

PAION AG, Aachen

Financial Statements

as of 31 December 2007 and

Management Report

for the Fiscal Year 2007

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Management Report for Fiscal Year 2007

Economic Background

I. Overall Economic Development

The global economy grew strongly once again in 2007. According to the Ifo Institute for Economic Research, global GDP rose by 5% following a 5.4% increase in 2006. However, the economic climate clouded significantly towards the end of the year as a result of the turbulence on the financial markets, which triggered the US real estate and financial crisis, record oil prices, and the euro's strength against the dollar.

The US economy was unstable in 2007. Following weak expansion in the first quarter, overall economic production received a strong boost in the summer months. Nevertheless, the real estate and financial crisis in the fourth quarter of 2007 resulted in a significant slowdown and there are even fears that the US could slide into recession. In 2007, emerging markets, especially China and India, continued their course of above-average real GDP growth which began in prior years. The upturn in the eurozone continued in 2007, albeit at a slightly slower pace. Overall economic growth of some 2.6% is forecast for 2007. The German economy proved to be robust in 2007 and continued the positive development it had experienced in the two prior years. The driving forces of this growth were once again export demand, which rose yet again despite the appreciation of the euro against the US dollar, and domestic demand. German GDP is expected to rise by about 2.5% in 2007 overall.

While equity markets were also able to post notable growth in 2007, insecurities regarding the effects of the real estate and financial crisis became noticeable in the second half of the year. Following the considerable dip on the European and US equity markets at the end of February 2007 in response to the crash on the Chinese equity markets, a tangible recovery was quick to follow. The DAX hit a record high of 8,106 points on 16 July 2007 and the Dow Jones Index cracked the 14,000 mark for the first time one day later. However, the soaring indices were subdued again by the US real estate and financial crisis. The Dow Jones was able to recover these losses in the fourth quarter but succumbed at the end of the year once again to the ongoing insecurity on the financial markets. Nevertheless, the Dow Jones Index posted growth of 6% for the full year. The DAX recovered from the decline it experienced in the third quarter and closed the year 22% higher than the prior year. The TecDax did even better, notching up growth of 30%.

2. Development of the Pharmaceutical and Biotechnology Industry

2007 was once again shaped by the risks and insecurities connected to clinical development. PAION was just one of a number of companies that experienced sustainable setbacks in their development programs, which, in some cases, even led to the development of individual drug candidates being discontinued.

The high risks connected to pharmaceutical development and the expiry of patent protection on a number of products in the years to come continued to drive company mergers in 2007. The number of mergers in 2007 remained at a similarly high level to 2006. Pharmaceutical companies not only merged among themselves; they also merged with or acquired biotechnology companies. In many cases, these acquisitions were preceded by long-standing cooperation between the parties.

The setbacks in the development programmes had a sustained effect on the share prices of the affected companies, especially the smaller ones. Overall, the listed pharmaceutical and biotechnology companies were able to maintain the growth course that they embarked on in the prior year but they were unable to match the growth rates achieved in the general indices. Deutsche Börse AG's Prime Pharma & Healthcare Performance Index increased by around 10% year on year, and the AMEX Biotechnology Index was up 4%. The NASDAQ Biotechnology Index, which only posted growth of 1% in 2006, grew by 5% in 2007.

Business Performance

I. Preliminary Remarks

PAION AG is a holding company that provides management and services for its sole subsidiary, PAION Deutschland GmbH, Aachen, Germany. Its services comprise accounting, legal and intellectual property services. In addition, PAION AG helps to finance PAION Deutschland GmbH's operating activities. The activities of the PAION Group (hereinafter also referred to as "PAION") are thus mainly determined by the research and development operations of PAION Deutschland GmbH, which is presented below.

PAION Deutschland GmbH is a biopharmaceutical company founded in 2000 which develops and markets innovative drugs for treating strokes and other thrombotic diseases. PAION Deutschland GmbH's research and development activities are currently focused on three substances: Desmoteplase, Enecadin and Solulin.

Fiscal year 2007 was shaped by the negative outcome of the clinical Phase III study (DIAS-2) with PAION's most advanced developed substance, Desmoteplase, and the discontinuation of the cooperation with Forest Laboratories, Inc. (Forest). PAION's efforts to quickly clarify the results of the DIAS-2 study and, on the basis of those results, to secure the continuation of the development programme with Desmoteplase were successfully concluded with the signing of a new licence agreement with PAION's cooperation partner, H. Lundbeck A/S (Lundbeck) in December 2007.

2. Overview of Research and Development Activities of PAION Deutschland GmbH

a. Desmoteplase

Desmoteplase is an intravenous therapeutic that may primarily serve for the causal treatment of acute ischemic stroke. Desmoteplase belongs to a group of blood clot-dissolving substances known as plasminogen activators.

Between spring 2005 and February 2007, PAION and its former cooperation partner, Forest, conducted a Phase III study with Desmoteplase on a total of 186 patients. This study examined the clinical improvement for patients who had suffered an acute ischemic stroke and received Desmoteplase in comparison to a placebo group. Patients received either a 90mcg/kg or a 125mcg/kg dose of Desmoteplase. Treatment took place within three to nine hours following the onset of stroke symptoms. The study only included patients with potentially salvageable tissue (penumbra) of at least 20%, compared to the infarct core. The penumbra was detected either via magnetic resonance imaging (MRI) or perfusion computed tomography (PCT). The primary efficacy endpoint of the study was defined as the percentage difference between the clinically measurable improvement in the condition of patients 90 days after treatment in the patient groups that were given either the test substance or the placebo. The first results of the study were published at the end of May 2007. Neither dose investigated showed a statistically significant difference in clinical improvement compared to the placebo group. The primary efficacy endpoint of the study was thus not achieved. However, Desmoteplase met the safety profile expectations for both doses. It was particularly surprising that an unusually large number of patients in the placebo group (46.0%) showed a strong clinical improvement. On average, the patients treated in the DIAS 2 study only displayed relatively minor stroke symptoms and thus had a greater chance of improvement. This was considered to be a first indication towards explaining the unexpected results, however, this on its own did not sufficiently explain the results of the study.

