

# PAION Q3#2009

Consolidated Financial Interim Report for the Third Quarter 2009  
and the Nine-Month Period Ending 30 September 2009

## Contents

Interim Group Management Report for the Nine-Month Period Ending 30 September 2009	3
Overview	3
Share Performance	4
Overview of Research and Development Activities	5
Net Assets, Financial Position, and Results of Operations	9
Personnel Development	12
Risks and Opportunities	12
Significant Events Occurring After the Balance Sheet Date	12
Outlook	12
Consolidated Balance Sheet	14
Consolidated Statement of Comprehensive Income	16
Consolidated Cash Flow Statement	17
Consolidated Statement of Changes in Equity	18
Selected Explanatory Notes to the Consolidated Interim Financial Statements as of 30 September 2009	19
Review Report	22

01.01.  
30.09.  
2009

PAION AG



## Key Figures

(all figures in EUR k unless otherwise noted)	Q3 2009	Q3 2008	Q1-Q3 2009	Q1-Q3 2008
Revenues	377	483	1,164	2,697
Research and development expenses	-2,783	-1,670	-8,275	-6,064
General and administrative expenses	-1,121	-1,407	-3,388	-6,161
Selling and marketing expenses	0	-18	0	-84
Net result for the period	-3,152	-2,284	-10,043	-9,320
Earnings per share in EUR for the period (basic)	-0.13	-0.07	-0.41	-0.49
Earnings per share in EUR for the period (diluted)	-0.13	-0.07	-0.41	-0.49

	Q1-Q3 2009	Q1-Q3 2008
Net cash from operating activities	-8,828	-2,144
Net cash from investing activities	-53	-467
Net cash from financing activities	-498	-1,471
Average number of group employees	30	50

	30 Sept. 2009	31 Dec. 2008
Intangible assets	11,257	11,336
Cash and cash equivalents	26,754	36,072
Equity	22,086	31,528
Non-current liabilities	12,291	13,426
Balance sheet total	39,028	49,313
Equity ratio	56.6 %	63.9 %

# Interim Group Management Report for the Nine-Month Period Ending 30 September 2009

## Overview

The third quarter 2009 was very successful for PAION. With the rapid progress made with CNS 7056 and the ongoing Phase III trials of PAION's cooperation partner Lundbeck with Desmoteplase, PAION was able to re-position itself in the public perception. The strategic repositioning performed in 2008 was recognised by a sharp rise in the share price. Further interest of the capital markets was generated by the completion of the recruitment of the Phase Ib and the Phase IIa studies with the innovative short-acting anaesthetic/sedative CNS 7056 in the third quarter.

The Phase Ib study (multiple dose) included two components, the first examining the reversal of the sedative effect of CNS 7056 by the benzodiazepine antagonist flumazenil which were reported in May 2009. The effect of CNS 7056 can be reversed by the established antagonist, flumazenil and no re-sedation of the volunteers was observed. These data strengthen the safety profile of CNS 7056. In the second part of the study volunteers underwent a colonoscopy after receiving one of three different dosages of CNS 7056 followed by "top ups" (i.e. multiple doses) as required to maintain an adequate sedation level for 30 minutes. This time period is usually required to perform a colonoscopy with an additional intervention (e.g. polypectomy of one or more polyps). A routine, purely diagnostic colonoscopy takes approx. 10-15 minutes.

The Phase IIa study (single dose) was performed with patients undergoing a diagnostic endoscopy of the upper gastrointestinal tract.

Headline data of both studies were published after the balance sheet date, demonstrating the good tolerability of CNS 7056 during the interventions and confirming the rapid onset and offset of sedative effect. The Phase IIa study showed that it is possible to achieve the same or better results as compared to a single dose of the gold standard midazolam with a single dose of CNS 7056. This clinically relevant improvement over the gold standard has to be confirmed in larger trials. The safety profile observed in this trial confirmed the good tolerability also shown in previous data and was anticipated for a benzodiazepine.

With the ongoing Phase III studies performed by Lundbeck, Desmoteplase is also on the right track as a value driver for PAION. As Lundbeck has taken over all development costs, PAION will profit from the progress of development in the form of license and milestone payments.

In the third quarter PAION received valuable feedback from the FDA regarding M6G. The outstanding development program to achieve approval in the US thus has been clarified.

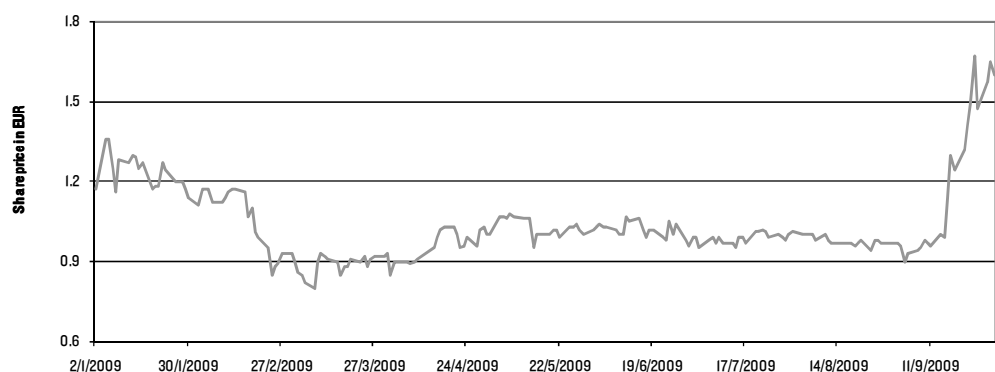
The loss for the period of the first nine months 2009 of EUR -10,043k was EUR 723k higher than in the corresponding prior-year period (EUR -9,320k). The revenues and the financial result decreased compared to the prior-year period and research and development expenses increased from EUR 2,211k to EUR 8,275k. In the reporting period general and administrative expenses amounted to EUR 3,388k, in the prior-year period these amounted to EUR 6,161k. Cash and cash equivalents decreased by EUR 9,318k in the first nine months 2009 and amounted to EUR 26,754k compared to EUR 36,072k as of 31 December 2008. The liquidity situation remains solid and secure with a sufficient cash reach at least until mid 2011.

