeNeS by virtue of paragraph (1) of the definition of “Associate”;
  - (N) **“Relevant Paion Securities”** means Paion Shares (or derivatives referenced thereto) and securities convertible into, rights to subscribe for and options (including traded options) in respect of, any Paion Shares;
  - (O) **“Relevant CeNeS Securities”** means CeNeS Shares (or derivatives referenced thereto) and securities convertible into, rights to subscribe for and options (including traded options) in respect of, any CeNeS Shares;
  - (P) **“Relevant Securities”** means Relevant Paion Securities or Relevant CeNeS Securities; and
  - (Q) **“Short Position”** means any short position (whether conditional or absolute and whether in the money or otherwise) including any short position under a derivative, any agreement to sell or any delivery obligation or right to require another person to purchase or take delivery.

#### 4.2 Interests in Relevant CeNeS Securities

- (A) As at the Disclosure Date, the interests of the CeNeS Directors and their Connected Persons, all of which are beneficial unless otherwise stated, in Relevant CeNeS Securities (other than the options detailed in paragraph 4.2(B) below) were as follows:

<i>Name</i>	<i>Number of CeNeS Shares</i>	<i>% of CeNeS's Issued Share Capital</i>
Alan Goodman <sup>(1), (2)</sup>	559,031	2.55
Neil Clark	24,020	0.11
Tony Osborne	4,500	0.02
Ronald Irwin	20,645	0.09
Peter Johnson	4,444	0.02
Alan Smith <sup>(2)</sup>	4,760	0.02
	<u>617,400</u>	<u>2.81</u>

(1) Includes 154,605 CeNeS Shares held by ATM Investments Limited, 58,047 CeNeS Shares held by Avlar Bioventures Limited and 33,333 CeNeS Shares held by the Avlar Pension Fund, each of which is a Connected Person in relation to Alan Goodman.

(2) Alan Goodman, the Chairman of CeNeS, is also a director of Avlar Bioventures Limited and a limited partner in the funds it manages. Alan Smith, a CeNeS Director, is also chairman of Avlar Bioventures Limited. Avlar Bioventures Fund II is a fund managed by Avlar Bioventures Limited and has an interest in 2,436,449 CeNeS Shares.

- (B) In addition, as at the Disclosure Date, the CeNeS Directors had outstanding the following interests in options over CeNeS Shares:

<i>Name</i>	<i>Note</i>	<i>Number of CeNeS Shares the subject of options</i>	<i>Exercise price (per CeNeS Share unless otherwise stated)</i>	<i>Expiry date</i>
Alan Goodman	1	33,731	147p	14-Jan-09
	2	4,230	£1 in aggregate	30-Jun-10
	2	30,937	£1 in aggregate	31-Dec-11
	2	43,312	£1 in aggregate	1-Aug-13
	2	26,666	£1 in aggregate	20-Apr-14
	3	15,877	233p	22-Dec-11
	3	33,333	210p	2-Feb-13
	3	33,332	184p	30-Mar-17
		<u>221,418</u>		

*Notes:*

- (1) Alan Goodman's spouse, Mrs Eileen Goodman, has entered into an option agreement with CeNeS Limited pursuant to which she has a right to subscribe for shares in CeNeS Limited at £1.00 per share. In the event that her option is exercised her ordinary shares in CeNeS Limited will be compulsorily transferred to CeNeS in return for approximately 0.68 CeNeS Shares for each CeNeS Limited ordinary share.
- (2) Options granted under the CeNeS Pharmaceuticals plc Executive Share Option Plan.
- (3) Options granted under the CeNeS Pharmaceuticals plc Unapproved Share Option Scheme.

<i>Name</i>	<i>Note</i>	<i>Number of CeNeS Shares the subject of options</i>	<i>Exercise price (per CeNeS Share unless otherwise stated)</i>	<i>Expiry date</i>
Neil Clark	2	3,365	in aggregate	03-Jul-10
	2	39,218	£1 in aggregate	31-Dec-11
	2	54,916	£1 in aggregate	1-Aug-13
	2	50,000	£1 in aggregate	20-Apr-14
	3	39,066	233p	22-Dec-11
	3	66,666	210p	2-Feb-13
	3	33,333	184p	30-Mar-17
		<u>286,321</u>		
Tony Osborne	3	17,187	240p	1-Jan-09
	3	30,000	120p	1-Aug-10
	3	25,666	311p	20-Apr-11
	3	14,955	232p	22-Dec-11
	3	28,333	206p	2-Feb-13
	3	26,666	184p	30-Mar-14
		<u>142,807</u>		

*Notes:*

- (1) Alan Goodman's spouse, Mrs Eileen Goodman, has entered into an option agreement with CeNeS Limited pursuant to which she has a right to subscribe for shares in CeNeS Limited at £1.00 per share. In the event that her option is exercised her ordinary shares in CeNeS Limited will be compulsorily transferred to CeNeS in return for approximately 0.68 CeNeS Shares for each CeNeS Limited ordinary share.
- (2) Options granted under the CeNeS Pharmaceuticals plc Executive Share Option Plan.
- (3) Options granted under the CeNeS Pharmaceuticals plc Unapproved Share Option Scheme.

#### 4.3 Dealings in CeNeS Shares

- (A) Dealings for value in Relevant CeNeS Securities (including the exercise of options and awards under the CeNeS Share Schemes) by CeNeS Directors and their Connected Persons during the Disclosure Period were as follows:

<i>Name</i>	<i>Date of Transaction</i>	<i>Transaction (sale or purchase)</i>	<i>CeNeS Shares</i>	<i>Price (p)</i>
Alan Goodman	23 August 2007	purchase	9,523	£1.05
Neil Clark	23 August 2007	purchase	9,523	£1.05
Ronald Irwin	23 August 2007	purchase	4,760	£1.05
Alan Smith	23 August 2007	purchase	4,760	£1.05

- (B) It is expected that, following the Court Meeting and the General Meeting, Neil Clark will exercise options under the Executive Plan over 147,499 CeNeS Shares and Alan Goodman will exercise options under the Executive Plan over 105,145 CeNeS Shares, but that other options held by the CeNeS Directors will be unexercised and will lapse in accordance with their terms. The issue of 252,644 CeNeS Shares pursuant to the exercise of such options granted under the Executive Plan, together with the interests in 617,400 CeNeS Shares currently held by the CeNeS Directors and their Connected Persons, will result in an aggregate interest in 870,044 CeNeS Shares which pursuant to the Acquisition will result in the CeNeS Directors and their Connected Persons holding interests in approximately 306,342 Paion Shares.
- (C) As noted in paragraph 9 of Part 2 of this document, after the Court Hearing, but prior to the time at which the Scheme becomes effective, Paion shall subscribe at nominal value for, and (subject to receipt of such subscription monies) CeNeS shall allot and issue to Paion as fully paid, one CeNeS Share (ranking pari passu with each other



CeNeS Share then in issue). The Panel has consented to the acquisition of such CeNeS Share by Paion and the waiver of Rule 11 of the Code in respect of such acquisition.

#### 4.4 *Interests in Relevant Paion Securities*

- (A) As at the Disclosure Date, the interests of the Directors of Paion and their Connected Persons, all of which are beneficial unless otherwise stated, in Relevant Paion Securities (other than the options detailed in paragraph 4.4(B) below and the stock appreciation rights detailed in paragraph 4.4(C) below) were as follows:

<i>Name</i>	<i>Number of Paion Shares</i>	<i>% of Paion's Issued Share Capital</i>
Dr Wolfgang Söhngen <sup>(1)</sup>	1,224,784 <sup>(2)</sup>	7.31
Dr Mariola Söhngen <sup>(1)</sup>	1,224,784 <sup>(2)</sup>	7.31

(1) Dr Wolfgang Söhngen and Dr Mariola Söhngen are married and are each therefore a Connected Person of one another.

(2) Includes both the 579,241 Paion Shares held by Dr Wolfgang Söhngen and the 645,543 Paion Shares held by Dr Mariola Söhngen.

- (B) As at the Disclosure Date, the Paion Directors had outstanding the following interests in options over Paion Shares:

<i>Name</i>	<i>Number of Paion Shares the subject of options</i>	<i>Exercise price per Paion Share (€)</i>	<i>Expiry date</i>
Dr Wolfgang Söhngen	138,964	8.00	10 March 2015
Dr Mariola Söhngen	109,816	8.00	10 March 2015
Bernhard Hofer	109,816	8.00	10 March 2015
Alexander Vos	138,964	8.00	10 March 2015

- (C) As at the Disclosure Date, the Paion Directors had outstanding the following interests in stock appreciation rights in respect of Paion Shares:

<i>Name</i>	<i>Number of stock appreciation rights</i>	<i>Exercise price per stock appreciation right (€)</i>	<i>Expiry date</i>
Dr Wolfgang Söhngen	25,000	7.89	25 December 2016
Dr Mariola Söhngen	25,000	7.89	25 December 2016
Bernhard Hofer	25,000	7.89	25 December 2016
Alexander Vos	25,000	7.89	25 December 2016

#### 4.5 *General*

- (A) Save as disclosed in this paragraph 4, as at the Disclosure Date none of CeNeS or any of the CeNeS Directors or any of their respective Connected Persons was interested in or had a right to subscribe for or a Short Position in any Relevant Securities nor has dealt for value in any Relevant Securities during the Disclosure Period.
- (B) Save as disclosed in this paragraph 4, as at the Disclosure Date none of Paion, any persons acting in concert with Paion or any of the Paion Directors or any of their respective Connected Persons was interested in or had a right to subscribe for or a Short Position in any Relevant Securities nor has any such person dealt for value in any Relevant Securities during the Disclosure Period.