For this reason, PAION and its cooperation partners began analysing the results of the study at the beginning of June 2007 placing primary emphasis on explaining the unusually high response to the placebo. PAION published the results of this analysis in October 2007. One of the main reasons for the unusually high response to the placebo was the fact that in contrast to previous Phase II studies more than half of the DIAS 2 patients did not display any visible blockage of major brain arteries at the start of treatment, despite positively having a penumbra. This became apparent after subsequent analysis of the images made of the blood vessels in the brain (angiographs). These patients would therefore have benefited less from the effects of the blood clot-dissolving substance Desmoteplase. In the past, stroke experts assumed the presence of a penumbra to be a key indication of both visible (in the larger brain arteries) and non-visible occlusions (in smaller arteries) and, independent of proof of the presence of a (partial) occlusion in the larger brain arteries, to represent an indication for reperfusion therapy. When analysing patient subgroups in which visible occlusion could be proved, a lower response rate was observed in the placebo group and a more positive effect registered in those patients who received Desmoteplase than those who received the placebo; however, due to the lower number of patients in the subgroup this did not reach statistical significance. Furthermore, the combined evaluation of the data from the Phase II and Phase III studies (DIAS/DEDAS/DIAS 2) showed Desmoteplase to have a statistically significant effect when patients without visible occlusion in major brain arteries were excluded. Furthermore, the follow-up analysis indicated that patients

with no visible artery occlusion but with a large penumbra may also benefit from treatment with Desmoteplase.

The results obtained provide as sound rationale for the further development of Desmoteplase, which is now ensured based on the continuation of the cooperation with Lundbeck.

Cooperation Agreements

Due to the negative results of the DIAS-2 study, PAION's cooperation partner Forest has decided to return the development and marketing rights for North America acquired in 2004 to PAION and announced this in August 2007 before completion of the analysis. Discontinuation of the cooperation with Forest did not result in any repayment obligations for PAION for the milestone payments received in the past by Forest and development expense refunds paid by Forest.

By contrast, Lundbeck, on the basis of the knowledge gained from the analysis of the DIAS-2 study results, decided to continue the cooperation with PAION and even to extend this cooperation to include North America (the contractual territory that had originally been outlicensed to Forest), and to bear all future development expenses. With the new license agreement, 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 undertake the following:

- 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;
- Milestone payments of up to EUR 63m, of which EUR 38m comprises milestone payments falling due prior to commencement of marketing activities and EUR 25m falling due upon commencement of marketing activities and the achievement of specific revenue targets; and
- Payments of licence fees (dependent on revenues) which, following the deduction of the licence fees PAION has to pay to the original licensor, Bayer Schering Pharma AG amount to a double-digit percentage.

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

Under the new agreement, Lundbeck will be responsible for the further development of Desmoteplase and will be supported by PAION. Lundbeck plans to initiate the next clinical Phase III study in the second half of 2008.

b. Enecadin

Enecadin is a neuroprotectant which may increase the survival time of damaged nerve cells and thus treat neuronal damage during acute ischemic stroke. In 2004, PAION procured exclusive licences for Enecadin from the Japanese manufacturer Nippon Shinyaku Co., Ltd for all markets outside of Japan. The Company has co-exclusive rights with Nippon Shinyaku for Japan. PAION has been conducting the Phase IIa clinical study called TEST (Tolerability of Enecadin in acute ischemic Stroke Trial) since the first quarter of 2006. TEST is designed as a multicentric, double-blind, randomised, placebo-controlled, dose-finding study. Its aim is to examine the safety and tolerability of the drug as well as obtain first indications of its efficacy in patients with acute ischemic stroke in a timeframe of up to nine hours after the onset of symptoms. Patient enrolment for the first dose group of this study was completed in the second quarter of 2007. The subsequent safety review of the study held by the independent Data Monitoring Committee (DMC) did not give rise to any reservations regarding the safety of the drug. Since its in-licensing, the development of Enecadin was aimed at a combination with blood clot-dissolving substances such as Desmoteplase. PAION opted mid-2007 to discontinue recruitment for the TEST study until a decision had been made regarding the strategic realignment of the development pipeline.

c. Solulin

Solulin is a thrombin modulator which may act as an “intelligent anticoagulant” with anti-inflammatory potential which could be useful for the treatment of thrombo-embolic diseases. The substance is an improved recombinant variant of the human protein thrombomodulin. In mid-2007, PAION initiated a Phase I clinical study in which Solulin will be tested on humans for the first time. The study is designed to evaluate Solulin’s safety, tolerability and pharmacokinetics, and to obtain information on pharmacodynamic properties of the drug upon intravenous injection. It is being conducted as a single-centre, randomised, single-blind, placebo-controlled Phase I study. The first part of this study, the administration of increasing single doses to explore tolerability of the substance, has already been completed. Solulin was tolerated well. Multiple-dose schedules are now being tested. The results are expected in the first half of 2008. PAION is currently evaluating various thrombo-embolic diseases as potential indications for a future Phase II study.