## Share Performance

After a lateral movement at the beginning of the third quarter 2009 at the level of 1 EUR, the PAION share marked the bottom level on Xetra in the third quarter with EUR 0.89 on 3 September 2009. Supported by positive news flow, company presentations as well as very positive feedback from the financial press, the share price – in combination with a steep increase in turnover – climbed to a new annual high within a short time-frame. On 25 September 2009 the share price peaked at EUR 1.74. The closing price on 30 September 2009 was EUR 1.60. After the moderate trend in the first 8 months of the year, there was an overall increase in the share price of 7.4 % at the end of the third quarter compared to the closing price on 31 December 2008. The third quarter saw a rise of 66.7 % against the closing price on 30 June 2009.

The overall average daily trading volume (Xetra, Frankfurt Stock Exchange resp. all German Stock Exchanges) in the first nine months 2009 amounted to 40,385 shares. In September the rise of the share price was accompanied by a marked rise of the trading volume. The average daily trading volume in September was 146,645 shares. A total of 7.7 million shares were traded in the first nine months, representing 31 % of the share capital.

## Development of the PAION Share Price (Xetra) in the First Nine-Month Period 2009



## Overview of Research and Development Activities

### a. CNS 7056

CNS 7056 is an innovative short-acting general anaesthetic/sedative that is initially being developed for use in minor medical interventions (procedural sedation). Sedatives are used, for example, in endoscopic procedures such as colonoscopies. After intravenous administration to human volunteers CNS 7056 rapidly induces the desired sedation. Importantly, this sedative effect quickly disappears. This rapid offset of the effect of the substance is due to its metabolism by tissue esterase enzymes that are widely distributed throughout the body. CNS 7056 is being developed as a sedative agent for day case procedures and for the induction and maintenance of anaesthesia. It could also be used as a sedative during artificial respiration in the Intensive Care Unit (ICU).

#### **Clinical Development**

On 9 January 2009 PAION published the data of the first Phase I study with CNS 7056. In the course of this proof of concept study intravenously administered CNS 7056 was compared to placebo and a standard dose of Midazolam, which is currently the sedative of choice for procedural sedation. The study confirmed the anticipated positive profile of the substance, with no safety problems occurring. The study comprised of several increasing dosage groups of CNS 7056. As expected, volunteers were successfully sedated in the higher dose cohorts and rapidly recovered to full consciousness.

During the first quarter of 2009, two further studies were set up.

The Phase Ib study (multiple dose) included two components, the first examining the reversal of the sedative effect of CNS 7056 by the benzodiazepine antagonist flumazenil which were reported in May 2009. The effect of CNS 7056 can be reversed by the established antagonist, flumazenil and no re-sedation of the volunteers was observed. These data strengthen the safety profile of CNS 7056. In the second part of the study volunteers underwent a colonoscopy after receiving one of three different dosages of CNS 7056 followed by “top ups” (i.e. multiple doses) as required to maintain an adequate sedation level for 30 minutes. This time period is usually required to perform a colonoscopy with an additional intervention (e.g. polypectomy of one or more polyps). A routine, purely diagnostic colonoscopy takes approx. 10-15 minutes.

A Phase IIa study (single dose) was performed with patients undergoing a diagnostic endoscopy of the upper gastrointestinal tract.

Headline data of both studies were published after the balance sheet date, demonstrating the good tolerability of CNS 7056 during the interventions and confirming the rapid onset and offset of sedative effect. The Phase IIa study showed that it is possible to achieve the same or better results as compared to a single dose of the gold standard midazolam with a single dose of CNS 7056. This clinically relevant improvement over the gold standard has to be confirmed in larger trials. The safety profile observed in this trial confirmed the good tolerability also shown in previous data and was anticipated for a benzodiazepine.

Based on the results of the successfully concluded Phase Ib and Phase IIa studies, currently a Phase IIb study with patients undergoing a colonoscopy is being prepared. The aim of this study is to further refine the optimal dose regimen for Phase III.

#### **Cooperation Agreements**

In 2007 Ono Pharmaceutical Co., Ltd. was granted the rights to develop and market CNS 7056 for the Japanese market.

PAION is exploring partnering opportunities for the territories outside Japan in order to be able to initiate the development of CNS 7056 in other indications as early as possible. The recent clinical data are expected to increase the momentum of this process.

### **b. Morphine-6-glucuronide**

Morphine-6-glucuronide (M6G), a highly potent opioid, demonstrated in clinical Phase II and Phase III studies a strong analgesic effect in the treatment of severe, postoperative pain. At the same time common side effects, such as nausea and vomiting, were significantly reduced with M6G.

#### **Clinical development**

Since the acquisition of the project, PAION has performed various in-depth analyses of the available clinical data. The results support PAION's view that M6G has a wider therapeutic margin than morphine at equi-analgesic dosages with a lower incidence of post-operative nausea and vomiting. Based on these findings, in the third quarter PAION consulted the FDA in order to receive advice on the outstanding clinical development program. This has provided a confirmation of PAION's development proposals to a great extent. The adaptations recommended by the FDA will neither impact the projected timelines nor the planned expenses. The aim of the remaining Phase III program is to prove that M6G causes significantly less post-operative nausea and vomiting compared to equi-analgesic doses of morphine. The FDA instructed PAION that M6G will be regarded as a New Medical Entity.

In the third quarter 2009 the production of new clinical trial material has been completed.

#### **Cooperation Agreements**

Based on the results of the in-depth re-analysis and the FDA consultation PAION will continue the search for a development partner for M6G, which is now targeted to be concluded in 2010.

### **c. Desmoteplase**

Desmoteplase is an intravenously administered substance for dissolving blood clots that is currently being developed for the treatment of acute ischemic stroke.