- (C) Save as disclosed in this paragraph 4, none of the following is interested in any Relevant Securities or has any Short Position in any Relevant Securities nor has any such person dealt for value in Relevant Securities during the Disclosure Period:
- (1) any company which is Paragraph 1 Associate of CeNeS;
  - (2) any pension fund of CeNeS or of a company which is a Paragraph 1 Associate of CeNeS;
  - (3) any employee benefit trust of CeNeS or of a company which is a Paragraph 1 Associate of CeNeS; and
  - (4) any connected adviser to CeNeS or to a company which is a Paragraph 1 Associate of CeNeS or to a person acting in concert with CeNeS or by persons controlled, controlled by, or under the same control as any such adviser (except for an Exempt Principal Trader or Exempt Fund Manager).
- (D) Save as disclosed in this paragraph 4, neither CeNeS nor any Associate of CeNeS has any arrangement of the kind referred to in note 6(b) to Rule 8 of the Code with any person in relation to any Relevant Securities.
- (E) Save as disclosed in this paragraph 4, neither Paion nor any person acting in concert with Paion has any arrangement of the kind referred to in note 6(b) to Rule 8 of the Code with any person in relation to any Relevant Securities.
- (F) During the Disclosure Period neither Paion or CeNeS has purchased or redeemed any Relevant Securities.
- (G) Save as disclosed in this paragraph 4, as at the Disclosure Date, none of the persons mentioned herein had borrowed or lent any Relevant Securities, save for any borrowed shares which have been either on-lent or sold.

## 5. Market Quotations

Set out below are the Closing Prices for CeNeS Shares and Paion Shares on:

- 5.1 the first dealing day of each of the six months immediately prior to the date of this document;
- 5.2 4 February 2008 (being the last dealing day before the commencement of the Offer Period);
- 5.3 9 April 2008 (being the last dealing day before the Announcement); and
- 5.4 30 April 2008 (being the latest practicable date prior to the publication of this document):

<i>Date</i>	<i>CeNeS Shares</i>	<i>Paion Shares</i>
1 October 2007	78.5p	€1.68
1 November 2007	68.5p	€1.99
3 December 2007	51p	€1.86
1 February 2008	30.5p	€1.91
4 February 2008	32p	€1.89
3 March 2008	50p	€1.81
1 April 2008	40p	€1.65
9 April 2008	37p	€1.74
30 April 2008	32.5p	€1.60

## 6. Service Contracts

- 6.1 The executive CeNeS Directors have entered into service contracts with CeNeS as follows:

(A) *Alan Goodman, Chairman*

Alan Goodman is employed by CeNeS pursuant to a service agreement dated 17 November 1999, terminable on 12 months' written notice. His current salary is £123,732 per annum, in addition to which he is entitled to a company car, life assurance, permanent health insurance, pension contributions (10% of salary) and discretionary participation in CeNeS's bonus schemes. In connection with his extra time commitment and efforts in connection with the Acquisition, the Remuneration Committee of CeNeS has determined that a bonus of £123,732 will be payable to him in connection with the Acquisition. It is intended that Alan Goodman's employment by CeNeS be terminated upon completion of the Acquisition and that in connection with such termination a payment of £203,732 (in addition to accrued but unpaid salary and pension contributions arising in respect of the period prior to termination) will be payable by CeNeS to Alan Goodman by way of compromise of his employment rights (including his entitlement to such bonus).

It is intended that, following completion of the Acquisition, Alan Goodman will become a member of the supervisory board of Paion, for which it is proposed that he be paid a basic fee of €15,000 per annum (plus a fee of €1,000 for each meeting of the supervisory board attended).

(B) *Neil Clark, Chief Executive*

Neil Clark is employed by CeNeS pursuant to a service agreement dated 14 August 2000, terminable on 12 months' written notice. His current salary is £198,744 per annum, in addition to which he is entitled to a car allowance (£5,000 per annum), life assurance, permanent health insurance, pension contributions (10% of salary) and discretionary participation in CeNeS's bonus schemes. In connection with his extra time commitment and efforts in connection with the Acquisition, the Remuneration Committee of CeNeS has determined that a bonus of £198,744 will be payable to him in connection with the Acquisition. It is intended that Neil Clark's employment by CeNeS be terminated upon completion of the Acquisition and that in connection with such termination a payment of £437,332 (in addition to accrued but unpaid salary and pension contributions arising in respect of the period prior to termination) will be payable by CeNeS to Neil Clark by way of compromise of his employment rights (including his entitlement to such bonus).

(C) *Tony Osborne, Finance Director*

Tony Osborne is employed by CeNeS pursuant to a service agreement dated 1 October 2007, terminable on 6 months written notice. His current salary is £105,000 per annum, in addition to which he is entitled to a car allowance (£5,000 per annum), life assurance, permanent health insurance, pension contributions (10% of salary) and discretionary participation in CeNeS's bonus schemes. In connection with his extra time commitment and efforts in connection with the Acquisition, the Remuneration Committee of CeNeS has determined that a bonus of £31,500 will be payable to him in connection with the Acquisition. It is intended that Tony Osborne's employment by CeNeS be terminated upon completion of the Acquisition and that in connection with such termination a payment of £97,310 (in addition to accrued but unpaid salary and pension contributions arising in respect of the period prior to termination) will be payable by CeNeS to Tony Osborne by way of compromise of his employment rights (including his entitlement to such bonus).

It is intended that, with effect from completion of the Acquisition, Tony Osborne will be engaged as a consultant by CeNeS Limited to provide services on a part-time basis for a period of 4 months for which he shall be paid a fee of £750 for each day worked.

6.2 The non-executive CeNeS Directors have entered into letters of appointment with CeNeS as follows:

(A) *Ron Irwin, non-executive director*

Ron Irwin is engaged by the Company pursuant to a letter of appointment dated 24 March 2004, terminable on 3 months' written notice. A fee of £33,826 per annum is payable to the director pursuant to his letter of appointment. It is intended that Ron Irwin's engagement by the Company be terminated upon completion of the Acquisition without any payment being made to him.

(B) *Peter Johnson, non-executive director*

Peter Johnson is engaged by the Company pursuant to a letter of appointment dated 16 October 2003, terminable on 3 months' written notice. A fee of £33,826 per annum is payable to the director pursuant to his letter of appointment. It is intended that Peter Johnson's engagement by the Company be terminated upon completion of the Acquisition without any payment being made to him.

(C) *Alan Smith, non-executive director*

Alan Smith is engaged by the Company pursuant to a letter of appointment dated 9 January 2004, terminable on 3 months' written notice. A fee of £25,225 per annum is payable to the director pursuant to his letter of appointment. It is intended that Alan Smith's engagement by the Company be terminated upon completion of the Acquisition without any payment being made to him.

6.3 Save as disclosed herein:

(A) there are no service agreements in force between any director or proposed director of CeNeS and CeNeS or any of its subsidiaries; and

(B) none of the service agreements described above were entered into during the six months preceding the date of this document nor have any amendments been made to any of such service agreements during that period.

6.4 Gavin Kilpatrick is employed by CeNeS Limited pursuant to a service agreement dated 21 October 2003, terminable on 6 months written notice. His current salary is £132,432 per annum, in addition to which he is entitled to a car allowance (£5,000 per annum), life assurance, permanent health insurance, pension contributions (10% of salary) and discretionary participation in CeNeS's bonus schemes (with a maximum possible bonus of 40% of salary in any 12 months).

It is intended that, with effect from completion of the Acquisition and in connection with his appointment as a member of the management board of Paion, Gavin Kilpatrick's salary will be increased to £152,000 per annum, and that his maximum possible bonus will be £72,000 (approximately 47% of salary).