3. Net Assets, Financial Position and Results of Operations of PAION AG

a. Results of Operations

The operating result improved by EUR 298k on the prior year and amounted to EUR -1,719k. However, a EUR 30,249k write-down on the equity investment in PAION Deutschland GmbH and a waiver of receivables of EUR 8,200k from the loan to PAION Deutschland GmbH resulted in a considerable increase in the net loss for the year. The net loss of EUR 38,672k would only have amounted to EUR 223k without these two extraordinary effects.

	2007	2006
	EUR k	EUR k
Other operating income	1,379	1,577
Personnel expenses	-1,386	-1,371
Other operating expenses	-1,710	-2,220
Taxes (other than income taxes)	-2	-3
Operating Result	-1,719	-2,017
Financial result	1,496	1,055
Write-downs on financial assets	-30,249	0
Extraordinary result	-8,200	0
Net loss for the year	-38,672	-962

Other operating income mainly comprises income from the management of and other services rendered for PAION Deutschland GmbH (EUR 1,289k; prior year: EUR 1,514k).

Other operating expenses mainly include legal and consulting fees (EUR 467k; prior year: EUR 1,021k), services from PAION Deutschland GmbH (EUR 282k; prior year: EUR 258k), supervisory board compensation (EUR 108k; prior year: EUR 104k), and travel expenses (EUR 88k; prior year: EUR 151k).

Compared to the prior year, the Company succeeded to increase the **financial result** based on the higher interest levels for short-term investments. Furthermore, PAION Deutschland GmbH was granted a loan in fiscal year 2007 with higher interest rates than those accrued on investments with banks. The financial result also contains interest expenses of EUR 595k (prior year: EUR 452k) for the subordinated loan raised in April 2006.

The **write-downs on financial assets** resulted exclusively from the write-downs on shares in PAION Deutschland GmbH. For more information on this please refer to our comments on financial assets in the notes to the financial statements.

The **extraordinary result** is entirely attributable to the waiver of receivables agreed between PAION AG and PAION Deutschland GmbH in connection with a loan of EUR 8,200k issued by PAION AG to PAION Deutschland GmbH in the fiscal year.

b. Net Assets and Financial Position

As a result of the two extraordinary effects from the write-down on the shares held in PAION Deutschland GmbH and the waiver of receivables, equity as of 31 December 2007 fell considerably by EUR 38,672k on the prior year and amounted to EUR 64,052k as of the balance sheet date. Based on the simultaneous reduction in the balance sheet total, the equity ratio as of the balance sheet date only fell by 3.9 percentage points compared to the prior year to 89.2%. If the subordinated loan is considered to be economic equity, the equity ratio remains unchanged at a very high 99%.

	31 Dec. 2007 EUR k	31 Dec. 2006 EUR k	Change EUR k
Fixed assets	39,300	54,545	-15,245
Current assets and prepaid expenses	32,503	55,787	-23,284
Assets	71,803	110,332	-38,529
Equity	64,052	102,724	-38,672
Long-term liabilities	7,000	7,000	0
Medium-term liabilities	13	6	7
Short-term liabilities	738	602	136
Equity and liabilities	71,803	110,332	-38,529

Fixed assets comprise the shares in PAION Deutschland GmbH only. The EUR -15,245k change resulted from a cash capital increase of EUR 15,004k as well as a write-down on shares in the subsidiary (EUR -30,249k).

The reduction in **current assets** is primarily attributable to lower cash and cash equivalents as of the balance sheet date. The change in cash and cash equivalents over the fiscal year is attributable to the following items:

	2007 EUR k	2006 EUR k
Cash flow from operating activities	72	-818
Cash flow from investing activities	-23,204	0
Cash flow from financing activities	0	16,160
Change in cash and cash equivalents	-23,132	15,342

The payments made within the section 'investing activities' resulted from a cash capital increase at PAION Deutschland GmbH (EUR 15,004k) as well as a loan granted to PAION Deutschland GmbH (EUR 8,200k).

The positive cash flow from **financing activities** in the prior year (EUR 16,160k) stemmed from cash received from a capital increase (EUR 9,440k) and from the bullet subordinate loan from HSBC Trinkaus & Burkhardt KGaA (EUR 7,000k before deduction of the EUR 280k debt discount).

4. Net Assets, Financial Position and Results of Operations of the PAION Group

The Group generated a consolidated net loss of EUR 10,512k (prior year: EUR 17,386k) in the fiscal year. This contained extraordinary effects of EUR 4,643k, mainly incurred in connection with Forest's discontinuation of the cooperation agreement. Without considering the income from these extraordinary effects, the net loss for the year would have amounted to EUR 15,155k.

The key items in the consolidated balance sheet as of 31 December 2007 were cash and cash equivalents of EUR 42,901k on the assets side (prior year: EUR 57,189k) and equity of EUR 35,664k on the liabilities side (prior year: EUR 45,471k). With a balance sheet total of EUR 45,542k, the equity ratio totalled 78.3% as of 31 December 2007 (prior year: 64.9%).

Headcount

Due to the negative results of the DIAS-2 study, PAION passed a plan of action in mid-2007 aimed at reducing internal and external costs. As a part of this plan, PAION reduced its headcount by 25%. The personnel cutback, which affected almost all areas of the company, was carried out on the condition that the development unit was retained. Contractual notice periods were adhered to and appropriate compensation paid to the terminated personnel. In addition, terminated employees were also offered outplacement advisory services aimed at facilitating the quick

transition to new employment. According to information made available to management, the majority of terminated personnel quickly found a new full-time position.