### **Clinical Development**

So far Desmoteplase has been tested in two Phase II studies and one Phase III study for the treatment of ischemic stroke. PAION's partner, H. Lundbeck A/S, has taken on the further development of Desmoteplase and is supported by PAION in this work. In December 2008 Lundbeck announced the initiation of the first of two Phase III studies. In April 2009 the second Phase III study was started.

### **Cooperation Agreements**

Under the extended license agreement, which came into effect in January 2008 and now includes the North American markets, Lundbeck has exclusive global rights to develop and market Desmoteplase. Under this agreement, Lundbeck has agreed to undertake the following:

- Payment of a non-refundable amount of EUR 8 million in advance, on the date the agreement takes effect (payment received in January 2008; disclosed as deferred income and being released proportional over the probable development period),
- Assumption of all future costs, especially for clinical development, production development and marketing approval,
- Milestone payments of up to EUR 63 million, of which up to EUR 38 million relate to milestones due until market approvals (regional splitting) and in total EUR 25 million are due upon commencement of marketing activities and the achievement of specific revenue targets, and
- Payment of licence fees (dependent on revenues) which amount to a double-digit percentage, following the deduction of the licence fees PAION has to pay to the original licensor, Bayer Schering Pharma AG.

PAION has reserved the option to co-promote Desmoteplase in Germany, Austria and Switzerland. If PAION decides to exercise this option it will receive a direct share of earnings rather than licence fees based on revenues.

## **d. CNS 5161**

CNS 5161 is an antagonist of the NMDA receptor which may prove beneficial for the treatment of neuropathic pain, i.e. pain caused by irritation or damage of the nervous system. A second potential indication is the treatment of cancer pain.

### **Clinical Development**

PAION completed an open label clinical Phase IIa study using CNS 5161 in December 2008. The study encompassed a total of 24 patients suffering from opioid-resistant cancer pain who were split into six groups receiving ascending higher dosages of CNS 5161 administered six times in total over a period of 24 hours. The primary objective of the study was to define the maximum tolerable dose and to assess the relationship between the plasma concentration of CNS 5161 and changes in pain level. PAION reported the full results on 9 April 2009. Efficacy signals were observed in all but the lowest dose cohort. On the 10-grade numerical pain rating scale (NPRS), mean values dropped by 3.0 points from 6.2 to 3.2 at 32 hours, excluding the first (lowest dose) cohort. This represents approximately a 50% reduction of pain in these patients. EMEA

guidelines for neuropathic pain indicate that a 30-50% reduction in pain can be considered a response.

### **Cooperation Agreements**

In July 2006 CeNeS entered into a development partnership focusing on CNS 5161 with ERGOMED Clinical Research Limited, Frankfurt. This agreement governs the joint development at shared costs and income according to a predefined allocation. The further development of this substance will depend on securing third-party financing.

### **e. Solulin**

Solulin is an improved variant of the human protein thrombomodulin, an important natural regulator of blood coagulation. Thrombomodulin is capable of inhibiting the activity and formation of thrombin, an endogenous substance which, when produced in excess, can lead to blood clots. In contrast to natural thrombomodulin, which is an integral protein of vascular membranes, Solulin can travel through the blood stream to reach its potential site of action. Animal models demonstrated that Solulin effectively inhibits the formation of blood clots in veins and arteries.

In 2008 PAION published the results of a clinical Phase I study which involved single and multiple administrations of Solulin. The study confirmed the substance's good safety profile as well as its anticoagulant mode of action offering good potential to inhibit the activity and formation of thrombin.

PAION is continuing its search for partners to support the further development of Solulin.

### **f. Flovogatran**

Flovogatran is a substance characterised by a very fast onset of anticoagulation but also very rapid deactivation once intravenous administration is stopped. This is a complementary mode of action to Solulin with an equally fast onset but longer lasting effect. Flovogatran could prove useful as an acute anticoagulant during major surgery such as coronary artery bypass grafting. The substance was previously tested by its originator in two smaller Phase II studies, however in other indications. Therefore PAION is conducting additional preclinical studies in preparation of the clinical assessment of Flovogatran for the reduction of blood loss during bypass surgery. These studies were started in the first half of 2009. Toxicological studies are ongoing, which will be complemented by safety and efficacy studies. Corresponding study results combined with a decision about the next steps will follow at the beginning of 2010.

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

### Results of Operations

The loss for the first nine months of 2009 increased by EUR 723k year on year to EUR -10,043k. Especially a decrease of EUR 1,533k in revenues, an increase of EUR 2,211k in research and development expenses as well as a EUR 1,104k lower financial result reduced the result of the period. On the other hand general and administrative expenses declined by EUR 2,773k which is mainly due to transaction and restructuring costs incurred in the prior-year period. The other income increased by EUR 433k mainly because of the repayment of a fully written-off loan receivable. The revenues of the corresponding prior-year period include a material amount of current cost reimbursements as well as a one-off reimbursement of prior production costs by Lundbeck. The clear increase of research and development expenses compared to the prior-year period reflects the broader product pipeline of the PAION group, especially the costs for the development of CNS 7056. The development costs for Desmoteplase were completely borne by Lundbeck. The financial result decreased compared to the previous year on the back of considerably lower money market interest rates as well as lower cash and cash equivalents.

	Q3 2009 EUR k	Q3 2008 EUR k	Q1-Q3 2009 EUR k	Q1-Q3 2008 EUR k
Revenues	377	483	1,164	2,697
Cost of revenues	-9	-93	-48	-717
<b>Gross profit</b>	<b>368</b>	<b>390</b>	<b>1,116</b>	<b>1,980</b>
Research and development	-2,783	-1,670	-8,275	-6,064
General and administrative	-1,121	-1,407	-3,388	-6,161
Selling and marketing	0	-18	0	-84
Other income (expenses)	431	37	519	86
<b>Operating expenses</b>	<b>-3,473</b>	<b>-3,058</b>	<b>-11,144</b>	<b>-12,223</b>
<b>Operating result</b>	<b>-3,105</b>	<b>-2,668</b>	<b>-10,028</b>	<b>-10,243</b>
Financial result	-131	295	-270	834
Taxes on income	84	89	255	89
<b>Net result for the period</b>	<b>-3,152</b>	<b>-2,284</b>	<b>-10,043</b>	<b>-9,320</b>

Revenues of EUR 1,164k in the first nine months of 2009 mainly include the monthly release of deferred income in connection with the license agreement concluded with Lundbeck (EUR 1,091k) as well as to a minor degree the refund of development expenses by Lundbeck. The revenues in the prior-year period furthermore included reimbursements of prior

production development costs by Lundbeck according to the licence agreement with Lundbeck.