## **7. Material Contracts**

### *7.1 The Paion Group*

The following contracts have been entered into by Paion since 5 February 2006 (being the date two years prior to the commencement of the Offer Period) which are outside the ordinary course of business and are or may be considered material:

(A) *The Implementation Agreement*

(i) The Implementation Agreement dated 10 April 2008 entered into by CeNeS and Paion relating to, among other things, various matters in relation to the implementation of the Scheme (or, if applicable the Takeover Offer), the conduct of CeNeS's business prior to the Effective Date or the lapse or withdrawal of the Acquisition, an inducement fee, and non-solicit undertakings. Under the Implementation Agreement, CeNeS will be required to pay Paion an inducement fee equal to 1 per cent. of the value of the fully diluted share capital of CeNeS calculated by reference to the value of the Acquisition set out in the Announcement (being approximately £109,000) if, following the publication of the Announcement:

- before the Scheme (or Takeover Offer, as applicable) lapses, terminates or otherwise fails, or within 60 days of such date, a competing proposal to acquire CeNeS is announced and that competing proposal, or any other competing proposal, becomes Effective or is otherwise completed;
  - the CeNeS Directors do not in the Scheme Document unanimously and without qualification recommend CeNeS Shareholders to vote in favour of the Scheme at the Meetings (or, in the case of a Takeover Offer, to accept the Takeover Offer), or they withdraw, qualify or adversely modify such recommendation, or recommend a competing proposal;
  - the Panel allows Paion not to make or withdraw the Acquisition by reason of a breach of the Conditions which arises as a result of an act or omission of CeNeS; or
  - CeNeS breaches its non-solicit undertakings described below.
- (ii) CeNeS has agreed that it will not, directly or indirectly, solicit, initiate, encourage or otherwise seek to procure any competing transaction. In addition, CeNeS has agreed to notify Paion promptly of any approach made to CeNeS in relation to a competing transaction or any request for information under Rule 20.2 of the Code. CeNeS has also agreed, subject to the fiduciary duties of the CeNeS Directors, not to participate in discussions regarding a competing transaction.
- (iii) The Implementation Agreement will terminate upon:
- either party giving notice following a material breach of the Implementation Agreement by the other party;
  - the CeNeS Directors withdrawing, modifying or qualifying their unanimous recommendation of the Acquisition or the Scheme or agreeing or resolving to recommend or recommending a competing proposal;
  - CeNeS Shareholders voting not to approve the Scheme at the Court Meeting or the relevant resolutions not being passed at the General Meeting;
  - a competing proposal becoming or being declared wholly unconditional or being completed;
  - unless the parties agree otherwise in writing, if the Effective Date has not occurred on or before 31 July 2008; or
  - the Acquisition lapsing or being withdrawn.

(B) *The New Lundbeck Agreement*

Under the New Lundbeck Agreement, Lundbeck is granted exclusive worldwide license with respect to the development and commercialisation of Desmoteplase, while requiring it to bear all future Desmoteplase-related development, registration and marketing costs. Lundbeck has the right to grant sublicenses, but sublicensees are not entitled to grant further sublicenses.

In return, the New Lundbeck Agreement entitles Paion to (1) an upfront payment of €8 million, which was received in February 2008, and (2) subject to the achievement of certain milestones, milestone payments totalling €63 million. €38 million of this amount is tied to pre-commercialisation milestones, that is, the filing for regulatory approval with the EMEA and FDA and the grant of regulatory approval by the European, U.S. and Japanese regulatory authorities, while the balance of €25 million is tied to sales-related milestones, that is, the first commercialisation of the drug and the first time annual net sales reach a specified sales target.

These terms apply only to the ischaemic stroke indication of Desmoteplase. While the agreement also covers other indications, the terms that apply to any such additional indications will be agreed by Paion and Lundbeck in good faith.



In addition, Paion is entitled to royalties and has co-promotion rights with respect to Germany, Austria and Switzerland. If Paion decides to exercise these rights with respect to one or more countries, it will, instead of receiving royalties, participate directly in the profits generated by Lundbeck and Paion in those countries, with a double-digit percentage of any such profits going to Paion and the balance, which constitutes the majority of such profits, going to Lundbeck. In addition, Paion would be required to repay Lundbeck a portion of the Desmoteplase-related development costs borne by it and certain of the milestone payments payable by Lundbeck under the agreement would be reduced.

Paion agreed to an initial development plan with Lundbeck for the European Union and the United States. Lundbeck will inform Paion of any changes to this plan and any future development plans. Under the development plan, Lundbeck is obligated to use commercially best reasonable efforts to promote Desmoteplase and is solely responsible for development and production of Desmoteplase. Lundbeck is likewise responsible for all necessary regulatory filings and will use commercially best reasonable efforts to obtain regulatory approval. Lundbeck is required to take all of these measures at its own expense, except to the extent Paion exercises the co-promotion rights described above.

Lundbeck's rights under the New Lundbeck Agreement are subject to minimum sales requirements specified in the agreement. If these requirements are not met, the scope of Paion's co-promotion rights will increase.

Paion retains all intellectual property rights related to Desmoteplase but is contractually obligated to negotiate in good faith should Lundbeck desire to acquire such rights from Paion. Lundbeck, on the other hand, retains all of its intellectual property. Any trademarks related to the commercialisation of Desmoteplase will refer to Paion as the licensor and will be registered, owned and retained by Lundbeck. However, should Paion decide to exercise its co-promotion rights, it will have the right to use these trademarks without paying royalties.

The New Lundbeck Agreement remains in force for as long as Lundbeck develops or commercialises Desmoteplase. However, Lundbeck is entitled to terminate the New Lundbeck Agreement under certain circumstances, including if it determines that Desmoteplase presents safety or efficacy issues or that the further development and commercialisation of Desmoteplase is no longer viable. In the event of an early termination, Paion and Lundbeck will negotiate in good faith the consequences of such termination.

## 7.2 The CeNeS Group

The following contracts have been entered into by CeNeS since 5 February 2006 (being the date two years prior to the commencement of the Offer Period) which are outside the ordinary course of business and are or may be considered material:

- (A) the Implementation Agreement described in paragraph 7.1(A) above.
- (B) CeNeS and JM Finn & Co. Ltd ("**JM Finn**") are party to a placing agreement (the "**2007 Placing Agreement**") dated 27 July 2007 pursuant to which JM Finn procured subscribers for 5,789,137 CeNeS Shares at a price of £1.05 per share, which shares were allotted and issued by CeNeS on 23 August 2007. The 2007 Placing Agreement contained warranties from CeNeS in favour of JM Finn in relation to, *inter alia*, the accuracy of the information set out in the circular published by CeNeS on 27 July 2007 and other matters relating to the CeNeS Group and its business. CeNeS agreed to indemnify JM Finn in respect of certain liabilities it may incur in respect of the placing of such CeNeS Shares. A commission of 5 per cent. on the placing price of £1.05 per share was payable on certain of the CeNeS Shares then allotted and issued (together with applicable VAT). In addition, CeNeS agreed to pay certain other costs and expenses (together with applicable VAT) incurred by JM Finn in connection with such placing.

- (C) CeNeS and JM Finn are party to a further placing agreement (the “**2006 Placing Agreement**”) dated 4 December 2006 pursuant to which JM Finn procured subscribers for 74,169,194 ordinary shares of 1p each in the then capital of CeNeS at a price of 6.5 pence per share, which shares were allotted and issued by CeNeS on 7 December 2006. The 2006 Placing Agreement contained warranties from CeNeS in favour of JM Finn in relation to, inter alia, the accuracy of the information set out in the press announcement published by CeNeS on 4 December 2006 and other matters relating to the CeNeS Group and its business. CeNeS agreed to indemnify JM Finn in respect of certain liabilities it may incur in respect of the placing of such CeNeS Shares. A commission of 5 per cent. on the placing price of 6.5 pence per share was payable on certain of the CeNeS Shares then allotted and issued together with a corporate finance fee of £25,000 (in each case, together with applicable VAT). In addition, CeNeS agreed to pay certain other costs and expenses (together with applicable VAT) incurred by JM Finn in connection with such placing.

## **8. Other Information**

- 8.1 Save as disclosed in this document, no agreement, arrangement or understanding (including any compensation arrangement) exists between Paion or any party acting in concert with Paion for the purposes of the Acquisition, and any of the CeNeS Directors, or recent CeNeS Directors, shareholders or recent shareholders of CeNeS having any connection with or dependence upon the outcome of the Acquisition.
- 8.2 There is no agreement, arrangement or understanding whereby the beneficial ownership of any of the Scheme Shares acquired by Paion in pursuance of the Acquisition will be transferred to any other person, save that Paion reserves the right to transfer any such Scheme Shares to any of its subsidiaries.
- 8.3 There is no agreement or arrangement to which Paion is a party which relates to the circumstances in which it may or may not invoke or seek to invoke a condition to the Acquisition.
- 8.4 Save as disclosed in this document, the total emoluments of the current Paion Directors will not be affected by the Acquisition or by any other associated transactions.
- 8.5 Nomura Code has given and has not withdrawn its written consent to the inclusion in this document of the references to its name in the form and context in which they appear.
- 8.6 Landsbanki has given and has not withdrawn its written consent to the inclusion in this document of references to its name in the form and context in which they appear.
- 8.7 Settlement of the consideration to which each Scheme Shareholder is entitled under the Scheme will be implemented in full in accordance with the terms of the Scheme without any regard to any lien or right of set-off, counter claim or other analogous right to which Paion may otherwise be, or claim to be, entitled against such Scheme Shareholder.
- 8.8 Save as disclosed in this document, there has been no material change in the financial or trading position of CeNeS since 31 December 2007, the date to which the latest published audited accounts of CeNeS were prepared.
- 8.9 Save as disclosed in this document, there has been no material change in the financial or trading position of Paion since 31 December 2007, the date to which the latest published audited accounts of Paion were prepared.
- 8.10 The New Paion Shares will not be made available generally but will only be available pursuant to the Scheme.
- 8.11 Save as disclosed in this document, the CeNeS Directors are not aware of any material change in relation to any material information previously published by or on behalf of CeNeS during the Offer Period.