As of 31 December 2007, the PAION Group employed 53 people (prior year: 81). The future headcount will depend upon the strategic realignment of the development pipeline.

Changes to the Supervisory Board

The annual general meeting of PAION AG appointed Dr. Jörg Spiekerkötter, Kleinmachow, Germany, to the supervisory board on 20 June 2007. Dr. Spiekerkötter replaced Dr. Franz A. Wirtz, who reached the age limit set by PAION AG for supervisory board members in 2007 and thus resigned from the supervisory board. The other members of the supervisory board are Dr. Walter Wenninger (chairman), Leverkusen, Germany, and Prof. Dr. Erich Schlick, Otterstadt, Germany. At its constituent meeting on 20 June 2007, the supervisory board appointed Prof. Dr. Erich Schlick as deputy chairman.

Dr. Spiekerkötter has many years of experience in the pharmaceutical industry where he held management positions in finance, legal affairs and human resources. He has been CFO of Conergy AG, Hamburg, Germany, since November 2007. Dr. Spiekerkötter is not a member of any other supervisory board.

Compensation Report

I. Management Board

The remuneration paid to management board members comprises fixed annual compensation, a variable bonus and a long-term performance-based compensation component in the form of stock options and stock appreciation rights. 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. Bonuses are limited to a maximum amount and are paid depending on personal goal achievement. Performance targets are not subsequently adjusted. The members of the management board received stock options from the stock option plan approved at the annual general meeting on 30 December 2004. The number of shares to be allocated to the management board was fixed by the supervisory board immediately after the IPO. The two to four-year vesting period before stock options can be exercised acts as a long-term incentive to increase the Company's value. The exercise price for the stock options is EUR 8.00 per stock option, the issue price of shares at the IPO. The stock option agreements with the members of the management board limit the quantities of stock options that can be granted. No restrictions have been imposed as to the change in value of the stock options, which is directly linked to the development of the PAION share, apart from minimum increases in value. The supervisory board granted the management board members a total of 100,000 stock appreciation rights under the employee participation plan 2006. The stock appreciation rights have a two-year vesting period after which time the holder is entitled to receive a sum of money based on the PAION AG share price. In addition to an annual minimum appreciation, the employee

participation plan 2006 also limits the value of the amount payable. The maximum amount paid out will be 100% of the exercise price, which for the stock appreciation rights granted in fiscal year 2006, is EUR 7.89. In fiscal year 2007, no stock options or stock appreciation rights were exercised by the management board.

Based on the agreements with the members of management, the compensation structure for fiscal year 2007 is as follows:

		Dr. Wolfgang Söhngen	Alexander Vos	Dr. Mariola Söhngen	Bernhard Hofer
Total remuneration 2007:					
Fixed salary	EUR	223,333	213,333	203,333	163,339
Variable bonus	EUR	53,333	48,000	63,000	42,667
Other compensation	EUR	26,724	15,659	21,128	14,154
Overview of outstanding stock options and stock appreciation rights as of 31 December 2007:					
Stock options	No.	138,964	138,964	109,186	109,186
Stock options - fair value*	EUR	494,017	494,017	388,156	388,156
Stock Appreciation Rights (SAR)	No.	25,000	25,000	25,000	25,000
SAR - fair value**	EUR	5,000	5,000	5,000	5,000
* fair value on the date of issue, determined on the basis of the Black/Scholes option pricing model					
** fair value as of the balance sheet date, determined on the basis of the Black/Scholes option pricing model					

The “other compensation” item contains insurance premiums assumed by PAION as well as non-monetary benefits from the provision of company cars.

Management board remuneration in fiscal year 2007 amounted to EUR 1,088k (prior year: EUR 1,083k).

A two-year non-compete agreement has been concluded with Mr. and Ms. Söhngen. For the duration of the prohibition of competition, Mr. and Ms. Söhngen will be entitled to payment of 75% of their average fixed compensation for the last 12 months before leaving the Company. Any sums which Mr. and Ms. Söhngen earn, or maliciously fail to earn, through their work elsewhere will be deducted from this compensation to the extent that the aggregate of such income and the compensation exceeds 100% of the last fixed compensation paid.

In the event of a change of control and the termination of employment within a certain period after the change of control, the management board members are each entitled to contractual severance payments in the amount of their capitalised and discounted aggregate fixed compensation calculated for the remainder of their employment term, but no less than 150% of their annual fixed basic compensation. However, a claim to a severance payment in connection with a change of control only exists when the change of control also entails a significant change in business strategy, a significant change in responsibilities or a relocation of the place of work by at least 300 kilometres. Sums earned by working elsewhere during the remainder of the contract term covered by the severance payment will be deducted from severance payment claims.

With the exception of changes of control as described above, the employment contracts of management board members do not contain any specific severance payment provisions for cases of early termination of employment relationships. Furthermore, the employment contracts of management board members do not provide for interim payment upon expiry.

The terms of the stock option plan 2005 stipulate that, in the event of a change of control, the vesting period for all stock options issued to management board members and employees will expire two years after the issue date. The employee participation plan 2006 states that in the event of a change of control, the vesting period for the stock appreciation rights issued expires on the date of the change of control, unless the supervisory board decides otherwise before that date.