The cost of revenues incurred in the first nine months of 2009 related as well as in the corresponding prior-year period to the development expenses incurred in this period, which were refunded by Lundbeck.

Research and development expenses of EUR 8,275k in the first nine months of 2009 increased by EUR 2,211k compared to the corresponding prior-year period. The increase is primarily attributable to the broader product pipeline compared to the prior year. The main research and development focus was on CNS 7056. Furthermore research and development expenses were incurred for M6G, Solulin, Flovagatran and CNS 5161.

General and administrative expenses in the first nine months of 2009 declined by EUR 2,773k down to EUR 3,388k which is mainly due to one-off transaction and restructuring costs incurred in the prior-year period.

Other income in the first nine months of 2009 increased by EUR 433k to EUR 519k compared to the corresponding prior-year period which is mainly due to the repayment of a written-off loan receivable in the amount of GBP 375k (corresponding to EUR 436k). The loan from PAION UK Ltd. to a British biotech company with projects in an early stage of clinical development was put in place in 2002 and was taken over in connection with the acquisition of the PAION UK-group. Since the repayment was judged to be unlikely the loan was written off in the books of PAION UK Ltd. Finally the loan was repaid in August 2009 after the borrower was able to raise additional cash through a capital increase. PAION UK Ltd also has a minor stake in the equity of the company. These shares remain fully written off, as the available financial information does not justify a write back of the shares.

The financial result for the first nine months of 2009 decreased year on year by EUR 1,104k down to EUR -270k. The main reasons for the decrease are significantly lower money market interest rates as well as the reduction in cash and cash equivalents compared to the prior-year period.

The income taxes are attributable to tax claims for reimbursement of parts of the research and development costs from the British tax authorities.

## Net Assets and Financial Position

The total assets as of 30 September 2009 decreased by EUR 10,285k compared to 31 December 2008 and amounted to EUR 39,028k. The decrease was mainly due to a lower equity through the loss of the period and lower cash and cash equivalents. As of 30 September 2009 the equity ratio is 56.6 %, which means a decline compared to 31 December 2008 (63.9 %). If the subordinate loan borrowed in 2006 and the deferred non-refundable upfront payment from Lundbeck were recognised as economic equity, the equity ratio would increase to 88.1 %.

	30 Sept. 2009	31 Dec. 2008	Change
	EUR k	EUR k	EUR k
Non-current assets	11,563	11,746	-183
Current assets	27,465	37,567	-10,102
<b>Assets</b>	<b>39,028</b>	<b>49,313</b>	<b>-10,285</b>
Equity	22,086	31,528	-9,442
Non-current liabilities	12,291	13,426	-1,135
Current liabilities	4,651	4,359	292
<b>Equity and liabilities</b>	<b>39,028</b>	<b>49,313</b>	<b>-10,285</b>

The non-current assets mainly comprise the capitalised development projects of PAION UK Ltd (EUR 10,962k) from the acquisition in 2008.

The EUR 10,102k decrease in current assets is mainly attributable to the decrease in cash and cash equivalents (EUR 9,318k) and the decrease in other assets because of the receipt of a payment of a tax reimbursement of parts of the research and development costs for the year 2008 from the British tax authorities (EUR 687k). The change in cash and cash equivalents stems from the following areas:

	Q1-Q3 2009	Q1-Q3 2008
	EUR k	EUR k
Cash flows from operating activities	-8,828	-2,144
Cash flows from investing activities	-53	-467
Cash flow from financing activities	-498	-1,471
Effects of exchange rate changes	61	1
<b>Change in cash and cash equivalents</b>	<b>-9,318</b>	<b>-4,081</b>

The negative cash flows from operating activities of EUR 8,828k were mainly due to the loss of the period in the amount of EUR 10,043k as well as countervailing to a cash inflow from a tax reimbursement of parts of the research and development costs from the British tax authorities (EUR 687k).

The negative cash flows from financing activities in the first nine months of 2009 and the prior-year period resulted from interest payments for the subordinated loan raised in April 2006. In the prior-year period the cash flows from financing activities included EUR 981k payments in connection with the issuing of new shares.

The decrease of EUR 1,135k in non-current liabilities is mainly attributable to the monthly release of the deferred non-refundable upfront payment in connection with the license agreement concluded with Lundbeck (EUR 1,091k).

The current liabilities amount to EUR 4,651k meaning an increase of EUR 292k compared to 31 December 2008 (EUR 4,359k) which is mainly due to higher trade payables.

## Personnel Development

On average, PAION employed 30 employees in the first nine months of 2009.

## Risks and Opportunities

Material risks and opportunities relating to future development are presented in detail in the group management report for fiscal year 2008 and have not changed significantly in the first nine months of 2009.

## Significant Events Occurring After the Balance Sheet Date

On 6 October PAION 2009 announced the completion of Phase Ib study with its short acting anesthetic/sedative CNS 7056.

On 12 October 2009 PAION announced that Alexander Vos, COO, has resigned from his position as member of the Management Board. Mr. Vos left the company on 31 October 2009.

On 28 October 2009 PAION announced the headline results of the Phase Ib study with PAION's short acting anesthetic/sedative CNS 7056.

On 3 November 2009 PAION announced the headline results of the Phase IIa study with PAION's short acting anesthetic/sedative CNS 7056.