8.12 Save as disclosed in this document, the Paion Directors are not aware of any material change in relation to any material information previously published by or on behalf of Paion during the Offer Period.

## **9. Documents available for inspection**

Copies of the following documents will be available for inspection during normal business hours on any business day at the offices of Morrison & Foerster, 7th Floor, CityPoint, One Ropemaker Street, London EC2Y 9AW up to and including the Effective Date or the date that the Scheme lapses or is withdrawn, whichever is the earlier:

- 9.1 the memorandum and articles of association of Paion;
- 9.2 the memorandum and articles of association of CeNeS;
- 9.3 the audited consolidated accounts of CeNeS for the three years ended 31 December 2007, 31 December 2006 and 31 December 2005 and the unaudited consolidated interim results for the three months ended 31 March 2008;
- 9.4 the audited consolidated accounts of Paion for the three years ended 31 December 2007, 31 December 2006 and 31 December 2005 and the unaudited consolidated interim results for the three months ended 31 March 2008;
- 9.5 the rules of the CeNeS Share Schemes;
- 9.6 the service contracts referred to in paragraph 6 above;
- 9.7 the material contracts referred to in paragraph 7 above;
- 9.8 the letters of consent referred to in paragraphs 8.5 and 8.6 above;
- 9.9 the irrevocable undertakings and the letter of intent referred to in paragraph 11 of Part 2 of this document; and
- 9.10 this document and the Forms of Proxy.

A copy of a draft (subject to amendment) of the form of trust deed to be executed by Capita Trust Company Limited, pursuant to which Capita Trust Company Limited will hold New Paion Shares on trust for relevant Scheme Shareholders in the circumstances described in Clause 3.2(B) of the Scheme, will be available for inspection during normal business hours on any business day at the offices of Morrison & Foerster, 7th Floor, City Point, One Ropemaker Street, London EC2Y 9AW as soon as reasonably practicable prior to the Effective Date and in any event expected to be so available as from on or about 16 May 2008. CeNeS shall announce via RNS when such form of trust deed is so available for inspection.

## APPENDIX F

### United Kingdom Taxation

The paragraphs set out below summarise certain UK tax consequences of the implementation of the Scheme for CeNeS Shareholders, based on current UK legislation and on what is understood to be current HM Revenue & Customs (“HMRC”) practice as at the date of this document. They are intended as a general guide and (except where express reference is made to the position of non-UK resident shareholders) apply only to CeNeS Shareholders who are resident and, if individuals, ordinarily resident in the UK for tax purposes. They relate only to CeNeS Shareholders who hold their CeNeS Shares directly as an investment (other than under a personal equity plan or an individual savings account) and who are absolute beneficial owners of those CeNeS Shares and who are not (and have not in the previous seven years been) employees of CeNeS or any person connected with CeNeS. These paragraphs do not deal with certain types of CeNeS Shareholders, such as persons holding or acquiring or being deemed to acquire or hold CeNeS Shares in the course of a trade or by reason of employment, or collective investment schemes and insurance companies. Special considerations may also apply to CeNeS Shareholders who have acquired or acquire their CeNeS Shares under the CeNeS Share Schemes.

In this Appendix reference to New Paion Shares includes any Paion DIs representing interests in New Paion Shares.

**If you are in any doubt as to your taxation position or if you are resident or otherwise subject to taxation in any jurisdiction other than the UK, you should consult an appropriate independent professional adviser immediately.**

#### 1. UK tax consequences of the Scheme

##### 1.1 *Receipt of New Paion Shares*

To the extent that a CeNeS Shareholder who is resident or ordinarily resident in the UK for tax purposes receives New Paion Shares in exchange for his CeNeS Shares and does not hold (either alone or together with persons connected with him) more than five per cent, of, or of any class of, shares in or debentures of CeNeS, he should not be treated as having made a disposal of his CeNeS Shares. Instead, the New Paion Shares should be treated as the same asset as the CeNeS Shares acquired at the same time and for the same consideration as the CeNeS Shares.

Any CeNeS Shareholder who holds (either alone or together with persons connected with him) more than five per cent, of, or of any class of, shares in or debentures of CeNeS should be treated in the manner described in the preceding paragraph, provided the Scheme (i) is effected for bona fide commercial reasons; and (ii) does not form part of a scheme of arrangement of which the main purpose, or one of the main purposes, is avoidance of liability to capital gains tax or corporation tax. Such CeNeS shareholders are advised that these conditions should be met and that an application for clearance has been made to HMRC under section 138 of the Taxation of Chargeable Gains Act 1992. The Scheme is not conditional on such clearance being obtained.

##### 1.2 *Miscellaneous*

An application has been made to HMRC for clearance under section 707 of the Income and Corporation Taxes Act 1988 and section 701 of the Income Tax Act 2007, that section 703 of the Income and Corporation Taxes Act 1988 and Chapter 1 Part 13 of the Income Tax Act 2007 of that Act, which provides for the cancellation of a tax advantage arising from certain transactions in securities and which might affect the UK tax treatment of the Scheme, will not apply.

##### 1.3 *Stamp duty and SDRT*

No liability to stamp duty will arise and no SDRT will be payable by CeNeS Shareholders in respect of the cancellation of the CeNeS Shares, the issue of the New Paion Shares by Paion to

CeNeS Shareholders or the issue of new CeNeS Shares by CeNeS, to Paion pursuant to the Scheme. Special rules apply in relation to the issue of shares into depositary receipt systems or clearing systems.

## **2. UK tax consequences of holding New Paion Shares**

### *2.1 Taxation of chargeable gains*

A subsequent disposal or deemed disposal of the New Paion Shares by a shareholder who is resident or ordinarily resident in the UK may, depending on individual circumstances (including the availability of exemptions and allowable losses), give rise to a chargeable gain or allowable loss for the purposes of UK taxation of chargeable gains.

On the basis that the tax treatment set out above in paragraph 1.1 entitled “Receipt of New Paion Shares” applies, any chargeable gain or allowable loss on a disposal of New Paion Shares should be calculated taking into account a proportion of the allowable expenditure relating to the CeNeS Shares from which the New Paion Shares are derived.

For corporate shareholders, in calculating a chargeable gain (but not an allowable loss) arising on any disposal or part disposal of CeNeS Shares or New Paion Shares, indexation allowance on the relevant proportion of the original allowable cost should be taken into account. The indexation allowance will be calculated by reference to the date of disposal of the CeNeS Shares or the New Paion Shares. For individual shareholders, the gain arising on disposal will be subject to an effective capital gains tax rate of 18%.

### *2.2 Taxation of dividends*

#### *Individual Cenes Shareholders*

A Cenes Shareholder who is an individual resident (for tax purposes) in the UK will, if he owns less than 10% of the issued share capital of Paion, be entitled to a tax credit equal to one-ninth of the dividend received from Paion. Such Cenes Shareholder will be taxable on the total of the dividend before deduction of German tax withheld (if any) and the related tax credit (the “**gross dividend**”), which will be regarded as the top slice of the Cenes Shareholder’s income.

Provided that the relevant Cenes Shareholder is not claiming the remittance basis of taxation, the tax credit will be treated as discharging the Cenes Shareholder’s liability to UK income tax in respect of the gross dividend, unless and except to the extent that the gross dividend falls above the threshold for the higher rate of income tax, in which case the Cenes Shareholder will, to that extent, pay UK income tax on the gross dividend calculated as 32.5% of the gross dividend less the related tax credit. So, for example, a dividend of £80 will carry a tax credit of £8.89 and the UK income tax payable on the dividend by a Cenes Shareholder liable to income tax at the higher rate would be 32.5% of £88.89, namely £28.89, less the tax credit of £8.89, leaving a net tax charge of £20.

If the Cenes Shareholder is claiming the remittance basis of taxation and remits a dividend paid on the New Paion Shares, the individual will pay UK income tax on the gross dividend calculated as 20% of the gross dividend less the related tax credit, unless and except to the extent that the gross dividend falls above the threshold for the higher rate of income tax, in which case the individual will, to that extent, pay UK income tax on the gross dividend calculated as 40% of the gross dividend less the related tax credit.

#### *Corporate Shareholders*

A corporate Cenes Shareholder that resides in the UK (for tax purposes) or carries on a trade in the UK through a permanent establishment in connection with which its New Paion Shares are held will generally be subject to UK corporation tax on the gross amount of any dividends paid by Paion before deduction of German tax withheld (if any).

#### *German withholding tax*

Dividends paid by Paion will generally be subject to German withholding tax, currently at a rate of 20% plus 5.5% solidarity surcharge thereon resulting in a total of 21.1% withholding tax rate. From 2009 on the German withholding tax rate will be 25% plus 5.5% solidarity charge thereon.

Where dividends are distributed to an incorporated company resident in the UK, the withholding of the dividend withholding tax may be waived entirely upon application (by virtue of the Parent-Subsidiary Directive), provided additional requirements are met. The dividend withholding tax rate for distributions to UK resident shareholders may also in principle be reduced in accordance with the applicable double taxation treaty.