2. Supervisory Board

Supervisory board remuneration comprises basic compensation and per-meeting fees. The members of the supervisory board do not currently receive performance-based remuneration. The chairman of the supervisory board receives twice the basic compensation and per-meeting fee, his deputy receives one-and-a-half time these amounts. The members of the supervisory board received the following remuneration for their activities in fiscal year 2007:

in EUR	Basic salary	Per-meeting fee	Total
Dr. Walter Wenninger	30,000	18,000	48,000
Prof. Dr. Erich Schlick	18,986	10,500	29,486
Dr. Franz A. Wirtz	10,541	9,000	19,541
Dr. Jörg Spiekerkötter	7,973	3,000	10,973

Supervisory board remuneration in fiscal year 2007 amounted to EUR 108k (prior year: EUR 104k).

Disclosures Pursuant to Sec. 289 (4) HGB [“Handelsgesetzbuch”: German Commercial Code] and Explanatory Report

Composition of Subscribed Capital

As of 31 December 2007, PAION AG had subscribed capital of EUR 16,755,552.00, divided into 16,755,552 no-par value shares, each representing a notional share in the capital stock of EUR 1.00. The no-par value shares are made out the bearer and are fully paid in. The shareholders have no right to receive a share certificate for their shares under Art. 6 (2) of the articles of incorporation unless certification is required by the regulations of the stock exchange on which the shares are listed. All shares carry the same rights and duties. Each share carries the right to one vote at the annual general meeting and also forms the basis of the holder’s share in profit. More information on the individual rights and duties of the shareholders can be found in the German Stock Corporation Act [“Aktengesetz”: AktG], in particular Secs. 12, 53a et seq., Sec. 118 et seq. and Sec. 186.

Restrictions Relating to Voting Rights or the Transfer of Shares

Under German law and the articles of incorporation of PAION AG, there are no restrictions on the voting rights or transferability of the shares. The management board of PAION AG is also not aware of any restrictions at shareholder level as to the voting rights or transfer of the shares.

Shareholdings Which Exceed 10% of Voting Rights

According to the German Securities Trading Act [“Wertpapierhandelsgesetz”: WpHG], every shareholder who achieves, exceeds or falls short of specific voting rights in the Company through the purchase or sale of shares or by other means, must inform the Company and the German Federal Financial Supervisory Authority [“Bundesanstalt für Finanzdienstleistungsaufsicht”: BaFin] of this. The lowest threshold for this reporting obligation is 3%. Direct or indirect shareholdings in the Company’s share capital that equal or exceed 10% have not been reported to the Company and the management board of PAION AG is not aware of any such shareholdings.

Shares With Special Rights Conferring Control

The bearers of PAION AG shares have not been granted any special rights by the Company, in particular with regard to powers of control.

Type of Control of Voting Rights When Employees are Shareholders and do not Directly Exercise Their Control Rights

The share options issued to employees and members of the management board can be exercised once the defined vesting period has expired and the other conditions have been met by the beneficiaries. Shares acquired in this way give the beneficiaries the same rights as other shareholders and are not subject to control rights.

Legal Provisions and Provisions of the Articles of Incorporation on the Appointment and Removal of Members of the Management Board and Amendments to the Articles of Incorporation

Members of the management board are appointed and removed in accordance with Secs. 84 and 85 AktG and the supplementary provisions of the supervisory board's rules of procedure which stipulate an age limit of 65 years for management board members. Pursuant to Sec. 84 AktG, members of the management board can be elected for a maximum of five years by the supervisory board. Repeat appointments or extensions of the term of office for up to a maximum of five years at a time are permissible. Pursuant to Art. 8 (1) of the articles of incorporation, the management board must comprise at least two persons. The supervisory board determines the number of members of the management board. Furthermore, pursuant to Sec. 84 (2) AktG and Art. 8 (2) of the articles of incorporation, the supervisory board may appoint a member of the management board to serve as chairman of the management board.

Amendments to the articles of incorporation are made in accordance with Secs. 179 and 133 AktG in conjunction with Art. 27 of PAION AG's articles of incorporation. The shareholder resolution required for an amendment of the articles of incorporation can, under PAION AG's articles of incorporation, be adopted by a simple majority of the capital stock represented upon adoption of the resolution, provided this is permitted by law.

Authority of the Management Board to Issue or Buy Back Shares

The management board is authorised to increase the 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 (Authorised Capital I). In capital increases in return for contributions in kind, the management board is also authorised to exclude the right to subscribe with the supervisory board's consent. In cash capital increases, shareholders must be granted a subscription right. The new shares may also be underwritten by one or more banks subject to the requirement that they are offered to shareholders. The management board is authorised, with the approval of the supervisory board, to exclude fractional amounts from the shareholders' subscription rights. The management board is also authorised to exclude the shareholders' subscription rights, with the consent of the supervisory board, if the issue price of 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 Sec. 186 (3) Sentence 4 AktG, do not exceed 10% of the share capital as of 10 May 2006. The management board is authorised to exclude the shareholders' subscription rights, with the consent of the supervisory board, to the extent necessary to grant subscription rights to holders of convertible bonds, participation rights or options as defined by Sec. 221 AktG. Furthermore, the management board is authorised to issue on or before 10 May 2011, on one or more occasions, bearer and/or registered convertible and/or warrant bonds of up to an aggregate of EUR 63,000,000.00 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). In addition, the management board is authorised to acquire treasury shares representing up to a total of 10% of the share capital on 20 June 2007, on one or more occasions until 20 December 2008, with the consent of the

supervisory board. The authorisations granted by the shareholder meeting have not yet been exercised.