## Outlook

In 2009 PAION's focus was on advancing its compound CNS 7056. The major part of the research and development expenses is allotted to the Phase Ib and Phase IIa studies with CNS 7056 which were initiated in April 2009 and headline results reported in October/November 2009. The recent clinical data are expected to increase the momentum of the licensing process. The signing of an agreement is likely to be achieved in the next months. PAION is currently preparing a Phase IIb study in colonoscopy, to be performed in 2010.

PAION will continue the search for a development partner for M6G based on the results of the in-depth re-analysis and the FDA consultation. An agreement is targeted to be concluded in 2010.

Since the beginning of 2009 several cost reduction measures were carried out which will lead to sustainable cost savings in the current and future fiscal years. In 2009 revenues will result mainly from the monthly release of the deferred income in connection with the

milestone payment received from Lundbeck in 2008. In total, a net loss is expected for the fiscal year 2009.

As of 30 September 2009 PAION's cash and cash equivalents amount to EUR 27 million. These provide the necessary flexibility to implement value-generating steps and – based on further optimised cost structures – secure a sufficient cash reach at least until mid 2011. This does not account for further cost reductions, upfront payments, milestone payments and cost reimbursements from existing and future cooperation partners, which could expand the cash reach but may also be used fully or in part for funding of additional development activities. The cooperation with Lundbeck alone provides for future milestone payments of up to EUR 63 million, of which up to EUR 38 million will become due until market approvals.

Aachen, Germany, 4 November 2009

PAION AG



Dr. Wolfgang Söhngen



Bernhard Hofer



Dr. Mariola Söhngen



Dr. Gavin Kilpatrick

## Consolidated Balance Sheet

ASSETS	30 Sept. 2009 EUR	31 Dec. 2008 EUR	30 Sept. 2008 EUR
<b>Non-current assets</b>			
Intangible assets	11,256,583.06	11,336,347.69	18,453,745.99
Equipment	305,817.99	409,471.11	462,506.55
Other assets	2.19	2.09	2.52
	<b>11,562,403.24</b>	<b>11,745,820.89</b>	<b>18,916,255.06</b>
<b>Current assets</b>			
Trade receivables	23,555.10	100,449.52	938,999.66
Prepaid expenses and other assets	687,841.47	1,395,034.81	1,357,427.22
Cash and cash equivalents	26,753,991.90	36,071,890.73	38,820,342.60
	<b>27,465,388.47</b>	<b>37,567,375.06</b>	<b>41,116,769.48</b>
<b>Total assets</b>	<b>39,027,791.71</b>	<b>49,313,195.95</b>	<b>60,033,024.54</b>

EQUITY AND LIABILITIES	30 Sept. 2009 EUR	31 Dec. 2008 EUR	30 Sept. 2008 EUR
<b>Equity</b>			
Share capital	24,602,919.00	24,602,919.00	24,602,919.00
Capital reserve	88,620,619.46	88,511,062.55	88,484,215.79
Translation reserve	-1,685,139.83	-2,177,128.79	-72,552.33
Loss carryforward	-79,409,073.92	-66,828,608.63	-66,828,608.63
Loss for the period	-10,043,164.97	-12,580,465.29	-9,319,547.84
	<b>22,086,159.74</b>	<b>31,527,778.84</b>	<b>36,866,425.99</b>
<b>Non-current liabilities</b>			
Financial liabilities	6,849,138.74	6,824,995.87	6,816,803.94
Deferred taxes	0.00	0.00	5,081,005.10
Provisions	1,366,974.14	1,426,929.28	1,249,352.88
Finance lease liabilities	0.00	0.00	6,264.00
Deferred income	4,074,999.98	5,174,242.44	5,540,656.58
	<b>12,291,112.86</b>	<b>13,426,167.59</b>	<b>18,694,082.50</b>
<b>Current liabilities</b>			
Trade payables	1,862,514.37	1,591,854.98	1,704,355.16
Provisions	985,639.80	867,153.17	980,671.92
Other current financial liabilities	43,234.24	0.00	0.00
Current portion of finance lease liabilities	6,263.00	61,760.00	73,644.00
Other current liabilities	261,918.90	372,824.81	248,188.41
Current portion of deferred income	1,490,948.80	1,465,656.56	1,465,656.56
	<b>4,650,519.11</b>	<b>4,359,249.52</b>	<b>4,472,516.05</b>
<b>Total equity and liabilities</b>	<b>39,027,791.71</b>	<b>49,313,195.95</b>	<b>60,033,024.54</b>

## Consolidated Statement of Comprehensive Income

EUR	1 July – 30 Sept. 2009	1 July – 30 Sept. 2008	1 January – 30 Sept. 2009	1 January – 30 Sept. 2008
Revenues	376,565.59	483,098.04	1,164,106.49	2,696,736.47
Cost of revenues	-8,862.55	-93,530.75	-48,600.95	-717,440.29
<b>Gross profit</b>	<b>367,703.04</b>	<b>389,567.29</b>	<b>1,115,505.54</b>	<b>1,979,296.18</b>
Research and development expenses	-2,782,759.94	-1,670,010.04	-8,274,937.40	-6,064,087.33
General and administrative expenses	-1,120,793.95	-1,407,041.24	-3,388,124.29	-6,160,610.76
Selling and marketing expenses	0.00	-18,480.00	0.00	-83,701.20
Other income (expenses), net	430,652.29	37,449.37	519,315.59	85,759.35
<b>Operating expenses</b>	<b>-3,472,901.60</b>	<b>-3,058,081.91</b>	<b>-11,143,746.10</b>	<b>-12,222,639.94</b>
<b>Operating result</b>	<b>-3,105,198.56</b>	<b>-2,668,514.62</b>	<b>-10,028,240.56</b>	<b>-10,243,343.76</b>
Financial income	60,276.22	452,630.58	312,879.01	1,430,211.85
Financial expenses	-191,595.14	-157,272.92	-582,627.94	-595,664.06
<b>Financial result</b>	<b>-131,318.92</b>	<b>295,357.66</b>	<b>-269,748.93</b>	<b>834,547.79</b>
<b>Loss for the period before taxes</b>	<b>-3,236,517.48</b>	<b>-2,373,156.96</b>	<b>-10,297,989.49</b>	<b>-9,408,795.97</b>
<b>Income taxes</b>	<b>84,593.26</b>	<b>89,248.13</b>	<b>254,824.52</b>	<b>89,248.13</b>
<b>Loss for the period</b>	<b>-3,151,924.22</b>	<b>-2,283,908.83</b>	<b>-10,043,164.97</b>	<b>-9,319,547.84</b>
of which attributable to other shareholders	0.00	0.00	0.00	0.00
of which attributable to shareholders of PAION AG	-3,151,924.22	-2,283,908.83	-10,043,164.97	-9,319,547.84
Foreign currency translation of subsidiaries	-730,771.58	-52,898.45	491,988.96	-72,552.33
<b>Other comprehensive income</b>	<b>-730,771.58</b>	<b>-52,898.45</b>	<b>491,988.96</b>	<b>-72,552.33</b>
<b>Total comprehensive income</b>	<b>-3,882,695.80</b>	<b>-2,336,807.28</b>	<b>-9,551,176.01</b>	<b>-9,392,100.17</b>
of which attributable to other shareholders	0.00	0.00	0.00	0.00
of which attributable to shareholders of PAION AG	-3,882,695.80	-2,336,807.28	-9,551,176.01	-9,392,100.17
Earnings per share (basic)	-0.13	-0.07	-0.41	-0.49
Earnings per share (diluted)	-0.13	-0.07	-0.41	-0.49