#### *Credit for German withholding tax*

If any German tax is withheld from dividends paid to UK tax resident Cenes Shareholders, HMRC will generally give credit for any German withholding tax withheld from the payment of a dividend and not recoverable from the German tax authorities against UK income tax or UK corporation tax payable by these shareholders in respect of the dividend. Cenes Shareholders who are not solely resident in the UK should consult their own tax adviser concerning their tax liabilities on dividends received.

#### *2.3 Stamp duty and SDRT*

The transfer of DIs representing interest in New Paion Shares within CREST will not give rise to a liability to SDRT.

## **APPENDIX G**

### **Sources and Bases**

1. Unless otherwise stated, the financial information on CeNeS is extracted from CeNeS's preliminary financial statements for the year ended 31 December 2007.
2. Unless otherwise stated, the financial information on Paion is extracted from Paion's consolidated financial statements for the year ended 31 December 2007.
3. The value of £9.9 million attributed to the fully diluted share capital of CeNeS is based upon (i) the 21,920,192 CeNeS Shares in issue as at the date of this document, (ii) the 252,644 CeNeS Shares in total which may be issued pursuant to the exercise of outstanding options under the Executive Plan at a total exercise price of £8, and (iii) the 120,752 CeNeS Shares in total which may be issued to SmithKline Beecham Corporation and Glaxo Group Limited as deferred consideration.
4. Unless otherwise stated in this document, all prices for CeNeS Shares have been derived from the London Stock Exchange and represent the Closing Price on the relevant date.
5. Unless otherwise stated in this document, all prices for Paion Shares have been derived from the Frankfurt Stock Exchange and represent the Closing Price on the relevant date.

## APPENDIX H

### Interpretation

Except in Part 3 the following definitions apply throughout this document unless the context otherwise requires:

<b>“Acquisition”</b>	the proposed acquisition of all of the issued and to be issued share capital of CeNeS by Paion, to be effected by means of the Scheme;
<b>“AIM”</b>	the AIM market operated by the London Stock Exchange;
<b>“AIM Rules for Companies”</b>	the rules of the London Stock Exchange which govern the admission to trading, and the operation, of companies on AIM;
<b>“Announcement”</b>	the announcement made by Paion and CeNeS on 10 April 2008 pursuant to Rule 2.5 of the Code;
<b>“Appendix” or “Appendices”</b>	an appendix or the appendices to this document;
<b>“Articles”</b>	the articles of association of CeNeS;
<b>“Australia”</b>	Australia, its possessions, provinces and all areas subject to its jurisdiction or any political subdivision thereof;
<b>“BaFin”</b>	the German Federal Financial Supervisory Authority;
<b>“Business Day”</b>	a day (excluding any Saturday or Sunday or public holiday) on which banks are generally open for normal business in the City of London, Edinburgh and Aachen;
<b>“Clearstream”</b>	Clearstream Banking AG, Frankfurt am Main;
<b>“Canada”</b>	Canada, its possessions, provinces and all areas subject to its jurisdiction or any political subdivision thereof;
<b>“CeNeS” or the “Company”</b>	CeNeS Pharmaceuticals plc, a public limited company incorporated in Scotland with registered number SC166791;
<b>“CeNeS Directors”</b>	the directors of CeNeS;
<b>“CeNeS Group”</b>	CeNeS and its subsidiaries and subsidiary undertakings;
<b>“CeNeS Shares”</b>	the ordinary shares of 30 pence each in the capital of CeNeS;
<b>“CeNeS Share Schemes”</b>	(i) the CeNeS Pharmaceuticals plc Approved Share Option Scheme; (ii) the CeNeS Pharmaceuticals plc Unapproved Share Option Scheme; (iii) the Executive Plan; (iv) those options granted to certain employees of CeNeS Limited prior to its acquisition by the CeNeS and which shares in CeNeS Limited are exchangeable for CeNeS Shares; and (v) those options granted to certain employees of Cambridge Neuroscience Inc. prior to its acquisition by CeNeS and which are exercisable in respect of CeNeS Shares;
<b>“CeNeS Shareholders”</b>	the holders of CeNeS Shares;
<b>“certificated” or “in certificated form”</b>	where a share or other security is not in uncertificated form (that is, not in CREST);
<b>“Closing Price”</b>	as regards securities traded on AIM, the closing middle market quotation of such a security derived from the London Stock Exchange and, as regards securities traded on the Frankfurt Stock Exchange, the XETRA closing price of the security as reported by the Frankfurt Stock Exchange;
<b>“CNS”</b>	the central nervous system;

<b>“Code”</b>	the Takeover Code;
<b>“Commercial Register”</b>	the commercial register ( <i>Handelsregister</i> ) of the local court ( <i>Amtsgericht</i> ) of Aachen;
<b>“Conditions”</b>	the conditions set out in Appendix A to this document;
<b>“Court”</b>	the Court of Session in Edinburgh, Scotland;
<b>“Court Hearing”</b>	the hearing by the Court of the petition to sanction the Scheme under section 896 of the Companies Act 2006 and confirm the Reduction under Section 137 of the Companies Act 1985;
<b>“Court Meeting”</b>	the meeting of the Scheme Shareholders (or any adjournment or postponement thereof) to be convened by an order of the Court pursuant to Part 26 of the Companies Act 2006 for the purposes of considering and, if thought fit, approving the Scheme;
<b>“Court Order(s)”</b>	the order(s) of the Court granted at the Court Hearing to sanction the Scheme under Part 26 of the Companies Act 2006 and confirm the Reduction under Section 137 of the Companies Act 1985;
<b>“CREST”</b>	the system for the paperless settlement of trades in securities and the holding of securities in uncertificated form operated by Euroclear in accordance with the Regulations;
<b>“CREST Manual”</b>	the CREST Manual published by Euroclear;
<b>“DI”</b>	a depository interest representing an entitlement to a share;
<b>“Effective”</b>	(i) if the Acquisition is implemented by way of the Scheme, the Scheme having become effective pursuant to its terms; or (ii) if the Acquisition is implemented by way of a Takeover Offer, the Takeover Offer having been declared or become unconditional in all respects in accordance with the requirements of the Code;
<b>“Effective Date”</b>	the date upon which the Acquisition becomes Effective;
<b>“Enlarged Group”</b>	means the Paion Group including the CeNeS Group following completion of the Acquisition;
<b>“Euroclear”</b>	Euroclear UK and Ireland Limited, being the current operators of CREST;
<b>“Excluded Shares”</b>	any CeNeS Shares beneficially owned by Paion or any member of the Paion Group and any shares held by CeNeS in treasury at the Scheme Record Time;
<b>“Executive Plan”</b>	the CeNeS Pharmaceuticals plc Executive Share Incentive Plan;
<b>“Explanatory Statement”</b>	the explanatory statement relating to the Scheme, as set out in Part 2 of this document, which constitutes the explanatory statement required by section 897 of the Companies Act 2006;
<b>“Forms of Proxy”</b>	the pink Form of Proxy in connection with the General Meeting and the blue Form of Proxy in connection with the Court Meeting, or either of them as the context requires;
<b>“General Meeting”</b>	the general meeting of CeNeS (and any adjournment or postponement thereof) to be convened in connection with the Acquisition;
<b>“HMRC”</b>	HM Revenue & Customs;
<b>“holder”</b>	includes any person entitled by transmission;
<b>“Implementation Agreement”</b>	the implementation agreement dated 10 April 2008 between CeNeS and Paion;



<b>“Japan”</b>	Japan, its possessions, provinces and all areas subject to its jurisdiction or any political subdivision thereof;
<b>“Landsbanki”</b>	Landsbanki Securities (UK) Limited, a company incorporated in England and Wales with registered number 3019293 and whose registered office is Beaufort House, 15 St Botolph Street, London EC3A 7QR;
<b>“London Stock Exchange”</b>	London Stock Exchange plc;
<b>“Lundbeck”</b>	H. Lundbeck A/S;
<b>“Meetings”</b>	the Court Meeting and the General Meeting;
<b>“Minute”</b>	the minute (approved by the Court) confirming the Reduction in accordance with section 138 of the Companies Act 1985;
<b>“New Lundbeck Agreement”</b>	the license and sublicense agreement between Paion and Lundbeck dated 21 December 2007, which took effect on 29 January 2008
<b>“New Paion Shares”</b>	the Paion Shares proposed to be issued fully paid and ranking pari passu with the existing Paion Shares pursuant to the Scheme;
<b>“New Zealand”</b>	New Zealand, its possessions, provinces and all areas subject to its jurisdiction or any political sub-division thereof;
<b>“Nomura Code”</b>	Nomura Code Securities Limited, a company incorporated in England and Wales with registered number 4778512 and whose registered office is 1 Carey Lane, London EC2V 8AE;
<b>“Offer Period”</b>	the period commencing on 5 February 2008 and ending on the Effective Date;
<b>“Overseas Shareholders”</b>	Scheme Shareholders who are resident in, or citizens of, jurisdictions outside the United Kingdom;
<b>“Paion”</b>	PAION AG, a stock corporation incorporated in Germany at the local court ( <i>Amtsgericht</i> ) of Aachen with registered number HRB12528;
<b>“Paion DI”</b>	a DI representing an entitlement to one Paion Share;
<b>“Paion Directors”</b>	the members of the management board ( <i>Vorstand</i> ) of Paion;
<b>“Paion Group”</b>	Paion and its subsidiaries and subsidiary undertakings (excluding the CeNeS Group);
<b>“Paion Shares”</b>	ordinary no-par value bearer shares representing a notional value equal to €1.00 per share in the capital of Paion;
<b>“Panel”</b>	the Panel on Takeovers and Mergers;
<b>“Paion Prospectus”</b>	the prospectus to be prepared and published by Paion in accordance with the German Prospectus Act ( <i>Wertpapierprospektgesetz</i> ) and containing information relating to Paion and CeNeS;
<b>“Reduction”</b>	the proposed reduction of the capital of CeNeS pursuant to section 137 of the Companies Act 1985, as provided for by the Scheme;
<b>“Reduction Order”</b>	the order of the Court confirming the Reduction under section 137 of the Companies Act 1985;
<b>“Registrars”</b>	Equiniti of Aspect House, Spencer Road, Lancing, BN99 6ZR;