Material Arrangements Dependent on a Change in Control in the Wake of a Take-Over Bid

The new licence agreement with Lundbeck stipulates that Lundbeck, in certain circumstances, has the authorisation to limit PAION's information rights to a minimum in the event of a change of control at PAION, and, if required, to terminate all options exercised by PAION with regard to co-marketing. If Lundbeck exercises its termination right, PAION retains its claim to a share in the joint marketing result.

Compensation Agreements Entered Into by the Company With Members of the Management Board and Employees in the Event of a Takeover Bid

For more information on existing compensation agreements, please refer to our comments in the section 'Compensation Report'.

Risks and Opportunities Report

I. Risk Management

As a bio-pharmaceutical company, PAION is exposed to the segment and market risks that are typically associated with the development of pharmaceutical products. In accordance with the German Law on Control and Transparency in Business [“Gesetz zur Kontrolle und Transparenz im Unternehmensbereich”: KonTraG], PAION has implemented a comprehensive and effect risk management system which is integrated into operating processes and is flexibly adapted to the changing environment. The task of the risk management system is to promote the conscious and responsible handling of risk, to identify future developments with inherent risks and opportunities early, and to monitor, analyse, assess, and manage such risks. By involving all management levels and project management in the process of the development of strategy and business, a shared awareness of the critical success factors and related risks is created.

PAION's risk management system comprises an internal control system, an early warning system for the detection of risk, and a control system. These three sub-systems interact directly with each other and also take on tasks from each of the other sub-systems.

The financial accounting and cost accounting software Navision and an enterprise planning tool customised for PAION form the basis for financial control. Monthly internal reporting is performed on a cost centre and cost unit basis, allowing deviations from the budget to be identified at an early stage. Short and long-term corporate planning (cost centre planning, cost unit and project planning, budget income statement, budget balance sheet and budget cash flow statement) is conducted using an Excel-based planning tool. Using this planning tool, management and controlling department are in a position to simulate various scenarios to identify, assess, and determine the impact of opportunities and risks on the future development of the Company, particularly with regard to the key factor of liquidity.

The implemented internal control system includes rules for the management of business activities as well as arrangements for the monitoring of compliance with these rules. The primary

tasks of the internal control system include determining which types of business transactions require approval, limiting the issuance of signing and banking authority, standardising workflows using procedural instructions, monitoring compliance with process steps using checklists, and establishing measures for the protection of data and IT systems.

PAION has implemented a matrix organisation which combines both project organisation and department organisation. Within this organisational structure, detailed reporting and information structures have been set up to ensure the early identification and communication of risks. The individual projects are managed and monitored by project teams. The project teams provide reports on an ongoing basis – also in writing – on the current progress of a project and potential risks to the individual department heads and to management.

2. Significant Risks to Future Development

a. Drug Development Risks

All of PAION's substances are currently at different stages of development. Before they can be approved and marketed, their safety and effectiveness must be proven in appropriate and carefully monitored clinical studies. The results of preclinical and clinical studies cannot be forecasted. There is always the danger that the results achieved in prior studies may not be achieved in later studies. If this turns out to be the case, further clinical development can be delayed considerably or development of a specific drug candidate may be discontinued altogether.

The completion of clinical studies depends, among other things, on the ability to enrol a sufficient number of patients to participate in them. Difficulties in enrolling patients in clinical studies may increase costs and negatively affect the timing of these clinical studies.

There is also the risk that the data provided by the individual clinical studies are deemed to be insufficient for commencement of the next development phase or as a basis for an application for approval by the regulatory authorities and, as such, additional data may have to be generated or further studies conducted. The assessments of the regulatory authorities in different countries may also vary. A data package which is deemed sufficient in one country may be considered to be insufficient by a regulatory authority in another country. In addition, it is possible that the regulatory authorities will demand additional studies, which would entail additional costs for the Company and would significantly delay its receipt of regulatory approval.

Once a certain level of development has been reached, PAION aims to minimise these risks by seeking development cooperations with established pharmaceutical and biotechnology companies which then bear some or all of the respective financing risk. Furthermore, PAION also cooperates closely with the regulatory authorities with a view to ensuring that all requirements are met and utilises the knowledge of external experts in this regard.

b. Risks in Relation to the Manufacture of Pharmaceutical Substances

PAION does not currently own or operate any production facilities. Accordingly, it relies on third parties for the supply of its pharmaceutical substances and the manufacture of clinical and commercial quantities of them. PAION might not be in a position to maintain or renew the existing agreements with third parties on acceptable terms or at all.

Some of PAION's substances are produced in biological production processes. These processes are highly complex and require extensive validation. In the past, the substances have been produced in sufficient quantities for clinical development, but it is not entirely certain that the larger batches needed for commercial purposes can be produced. Should this be the case, costs could increase and market potential might not be fully exploited.

c. Risks in Relation to the Marketing of Drugs

In the foreseeable future, PAION expects to continue to be dependent on cooperation agreements with experienced partners to complete the development of its current and future drug candidates and to market them successfully. Should PAION fail to enter into cooperation agreements on terms favourable to it, fail to enter into cooperation agreements at all, or fail to maintain existing cooperation agreements, its ability to develop and market its existing and future drug candidates may be reduced, which may increase development and marketing expenses.