## Consolidated Cash Flow Statement

EUR	1 January – 30 Sept. 2009	1 January – 30 Sept. 2008
<b>Cash flows from operating activities:</b>		
Net result for the period	-10,043,164.97	-9,319,547.84
<b>Reconciliation of net profit (loss) for the period to cash flows from operating activities:</b>		
Amortization/depreciation and non-cash exchange rate changes of fixed assets	220,712.78	937,725.55
Loss/Profits from the disposal of non-current assets	15,148.86	63,834.68
Interest expenses and interest income	269,748.93	-834,547.79
Release of deferred income	-1,123,134.26	-1,145,241.33
Expenses from stock option plans	109,556.91	196,992.01
<b>Change in assets and liabilities which are not attributable to investing or financing activities:</b>		
Trade receivables	76,894.42	-162,193.33
Prepaid expenses and other assets	44,975.76	-16,839.17
Trade payables	270,660.38	-2,377,027.34
Provisions	-13,847.53	315,322.81
Other current liabilities	-110,905.98	-199,362.76
Deferred income	49,184.04	8,100,000.00
Non-cash exchange losses/gains	430,649.46	0.00
	-9,803,521.20	-4,440,884.51
Interest received	288,139.06	1,238,807.13
Tax payments received	686,959.55	1,058,525.40
<b>Net cash used in operating activities</b>	<b>-8,828,422.59</b>	<b>-2,143,551.98</b>
<b>Cash flows from investing activities:</b>		
Cash paid for investments in intangible assets and equipment	-52,443.89	-311,765.36
Cash received from the sale of intangible assets and equipment	0.00	320,529.05
Net cash paid for/received from business combinations	0.00	-476,249.61
<b>Net cash used in investing activities</b>	<b>-52,443.89</b>	<b>-467,485.92</b>
<b>Cash flows from financing activities:</b>		
Payments in connection with the issuing of new shares	0.00	-981,364.40
Interest paid	-441,801.78	-432,841.36
Payment of finance lease liabilities	-56,568.00	-56,568.00
<b>Net cash used in financing activities</b>	<b>-498,369.78</b>	<b>-1,470,773.76</b>
Change in cash and cash equivalents	-9,379,236.26	-4,081,811.66
Effect of exchange rate changes on cash	61,337.43	1,031.08
Cash and cash equivalents at beginning of the period	36,071,890.73	42,901,123.18
<b>Cash and cash equivalents at end of the period</b>	<b>26,753,991.90</b>	<b>38,820,342.60</b>
<b>Composition of cash and cash equivalents at the end of the period:</b>		
Cash	26,753,991.90	38,820,342.60

## Consolidated Statement of Changes in Equity

EUR	Share capital	Capital reserve	Translation reserve	Loss carryforward	Equity
<b>31 December 2007</b>	<b>16,755,552.00</b>	<b>85,737,273.03</b>	<b>0.00</b>	<b>-66,828,608.63</b>	<b>35,664,216.40</b>
Total comprehensive income	0.00	0.00	-72,552.33	-9,319,547.84	-9,392,100.17
Issue of shares	7,847,367.00	0.00	0.00	0.00	7,847,367.00
Contribution to the capital reserve	0.00	3,531,315.15	0.00	0.00	3,531,315.15
Cost of raising capital	0.00	-981,364.40	0.00	0.00	-981,364.40
Additional contribution to the capital reserve due to the issue of options	0.00	196,992.01	0.00	0.00	196,992.01
<b>30 September 2008</b>	<b>24,602,919.00</b>	<b>88,484,215.79</b>	<b>-72,552.33</b>	<b>-76,148,156.47</b>	<b>36,866,425.99</b>
Total comprehensive income	0.00	0.00	-2,104,576.46	-3,260,917.45	-5,365,493.91
Cost of raising capital	0.00	0.00	0.00	0.00	0.00
Additional contribution to the capital reserve due to the issue of options	0.00	26,846.76	0.00	0.00	26,846.76
<b>31 December 2008</b>	<b>24,602,919.00</b>	<b>88,511,062.55</b>	<b>-2,177,128.79</b>	<b>-79,409,073.92</b>	<b>31,527,778.84</b>
Total comprehensive income	0.00	0.00	491,988.96	-10,043,164.97	-9,551,176.01
Additional contribution to the capital reserve due to the issue of options	0.00	109,556.91	0.00	0.00	109,556.91
<b>30 September 2009</b>	<b>24,602,919.00</b>	<b>88,620,619.46</b>	<b>-1,685,139.83</b>	<b>-89,452,238.89</b>	<b>22,086,159.74</b>