<b>“Registrar of Companies”</b>	the Registrar of Companies of Scotland;
<b>“Regulation S”</b>	Regulation S made under the US Securities Act;
<b>“Regulations”</b>	the Uncertificated Securities Regulations 2001 (SI 2001/3755);
<b>“Regulatory Information Service”</b>	any of the services authorised by the London Stock Exchange for the distribution to the public of AIM announcements and included within the list maintained on the London Stock Exchange’s website <a href="http://www.londonstockexchange.com">www.londonstockexchange.com</a> ;
<b>“Restricted Overseas Jurisdictions”</b>	Australia, New Zealand, Canada, South Africa and Japan;
<b>“Restricted Overseas Person”</b>	a person (including an individual, partnership, unincorporated syndicate or association, company, unincorporated organisation, trust, trustee, executor, administrator or other legal representative) who is a national or citizen of or in, or resident in, or any person whom Paion reasonably believes to be a national or citizen of or in, or resident in any of the Restricted Overseas Jurisdictions and persons in any other jurisdiction whom Paion or CeNeS is advised to treat as restricted overseas persons in order to observe the laws of any jurisdiction other than the UK and the United States or to avoid the requirement to obtain or comply with any governmental or other consent or any registration, filing or other formality with which Paion or CeNeS is unable to comply or Paion or CeNeS as the case may be, acting reasonably, regards as unduly onerous;
<b>“Scheme”</b>	the scheme of arrangement under Part 26 the Companies Act 2006 between CeNeS and the Scheme Shareholders set out in Part 3 of this document, with or subject to any modification thereof or in addition thereto or condition approved or imposed by the Court and agreed by CeNeS and Paion;
<b>“Scheme Document”</b>	this document, being dated 2 May 2008 and sent by CeNeS to Scheme Shareholders and of which this Appendix forms part;
<b>“Scheme Record Time”</b>	6:00 p.m. on the Business Day immediately preceding the Court Hearing;
<b>“Scheme Shares”</b>	all CeNeS Shares: <ul style="list-style-type: none"> <li>(a) in issue at the date of the Scheme Document;</li> <li>(b) (if any) issued after the date of the Scheme Document and prior to the Voting Record Time; and</li> <li>(c) (if any) issued on or after the Voting Record Time but before the Scheme Record Time on terms that the original or any subsequent holders shall be, or shall have agreed in writing by such time to be, bound by the Scheme,</li> </ul> in each case, excluding any Excluded Shares;
<b>“Scheme Shareholder”</b>	a holder of Scheme Shares;
<b>“SDRT”</b>	UK stamp duty reserve tax;
<b>“SEC”</b>	the Securities and Exchange Commission of the United States;
<b>“South Africa”</b>	South Africa, its possessions, provinces and all areas subject to its jurisdiction or any political sub-division thereof;

<b>“Subscription Certificate”</b>	the certificate to be executed by the Trustee, as trustee for the Scheme Shareholders, in the form schedule to the Trust Deed, with such modifications and additions, if any, as may be agreed between Paion, CeNeS and the Trustee;
<b>“Takeover Offer”</b>	a takeover offer as defined in section 974 of the Companies Act 2006;
<b>“Trust Deed”</b>	the trust deed to be executed by CeNeS (on behalf of Scheme Shareholders) and the Trustee, under which the Trustee will subscribe for, receive, hold and transfer New Paion Shares on trust for the Scheme Shareholders;
<b>“Trustee”</b>	Landsbanki Kepler, Frankfurt branch, in its capacity as trustee under the Trust Deed;
<b>“UK” or “United Kingdom”</b>	United Kingdom of Great Britain and Northern Ireland;
<b>“uncertificated” or “in uncertificated form”</b>	in respect of a share or other security, where that share or security is recorded on the relevant register of the share or security concerned as being in uncertificated form, in CREST and title to which may be transferred by means of CREST;
<b>“United States” or “US”</b>	the United States of America (including the states of the United States and the District of Columbia), its possessions and territories and all other areas subject to its jurisdiction or any political subdivision thereof;
<b>“US Person”</b>	a US person as defined in Rule 901(k) of Regulation S;
<b>“US Securities Act”</b>	the US Securities Act of 1933, as amended;
<b>“Voting Record Time”</b>	the time fixed by the Court and CeNeS for determining the entitlement to vote at the Court Meeting as set out in the notice thereof;
<b>“Wider CeNeS Group”</b>	the CeNeS Group and associated undertakings of CeNeS and any other body corporate, partnership, joint venture or person in which CeNeS and/or such undertakings (aggregating their interests) have an interest of more than 20 per cent. of the voting or equity capital or the equivalent; and
<b>“Wider Paion Group”</b>	the Paion Group and associated undertakings of Paion and any other body corporate, partnership, joint venture or person in which Paion and/or such undertakings (aggregating their interests) have an interest of more than 20 per cent. of the voting or equity capital or the equivalent.

Unless otherwise stated, all times referred to in this document are references to the time in London.

All references to legislation in this document are to UK legislation unless the contrary is indicated. Any reference to any provision of any legislation shall include any amendment, modification, re-enactment or extension thereof.

Words importing the singular shall include the plural and vice versa, and words importing the masculine gender shall include the feminine or neutral gender.

For the purpose of this document, the terms **“subsidiary”**, **“subsidiary undertaking”**, **“undertaking”** and **“associated undertaking”** have the meanings given by the Companies Act 1985.

References to **“€”** and **“Euro”** are to the single currency unit of the European Union.

References to **“£”**, **“Sterling”**, **“p”** and **“pence”** are to the lawful currency of the United Kingdom.

References to **“US\$”** and **“Dollars”** are to the lawful currency of the United States.

## APPENDIX I

### Notice of Court Meeting

NOTICE IS HEREBY GIVEN that, on 2 May 2008, an order was pronounced in the Court of Session, Edinburgh (the “**Court**”) directing that a meeting (the “**Court Meeting**”) be convened of the holders of Scheme Shares (as defined in the Scheme of Arrangement referred to below) for the purpose of considering and, if thought fit, approving (with or without modification) a scheme of arrangement (the “**Scheme of Arrangement**”) pursuant to Part 26 of the Companies Act 2006 (the “**Act**”) proposed to be made between CeNeS Pharmaceuticals plc (the “**Company**”) and the holders of Scheme Shares and that such Court Meeting will be held at the offices of Morrison & Foerster, 7th Floor, CityPoint, One Ropemaker Street, London, EC2Y 9AW on 28 May 2008 at 11:00 a.m. at which place and time all holders of such Scheme Shares are requested to attend.

At the Court Meeting the following resolution will be proposed:

“The scheme of arrangement dated 2 May 2008 (in its original form or subject to such modification, addition or condition which may be agreed by the Company and PAION AG and approved or imposed by the Court (the “**Scheme**”)) proposed to be made between the Company and the Scheme Shareholders (as defined in the Scheme), a print of which has been produced to the meeting and (for the purpose of identification only) signed by the Chairman hereof, be and it is hereby approved and the directors of the Company be authorised to take all such actions as they may consider necessary or appropriate for carrying the Scheme into effect.”

Voting on the resolution will be by poll which may be conducted as the chairman of the Court Meeting shall determine. For the Court Meeting (or any adjournment thereof) to be properly convened, a quorum of two persons entitled to vote upon the business to be transacted, each being a Scheme Shareholder, the proxy of a Scheme Shareholder or (where a Scheme Shareholder is a corporation) a duly authorised representative of a Scheme Shareholder must be present.

A copy of the Scheme of Arrangement and a copy of the explanatory statement required to be furnished pursuant to Part 26 of the Act in relation to the Scheme of Arrangement are incorporated in the document of which this Notice forms part.

By the said order, the Court appointed Alan Goodman or, failing him, Neil Clark, or failing him, Tony Osborne to act as chairman of the Court Meeting and directed the chairman to report the result of the Court Meeting to the Court.