d. Risks in Relation to Patents and Other Intellectual Property

PAION's business operations are to a large extent dependent on its ability to achieve an extensive patent protection and other intellectual property protection for the individual substance and to protect these from third parties without violating their rights. There can be no assurance that patents with respect to our current or future applications will be granted or that any patents issued or licensed to us will be valid and of sufficient scope to provide us with sufficient legal protection or any commercial advantage.

e. Competitive Risks

PAION's business environment is shaped by strong competition, intensive research activities and rapid technical change. PAION's success is highly dependent on its ability to develop existing and new drug candidates on a cost-effective basis and to market them successfully. In doing so, it faces and will continue to face stiff competition from a variety of competitors, ranging from small biotech companies to large international pharmaceutical groups.

f. Risks in Relation to Additional Financing Requirements

PAION believes that the currently available cash and cash equivalents and future payments expected from the cooperation with Lundbeck and possible future cooperation agreements will be sufficient to finance its mid-term financing needs. However, it may need additional funding within this timeframe in order to licence new drugs, acquire or invest in businesses, drug candidates or technologies, and to fund preclinical studies and clinical studies, for example. Funding requirements may also arise due to delays in clinical development and the related delays in milestone payments from cooperation partners. Milestone payments could even be cancelled altogether if the agreed-upon targets are not reached. PAION's future ability to secure additional funding will depend on the success of its development activities, the situation on the capital

markets and other factors. If PAION is unable to raise financing on favourable terms or unable to raise financing at all, it could be forced to reduce its operating expenses by delaying, reducing or discontinuing the clinical development of one or more of its drug candidates.

g. Risks in Relation to Personnel

PAION's management and the scientific and technical staff it has in key positions play a key role in its success, many of whom have substantial experience with our Company and would be difficult to replace. In addition, competition for qualified personnel is intense in PAION's industry and PAION might be unable to attract and retain highly qualified employees.

3. Market Opportunities

PAION is aiming to become a leading player in the development and marketing of innovative drugs for the treatment of stroke and other thrombotic conditions for which there is substantial unmet medical demand. With its most advanced drug candidate Desmoteplase, PAION has already demonstrated in two clinical Phase II studies that the previous timeframe for treating patients with ischemic stroke may possibly be extended by six hours to nine hours, and other parameters indicate superior effectiveness of Desmoteplase compared with currently approved drugs. It was not possible to confirm these successful results in the DIAS-2 study but the knowledge gained from the analysis of the DIAS-2 results provide a strong rationale for the further development of Desmoteplase. The management board is of the opinion that the conclusion of the extended cooperation agreement with Lundbeck secures the continuation of the development programme with Desmoteplase and underlines the potential of Desmoteplase for the treatment of acute ischemic stroke. If Desmoteplase and the other two substances are successfully developed, PAION would have substantial earnings potential in the future.

Events After the Balance Sheet Date

On 29 January 2008, PAION was informed by its cooperation partner Lundbeck that the licence agreement entered into on 21 December 2007 took full effect without condition following the patent review which had since been concluded.

Furthermore, no other significant events occurred in the period between the balance sheet date (31 December 2007) and the date of completion of this report.

Forecast

Given that continuation of the development programme with Desmoteplase has now been secured through the conclusion of the new cooperation agreement with Lundbeck, PAION now aims to drive forward the strategic realignment of the development pipeline. PAION intends to reduce the risks connected to the development of substances through cooperation arrangements as well as through expansion of the development pipeline and consideration of additional fields of therapy besides that of stroke. In this regard, PAION has already evaluated numerous substances and companies in the past. PAION will pursue this process more intensively in 2008.

The further development of Desmoteplase is now being lead-managed by Lundbeck. Lundbeck plans to present data to the regulatory authorities in order to gain acceptance on the new Phase III study with Desmoteplase. Lundbeck expects this study to be initiated in the second half of 2008.

The further development of Enecadin will be decided as part of the strategic realignment of the development pipeline.

PAION expects to be able to publish the results of the Phase I study with Solulin in the first half of 2008 and at the same time aims to prepare a Phase II study with Solulin.

Based on the cash and cash equivalents of EUR 43m as of 31 December 2007 and considering the upfront payment of EUR 8m received by Lundbeck at the beginning of 2008, PAION started fiscal year 2008 with solid cash and cash equivalents of approximately EUR 50m. PAION AG is expected to generate a negative result in fiscal year 2008. However, the actual amount of expenses incurred and the result for the year will depend heavily on the new corporate strategy.

Balance Sheet as of December 31, 2007

ASSETS	31 Dec. 2007 EUR	31 Dec. 2006 EUR
Fixed Assets		
Financial assets		
Shares in affiliated companies	39,300,000.00	54,544,941.10
Current Assets		
Receivables and other assets		
Receivables from affiliated companies	65,048.40	48,036.29
Other assets	106,311.16	239,112.44
	171,359.56	287,148.73
Cash on hand and bank balances	32,062,711.28	55,194,959.44
	32,234,070.84	55,482,108.17
Prepaid Expenses		
thereof debt discount: EUR 211,666.66 (prior year: EUR 251,666.66)	269,128.78	305,186.44
	71,803,199.62	110,332,235.71