## Selected Explanatory Notes to the Consolidated Interim Financial Statements as of 30 September 2009

### General

The quarterly report of PAION AG includes interim consolidated financial statements and an interim group management report in accordance with the provisions of Secs. 37x (3) and 37w (2) to (4) WpHG [“Wertpapierhandelsgesetz”: German Securities Trading Act] in conjunction with Sec. 37y WpHG. The 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 subsidiaries, which are fully consolidated:

- PAION Deutschland GmbH, Aachen/Germany
- PAION Holdings UK Ltd, Cambridge/UK
- PAION UK Ltd, Cambridge/UK
- CeNeS Drug Delivery Ltd, Cambridge/UK
- TheraSci Limited, Cambridge/UK
- CeNeS Pharmaceuticals Inc., Norwood/USA
- CeNeS (Bermuda) Ltd, Bermuda

### Basis of Accounting

The interim consolidated financial statements have been prepared in accordance with Sec. 315a HGB [“Handelsgesetzbuch”: German Commercial Code] and IFRSs, as adopted by the EU, and the interpretations of the International Financial Reporting Interpretations Committee (IFRIC). All IFRSs issued by the International Accounting Standards Board (IASB), London, UK, which were effective as of the balance sheet date of 30 September 2009 and applied by PAION, were adopted by the European Commission for application in the EU.

The following new announcements were published by the IASB during the reporting period and will be applied as soon as they come into effect if at that point an adoption by the European Commission has taken place.

- IFRIC 18: The IASB published IFRIC 18 Transfers of Assets from Customers in January 2009. IFRIC 18 clarifies the accounting methods for agreements in which a company receives assets or cash from a customer that it must then use to either connect that customer to a network or provide that customer with ongoing access to goods or services (e.g. energy, gas, water). IFRIC 18 must be applied to assets transferred on or after 1 July 2009. This will not have any effects on the Group’s net assets, financial position and results of operations or lead to further disclosures.
- Amendment to IFRS 7 Financial Instruments: Disclosures: On 5 March 2009 the IASB published amendments to IFRS under the title “Improving Disclosures about Financial Instruments – Amendments to IFRS 7”. The amendments relate to disclosures about fair value measurements and liquidity risk. The amendments require that fair value measurement disclosures use a three-level fair value hierarchy and that disclosures are extended. Furthermore the disclosures related about liquidity risks are clarified and extended. For this disclosures are required about maturity of financial liabilities, broken down by non-derivative and derivative financial instruments and the corresponding qualitative disclosures about the management of liquidity risk are changed. The amendments are effective for fiscal years beginning on or after 1 January 2009; earlier application would be permitted. In the first year of application, comparative disclosures are not required. The application of these amendments could result in additional disclosure obligations in future consolidated financial statements. The amendments do not have any effects on the Group’s net assets, financial position and results of operations.
- Amendments to IFRIC 9 and IAS 39: On 12 March 2009 the IASB published amendments to IFRIC 9 Reassessment of Embedded Derivatives and IAS 39: Financial Instruments: Recognition and Measurement. The amendments clarify the accounting of embedded derivatives in entities that make use of the option to reclassify financial instruments which was published by the IASB in October 2008. The amendments clarify that in case of a reclassification all embedded derivatives have to be measured and if necessary separated. The amendments apply retrospectively and

are required to be applied for fiscal years ending on or after 30 June 2009. Since PAION does not own any financial instruments affected by the amendments, the amendments do not have any effects on the Group's net assets, financial position and results of operations.

- On 16 April 2009 the IASB published the collective standard „Improvements to IFRSs“, which implements minor changes to the existing IFRSs. The standard contains 15 amendments to 12 standards. The majority of the amendments must be applied to fiscal years commencing on or after 1 January 2010. This will not have any effects on the Group's net assets, financial position and results of operations or lead to further disclosures.
- Amendments to IFRS 2 Share-based Payment: On 18 June 2009 the IASB published amendments to IFRS 2 Share-based Payment. The amendments clarify the accounting treatment of share-based payments with cash-settlement in a group of companies. The amendments to IFRS 2 also incorporate guidance previously included in IFRIC 8 „Scope of IFRS 2“ and IFRIC 11 „IFRS 2 – Group and Treasury Share Transactions“. As a result, the IASB has withdrawn IFRIC 8 and IFRIC 11. The amendments are effective for fiscal years ending on or after 1 January 2010; earlier application would be permitted. This will not have any effects on the Group's net assets, financial position and results of operations or lead to further disclosures.
- IFRS for Small and Medium-Sized Entities: On 9 July 2009 the IASB published an IFRS for Small and Medium-Sized Entities (SME). The IFRS for SME is a self-contained standard that fits the needs of small and medium-sized entities. Since PAION AG as a listed company does not meet the definition of small and medium-sized entities, this will not have any effects on the Group's net assets, financial position and results of operations or lead to further disclosures.
- Amendments to IFRS 1: On 23 July 2009 the IASB published amendments to IFRS 1 “First-time adoption of International Financial Reporting Standards”. The amendments address the retrospective application of IFRSs to particular situations and are aimed at ensuring that entities applying IFRSs will not face undue cost in the transition process. This will not have any effects on the Group's net assets, financial position and results of operations or lead to further disclosures.
- Amendments to IAS 32: On 8 October 2009 the IASB published amendments to IAS 32 “Financial Instruments: Presentation”. The amendments address the accounting of

issuers for rights issues, options and warrants to acquire a fixed amount of equity instruments that are denominated in a currency other than the functional currency of the issuer. The amendments are effective for fiscal years beginning on or after 1 February 2010; earlier application would be permitted. This will not have any effects on the Group's net assets, financial position and results of operations or lead to further disclosures.

The provisions of IAS 34, “Interim Financial Reporting”, have been applied. The interim financial statements as of 30 September 2009 should be read in conjunction with the consolidated financial statements as of 31 December 2008.