**Holders of Scheme Shares may vote in person at the Court Meeting or they may appoint another one or more person(s) as their proxy to attend and vote in their stead. A proxy need not be a member of the Company. A blue Form of Proxy for use at the Court Meeting is enclosed with this Notice. Completion and return of the blue Form of Proxy will not preclude a holder of Scheme Shares from attending and voting at the Court Meeting or any adjournment thereof in person if he wishes to do so. Where a holder of Scheme Shares appoints more than one proxy, each proxy must be appointed in respect of different Scheme Shares comprised in his or her holding of Scheme Shares, which must be identified on the proxy form. Each such proxy will have the right to vote in respect of the number of votes attaching to the number of Scheme Shares in respect of which the proxy has been appointed. Where more than one joint holder of Scheme Shares appoints a proxy in respect of the same Scheme Shares, only the appointment of the most senior holder of Scheme Shares will be accepted as determined by the order in which their names appear in the Company’s register of members. If you wish your proxy to speak at the meeting, you should appoint a proxy other than the chairman of the Court Meeting and give instructions to that proxy.**

In the case of joint holders of Scheme Shares, the vote of the senior who tenders a vote, whether in person or by proxy, will be accepted to the exclusion of the votes of the other joint holder(s) and for this purpose seniority will be determined by the order in which the names stand in the register of members of the Company in respect of the relevant joint holding.

**It is requested that Forms of Proxy for use at the Court Meeting be lodged with Equiniti, Aspect House, Spencer Road, Lancing, BN99 6ZR by not less than 48 hours before the time appointed for the Court Meeting but, if forms are not so lodged, they may be handed to the Registrars on behalf of the chairman of the Court Meeting before the taking of the poll.**

Holders of Scheme Shares who hold shares through CREST and who wish to appoint a proxy through the CREST Electronic Proxy Appointment Service may do so for the Court Meeting and any adjournment(s) thereof by using the procedures described in the CREST Manual. CREST personal members or other CREST sponsored members, and those CREST members who have appointed a voting service provider, should refer to their CREST sponsor or voting service provider who will be able to take the appropriate action on their behalf.

In order for a proxy appointment or instruction made using the CREST service to be valid, the appropriate CREST message (a “**CREST Proxy Instruction**”) must be properly authenticated in accordance with the specifications of Euroclear UK & Ireland Limited (“**Euroclear**”) and must contain the information required for such instructions, as described in the CREST Manual. The message, regardless of whether it relates to the appointment of a proxy or to an amendment to the instruction given to a previously appointed proxy must, in order to be valid, be transmitted so as to be received by the Company’s agent (ID 7RA01) by not later than 48 hours before the time appointed for the Court Meeting. For this purpose, the time of receipt will be taken to be the time (as determined by the time stamp applied to the message by the CREST Application Host) from which the Company’s agent is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST.

CREST members and, where applicable, their CREST sponsors or voting service providers should note that Euroclear does not make available special procedures in CREST for any particular message. Normal system timings and limitations will therefore apply in relation to the input of CREST proxy instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member or sponsored member or has appointed a voting service provider to procure that this CREST sponsor or voting service provider takes) such action as shall be necessary to ensure that a message is transmitted by any particular time. Reference should be made to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.

The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.

Only those shareholders registered in the register of members of the Company as at 6:00 p.m. on 27 May 2008 or, in the event that the Court Meeting is adjourned, in the register of members 48 hours before the time of any adjourned meeting shall be entitled to attend or vote in respect of the number of Scheme Shares registered in their name at the relevant time. Changes to entries in the register of members after 6:00 p.m. on 27 May 2008 or, in the event that the Court Meeting is adjourned, after the time 48 hours before the time of any adjourned meeting shall be disregarded in determining the rights of any person to attend or vote at the Court Meeting.

In order to facilitate voting by corporate representatives at the meeting, arrangements will be put in place at the meeting so that (i) if a corporate shareholder has appointed the chairman of the Court Meeting as its corporate representative with instructions to vote on a poll in accordance with the directions of all the other corporate representatives for that shareholder at the meeting who have been appointed in respect of different parts of the holding of that corporate shareholder then on a poll those corporate representatives will give voting directions to the chairman of the Court Meeting and the chairman will vote (or withhold a vote) in respect of each different part of the shareholding as corporate representative in accordance with the directions he has received from such corporate representatives in relation to the respective parts of the shareholding in respect of which they are each appointed or (ii) if more than one corporate

representative for the same corporate shareholder attends the meeting but the corporate shareholder has not appointed the chairman of the Court Meeting as its corporate representative, a designated corporate representative will be nominated, from those corporate representatives who attend, who will vote on a poll in accordance with the directions he receives from the other corporate representatives in respect of the parts of the corporate shareholder's shareholding in respect of which such corporate representatives have each been appointed. Corporate shareholders are referred to the guidance issued by the Institute of Chartered Secretaries and Administrators on proxies and corporate representatives – [www.icsa.org.uk](http://www.icsa.org.uk) – for further details of this procedure. The guidance includes a sample form of representation letter if the chairman of the Court Meeting is being appointed as described in (i) above.

The Scheme of Arrangement will be subject to the subsequent sanction of the Court.

Dated 2 May 2008

Morrison & Foerster MNP  
7th Floor, CityPoint  
One Ropemaker Street  
London EC2Y 9AW

Brodies LLP  
15 Atholl Crescent  
Edinburgh  
EH3 8HA

Solicitors for the Company



## APPENDIX J

### Notice of General Meeting

# CENES PHARMACEUTICALS PLC

(Registered in Scotland No. SC166791)

NOTICE IS HEREBY GIVEN that a General Meeting of the above company (the "**Company**") will be held at the offices of Morrison & Foerster, 7th Floor, CityPoint, One Ropemaker Street, London, EC2Y 9AW at 11:30 a.m. on 28 May 2008 (or as soon thereafter as the meeting convened by order of the Court of Session, Edinburgh (the "**Court**") for 11:00 a.m. on the same date and at the same place shall have concluded or been adjourned) to propose and, if thought fit, to pass the following resolution which will be proposed as a special resolution:

#### SPECIAL RESOLUTION

THAT:

- (1) for the purpose of giving effect to the scheme of arrangement dated 2 May 2008 (in its original form or subject to such modification, addition or condition which may be agreed by the Company and PAION AG and approved or imposed by the Court (the "**Scheme**")) proposed to be made between the Company and the Scheme Shareholders (as defined in the Scheme), a print of which has been produced to the meeting and (for the purpose of identification only) signed by the chairman hereof:
  - (a) the Directors of the Company be authorised to take all such actions as they may consider necessary or appropriate for carrying the Scheme into effect;
  - (b) the share capital of the Company be reduced by cancelling and extinguishing all the Scheme Shares; and
  - (c) subject to and forthwith upon such reduction of capital taking effect and notwithstanding any other provision in the Company's Articles of Association:
    - (i) the authorised share capital of the Company be increased to its former amount by the creation of such number of new ordinary shares of 30 pence each as shall be equal to the aggregate number of Scheme Shares cancelled pursuant to sub-paragraph (a) above;
    - (ii) the reserve arising in the books of the Company as a result of the cancellation of the Scheme Shares be applied in paying up in full at par the new ordinary shares referred to in sub-paragraph (b)(i) above, such new ordinary shares to be allotted and issued credited as fully paid to PAION AG and/or its nominee(s); and
    - (iii) the Directors of the Company be generally and unconditionally authorised for the purposes of section 80 of the Companies Act 1985 to give effect to this resolution and accordingly to effect the allotment of the new ordinary shares referred to in sub-paragraph (c)(ii) above, provided that (1) the maximum aggregate nominal amount of shares which may be allotted hereunder shall be the aggregate nominal amount of the new ordinary shares created pursuant to sub-paragraph (c)(i) above, (2) this authority shall expire on the fifth anniversary of the date on which this resolution is passed and (3) this authority shall be in addition and without prejudice to any other authority under the said section 80 previously granted and in force on the date on which this resolution is passed; and
- (2) the articles of association of the Company be and are hereby amended by including the following new article as article 146 (and amending the remainder of the articles of association and any cross-references thereto accordingly):

#### **"146 Shares not subject to Scheme of Arrangement**

- (A) In this Article 146, references to the "**Scheme**" are to the scheme of arrangement dated 2 May 2008 under Part 26 of the Companies Act 2006 between the Company and the Scheme Shareholders as it may be modified or amended in accordance with its terms, and expressions defined in the Scheme shall have the same meanings in this Article.
- (B) If the Company allots or issues any shares on or after the Voting Record Time and prior to the Scheme Record Time, such shares shall be issued subject to the terms of the Scheme (and shall be Scheme Shares for the purposes thereof) and the original or any subsequent holder or holders of such shares shall be bound by the Scheme accordingly.