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 estimations and discretionary valuations made in the course of preparing the interim consolidated financial statements apply primarily to the measurement of intangible assets and provisions. The development projects that were capitalised following the acquisition of the PAION UK Group are being written off over a useful life of 14.5 years based on forward-looking assumptions in respect of the time at which regulatory approval is obtained and the patent protection of the products. The provision for long-term leased, unused premises is based on estimated costs incurring up to the end of the contract term.

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

## Consolidation Principles

The consolidation principles used in the interim consolidated financial statements as of 30 September 2009 were the same as those used in the consolidated financial statements as of 31 December 2008.

## Foreign Currency Translation

The consolidated financial statements are shown in Euro, which is the functional currency of PAION AG and the reporting currency of the Group. Each company within the Group defines its own functional currency. This is the Euro in the case of the German companies, whereas the UK-based

companies use Pound Sterling as their functional currency. All items on the respective financial statements of each company are initially converted to the functional currency at the exchange rate applicable on the transaction date. Monetary assets and liabilities denominated in a foreign currency are converted to the functional currency on the reporting date at the exchange rate applicable on that date. All ensuing currency differences are recognised in profit or loss with the exception of exchange rate gains and losses from intra-Group loans classified in accordance with IAS 21 as net investments in foreign business operations; these are recognised in equity.

The assets and liabilities of the foreign companies are converted to Euro on the balance sheet reporting date at the exchange rate applicable on that date. These include any and all goodwill in connection with the acquisition of a foreign company and any and all fair value adjustments to the book values of the foreign company's assets and liabilities. Equity components are converted to Euro at historical rates at the time of initial consolidation. Expenses and income are converted to Euro at average monthly exchange rates. The resulting currency differences are accounted for separately within equity.

## Accounting Policies

The accounting policies used in the interim consolidated financial statements as of 30 September 2009 were the same as those used in the consolidated financial statements as of 31 December 2008 except for the changes resulting from the revision of IAS 1.

## Presentation of the Cash Flow Statement

In the current period the presentation of received tax payments in the cash flow statement was changed. In the previous year these payments were presented within the changes of other assets. From the third Quarter 2009 onwards these payments are presented as a separate position within the cash flows from operating activities. In order to ensure comparability to the previous year, the tax payments received last year are also presented as a separate position from the third quarter 2009 onwards.

## Tax Effects on the Other Comprehensive Income

Because of the negative results of the PAION Group and the existing tax losses carried forward no income taxes are being paid at the moment. In the reporting period the Other Comprehensive Income (foreign currency translation of foreign subsidiaries) does not have any tax effects.

## Related Parties

The relationships with related parties have not changed in comparison to those applied in the consolidated financial statements as of 31 December 2008.

## Significant Events Occurring After the Balance Sheet Date

On 6 October 2009 PAION announced the completion of Phase Ib study with its short acting anesthetic/sedative CNS 7056.

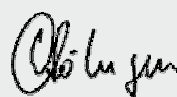
On 12 October 2009 PAION announced that Alexander Vos, COO, has resigned from his position as member of the Management Board. Mr. Vos left the company on 31 October 2009.

On 28 October 2009 PAION announced the headline results of the Phase Ib study with PAION's short acting anesthetic/sedative CNS 7056.

On 3 November 2009 PAION announced the headline results of the Phase IIa study with PAION's short acting anesthetic/sedative CNS 7056.

Aachen, Germany, 4 November 2009


PAION AG



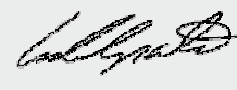
Dr. Wolfgang Söhngen



Bernhard Hofer



Dr. Mariola Söhngen



Dr. Gavin Kilpatrick

# Review Report

## To PAION AG, Aachen:

We have reviewed the interim condensed consolidated financial statements, comprising the balance sheet, statement of comprehensive income, cash flow statement, statement of changes in equity and selected explanatory notes, and the interim group management report of PAION AG, Aachen, for the period from January 1 to September 30, 2009 which are part of the quarterly financial report pursuant to SEC 37x (3) WpHG ["Wertpapierhandelsgesetz": German Securities Trading Act]. The preparation of the interim condensed consolidated financial statements in accordance with the IFRSs on interim financial reporting as adopted by the EU and of the group management report in accordance with the requirements of the WpHG ["Wertpapierhandelsgesetz": German Securities Trading Act] applicable to interim group management reports is the responsibility of the Company's Management. Our responsibility is to issue a report on the interim condensed consolidated financial statements and the interim group management report based on our review.

We conducted our review of the interim condensed consolidated financial statements and the interim group management report in accordance with German generally accepted standards for the review of financial statements promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW) and additionally in accordance with the International Standard on Review Engagements "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" (ISRE 2410). Those standards require that we plan and perform the review to obtain a certain level of assurance in our critical appraisal to preclude that the interim condensed consolidated financial statements are not prepared, in all material respects, in accordance with IFRSs on interim financial reporting as adopted by the EU and that the interim group management report has not been prepared, in all material respects, in accordance with the provisions of the WpHG. A review is limited primarily to making inquiries of company personnel and applying analytical procedures and thus does not provide the assurance that we would obtain from an audit of financial statements. In accordance with our engagement, we have not performed a financial statement audit and, accordingly, we do not express an audit opinion.

Based on our review nothing has come to our attention that causes us to believe that the interim condensed consolidated financial statements are not prepared, in all material respects, in accordance with IFRSs on interim financial reporting as adopted by the EU and that the interim group management report has not been prepared, in all material respects, in accordance with the provisions of the WpHG applicable to interim group management reports.

Cologne, Germany, 4 November 2009

Ernst & Young GmbH

Wirtschaftsprüfungsgesellschaft

(s) Gockel

Wirtschaftsprüfer

[German Public Auditor]

(s) Zwirner

Wirtschaftsprüfer

[German Public Auditor]



PAION AG

Martinstrasse 10-12

52062 Aachen Germany

Phone +49-241-4453-0

Fax +49 241 4453-100

info@paion.com [www.paion.com](http://www.paion.com)