- (C) Notwithstanding any other provision of these Articles, if the Company allots or issues any shares to any person other than to Paion or any subsidiary of Paion or its or their nominee(s) (a “**new member**”) at or after the Scheme Record Time and prior to or at the time at which Paion issues the Paion Shares referred to in clause 2.1 of the Scheme, such shares will be transferred to Paion or its nominee(s) immediately after the Scheme becomes effective in accordance with its terms in consideration of and conditional on the issue to that new member of such number of New Paion Shares as that new member would have been entitled to had each share transferred to Paion hereunder been a Scheme Share at the Scheme Record Time, being Paion Shares which rank *pari passu* with all other Paion Shares in issue at that time.
- (D) As a matter supplemental to and separate from the Scheme, if the Company allots or issues any shares (“**post-merger shares**”) to any person other than to Paion or any subsidiary of Paion or its or their nominee(s) (a “**post-merger member**”) after the time at which Paion issues the Paion Shares referred to in clause 2.1 of the Scheme, those post-merger shares will, provided Paion or any subsidiary of Paion or its or their nominee(s) is still a member of the Company at the time when the post-merger shares are issued, be immediately transferred to Paion or its nominee(s) in consideration of and conditional on, at Paion’s sole discretion, either (i) the issue to or (in accordance with clause 3.2 of the Scheme) for the account of such post-merger member of such number of Paion Shares as such post-merger member would have been entitled to had each share transferred to Paion or its nominee(s) been a Scheme Share at the Scheme Record Time, being Paion Shares which rank *pari passu* with all other Paion Shares in issue at that time (other than as to any dividend or other benefit payable to shareholders on the register of members of Paion on a record date preceding the date of allotment of such Paion Shares) and which may, if applicable, be represented by Paion DIs, or (ii) a cash payment in Euro by Paion to such post-merger member equal to the Closing Price of such number of Paion Shares as at the date of such transfer.
- (E) To give effect to any transfer required by Article 146(C) or (D) the Company may appoint any person to execute and deliver as transferor a form of transfer on behalf of the new member or post-merger member (or any subsequent holder or any nominee of such new member or post-merger member or any such subsequent holder) in favour of Paion or its nominee(s) and, if applicable, to agree for and on behalf of the new member or post-merger member (or any subsequent holder or any nominee of such new member or post-merger member or any such subsequent holder) to become a member of Paion or to the Terms and Conditions of Appointment, as applicable. Pending the registration of Paion or its nominee(s) as the holder of any share to be transferred pursuant to this Article 146, Paion or its nominee(s) shall be empowered to appoint a person nominated by the directors of the Company to act as attorney on behalf of each holder of any such share in accordance with such directions as Paion or its nominee(s) may give in relation to any dealings with or disposal of such share (or any interest therein), exercising any rights attached thereto or receiving any distribution or other benefit accruing or payable in respect thereof and the registered holder of such share shall exercise all rights attaching thereto in accordance with the directions of Paion or its nominee(s) but not otherwise.
- (F) On any reorganisation of, or material alteration to, the share capital of the Company or Paion (including, without limitation, any subdivision and/or consolidation), the number of Paion Shares to be issued under Article 146(D) shall be adjusted by the directors of the Company in such manner as the auditors of the Company may determine to be appropriate to reflect such reorganisation or alteration.
- (G) Notwithstanding any other provision of these Articles, the directors of the Company shall refuse to register the transfer of any shares at or after the Scheme Record Time and prior to the time at which the reduction of capital referred to in clause 1.1 of the Scheme takes effect.”

Registered office:  
Riverside Way  
Riverside Business Park  
Irvine KA11 5DJ  
Scotland

BY ORDER OF THE BOARD  
Tony Osborne  
Company Secretary

2 May 2008

**Notes:**

- (1) A Shareholder entitled to attend and vote at the General Meeting is also entitled to appoint one or more proxies to attend, speak and vote on a show of hands and on a poll instead of him or her. The proxy need not be a member of the Company. Where a Shareholder appoints more than one proxy, each proxy must be appointed in respect of different shares comprised in his or her shareholding which must be identified on the Form of Proxy. Each such proxy will have the right to vote on a poll in respect of the number of votes attaching to the number of shares in respect of which the proxy has been appointed. Where more than one joint Shareholder purports to appoint a proxy in respect of the same shares, only the appointment by the most senior Shareholder will be accepted as determined by the order in which their names appear in the Company's register of members. If you wish your proxy to speak at the General Meeting, you should appoint a proxy other than the chairman of the General Meeting and give your instructions to that proxy.
- (2) A Form of Proxy for use by Shareholders is enclosed. Please read carefully the instructions on how to complete the form. To be effective an instrument appointing a proxy and any authority under which it is executed (or a notarially certified copy of such authority) must be deposited at the offices of Equiniti at Aspect House, Spencer Road, Lancing, BN99 6ZR not later than 11:30 a.m. on 26 May 2008 except that (a) should the General Meeting be adjourned, such deposit may be made not later than 48 hours before the time of the adjourned meeting and (b) in the case of a poll taken more than 48 hours after it was demanded, such deposit may be made not later than 24 hours before the time appointed for the taking of the poll. Shareholders who intend to appoint more than one proxy can obtain additional Forms of Proxy from Equiniti by telephoning them on 0871 384 2998 (or, if calling from outside the United Kingdom, +44 121 415 0281). Alternatively, the form provided may be photocopied prior to completion. In respect of shares held in CREST one or more proxies may be appointed electronically by following the instructions in Note (4) below. Completion and return of the Form of Proxy or the electronic appointment of a proxy will not preclude Shareholders from attending and voting in person at the General Meeting.
- (3) In accordance with Regulation 41 of the Uncertificated Securities Regulations 2001, the Company specifies that only those Shareholders registered in the register of members of the Company as at 6:00 p.m. on 27 May 2008 or, in the event that the General Meeting is adjourned, in such register not later than 48 hours before the time of the adjourned meeting, shall be entitled to attend, or vote (whether in person or by proxy) at the meeting in respect of the number of shares registered in their names at the relevant time. Changes after the relevant time will be disregarded in determining the rights of any person to attend or vote at the General Meeting.
- (4) CREST members who wish to appoint a proxy or proxies by using the CREST electronic proxy appointment service may do so by utilising the procedures described in the CREST Manual. The message, (a CREST proxy instruction) must be properly authenticated in accordance with the specifications of Euroclear UK & Ireland Limited ("EUI") and must contain the information required for such instructions, as described in the CREST Manual. The message, regardless of whether it relates to the appointment of a proxy or to an amendment to the instruction given to a previously appointed proxy must, in order to be valid, be transmitted so as to be received by the Company's agent (ID 7RA01) not later than the time stated in Note (2) above. For this purpose, the time of receipt will be taken to be the time (as determined by the time stamp applied to the message by the CREST Applications Host) from which the Company's agent is able to retrieve the message by enquiry to CREST in the manner prescribed by EUI. CREST members and, where applicable, their CREST sponsors or voting service providers should note that EUI does not make available special procedures for any particular messages. Normal system timings and limitations will therefore apply in relation to the input of CREST proxy instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member or sponsored member or has appointed a voting service provider, to procure that his CREST sponsor or voting service provider takes) such action as shall be necessary to ensure that a message is transmitted by any particular time. Reference should be made to those sections of the CREST Manual concerning practical limitations of the CREST system and timings. The Company may treat as invalid a CREST proxy instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.
- (5) In order to facilitate voting by corporate representatives at the General Meeting, arrangements will be put in place at the General Meeting so that (i) if a corporate shareholder has appointed the chairman of the General Meeting as its corporate representative with instructions to vote on a poll in accordance with the directions of all the other corporate representatives for that shareholder at the General Meeting who have been appointed in respect of different parts of the holding of that corporate shareholder then on a poll those corporate representatives will give voting directions to the chairman of the General Meeting and the chairman will vote (or withhold a vote) in respect of each different part of the shareholding as corporate representative in accordance with the directions he has received from such corporate representatives in relation to the respective parts of the shareholding in respect of which they are each appointed or (ii) if more than one corporate representative for the same corporate shareholder attends the General Meeting but the corporate shareholder has not appointed the chairman of the General Meeting as its corporate representative, a designated corporate representative will be nominated, from those corporate representatives who attend, who will vote on a poll in accordance with the directions he receives from the other corporate representatives in respect of the parts of the corporate shareholders shareholding in respect of which such corporate representatives have each been appointed. Corporate shareholders are referred to the guidance issued by the Institute of Chartered Secretaries and Administrators on proxies and corporate representatives – [www.icsa.org.uk](http://www.icsa.org.uk) – for further details of this procedure. The guidance includes a sample form of representation letter if the chairman is being appointed as described in (i) above.
- (6) Copies of the Company's existing articles of association and copies of the articles of association as proposed to be amended by the special resolution set out in the notice of General Meeting are available for inspection at the offices of Morrison & Foerster, 7th Floor, CityPoint, One Ropemaker Street, London, EC2Y 9AW and at the Company's registered office, Riverside Way, Riverside Business Park, Irvine, KA11 5DJ, Scotland until opening of business on the day on which the General Meeting is held and will also be available for inspection at the place of the General Meeting for at least 15 minutes prior to the General Meeting.

Please note that the General Meeting is a private meeting for shareholders, proxies, and any other duly authorised representatives. Other persons, including spouses and partners of those entitled to attend are not entitled as of right to admission to the meeting.