EQUITY AND LIABILITIES	31 Dec. 2007 EUR	31 Dec. 2006 EUR
Equity		
Subscribed capital	16,755,552.00	16,755,552.00
thereof: 16,755,552 no-par value shares (prior year: 16,755,552 no-par value shares)		
Conditional capital: EUR 7,410,000.00 (prior year: EUR 7,410,000.00)		
Capital reserve	93,279,389.10	93,279,389.10
Accumulated loss	-45,982,390.24	-7,310,549.90
	64,052,550.86	102,724,391.20
Accruals		
Other accruals	576,600.46	459,499.89
Liabilities		
Liabilities to banks	7,000,000.00	7,000,000.00
thereof due in up to one year:		
EUR 0.00 (prior year: EUR 0.00)		
Trade payables	53,566.93	106,997.83
thereof due in up to one year:		
EUR 53,566.93 (prior year: EUR 106,997.83)		
Other liabilities	120,481.37	41,346.79
thereof due in up to one year:		
EUR 120,481.37 (prior year: EUR 41,346.79)		
thereof for taxes: EUR 32,789.42 (prior year: EUR 41,346.79)		
	7,174,048.30	7,148,344.62
	71,803,199.62	110,332,235.71

Income Statement for Fiscal Year 2007

	2007 EUR	2006 EUR
Other operating income	1,378,845.03	1,576,965.08
Personnel expenses		
a) Wages and salaries	-1,330,394.11	-1,307,810.22
b) Social security	-55,857.43	-63,274.71
	-1,386,251.54	-1,371,084.93
Other operating expenses	-1,709,480.07	-2,220,433.85
Other interest and similar income	2,091,087.28	1,506,983.62
thereof from affiliated companies: EUR 432.827.12 (prior year: EUR 0.00)		
Write-offs of financial assets and marketable securities	-30,248,497.10	0.00
Interest and similar expenses	-595,310.00	-451,832.38
Result from ordinary activities	-30,469,606.40	-959,402.46
Extraordinary expenses	-8,200,000.00	0.00
Other taxes	-2,233.94	-2,775.15
Net loss for the year	-38,671,840.34	-962,177.61
Loss carryforward	-7,310,549.90	-6,348,372.29
Accumulated loss	-45,982,390.24	-7,310,549.90

Notes to the Financial Statements for Fiscal Year 2007

Preliminary Remarks

The financial statements for the fiscal year from 1 January 2007 to 31 December 2007 were prepared in accordance with the applicable provisions of the German Commercial Code [“Handelsgesetzbuch”: HGB] and the German Stock Corporation Act [“Aktengesetz”: AktG], as amended. The balance sheet and income statement have been classified according to the provisions of Secs. 266 and 275 HGB. The notes to the financial statements were prepared in accordance with the requirements of Secs. 284 to 288 HGB.

PAION AG stock is admitted to trading on the Frankfurt stock exchange and listed in the Prime Standard of the regulated market. In accordance with Sec. 267 (3) Sentence 2 HGB, PAION AG qualifies as a large corporation as it has issued securities which use an organized market within the meaning of Sec. 2 (5) WpHG [“Wertpapierhandelsgesetz”: German Securities Trading Act].

Accounting and Valuation Methods

1. Financial assets are recognised at the lower of cost or market.
2. Receivables and other assets are stated at nominal value. Receivables denominated in a foreign currency are valued at the lower exchange rate on the balance sheet date if necessary.
3. Differences between the amount repayable on a liability and a lower issue amount (discount) are recognised as an asset and amortised over the term of the liability.
4. Accruals are recognised at the amount required according to prudent business judgment, are necessary and are adequately valued.
5. Liabilities (including those denominated in foreign currencies) are carried at the amount repayable. Liabilities denominated in a foreign currency are stated using the higher of the exchange rate on the transaction date or the balance sheet date.
6. The income statement is prepared using the cost-summary method in accordance with Sec. 275 (2) HGB.

Notes to the Items of the Balance Sheet and the Income Statement

1. Financial Assets

Shares in affiliated companies as of 31 December 2007 relate solely to PAION Deutschland GmbH, Aachen, Germany. In the fiscal year, the carrying value of the equity investment changed as follows:

	EUR
Carrying value of the equity investment as of 1 Jan. 2007	54,544,941.10
Capital increase	15,003,556.00
Write down	-30,248,497.10
Carrying value of the equity investment as of 31 Dec. 2007	39,300,000.00

By shareholder resolution of PAION Deutschland GmbH dated 20 July 2007, the share capital of PAION Deutschland GmbH was increased by EUR 140,050.00 to EUR 318,550.00. The new shares were acquired in full by the sole shareholder PAION AG in return for a cash contribution. In addition, PAION AG contributed EUR 14,863,506.00 to the capital reserve of PAION Deutschland GmbH.

In the first half of 2007, PAION Deutschland GmbH published the results of a Phase III clinical study on its main product Desmotepase. The primary efficacy endpoint of the study was not achieved. Due to these negative results, a significant delay in the approval of Desmotepase is expected and consequently also a delayed realisation of sales potential related to this substance. In addition, the termination of the cooperation agreement with Forest and the newly concluded cooperation agreement with Lundbeck have changed the estimated future cash flows. Based on these new conditions, the carrying value of the equity investment was reviewed by way of a business valuation as of the balance sheet date which resulted in a EUR 30.2m write-down requirement. As permanent impairment is probable, the carrying value of the equity investment was adjusted accordingly.

2. Receivables from Affiliated Companies

The receivables from affiliated companies are due from PAION Deutschland GmbH and relate primarily to services rendered.

3. Other Assets

Other assets as of 31 December 2007 mainly comprise interest claims on investments of EUR 99,919.87 (prior year: EUR 187,244.54).

4. Equity

The share capital amounts to EUR 16,755,552.00 and is divided into 16,755,552 no-par value shares.

By virtue of a resolution adopted by the annual general meeting on 10 May 2006, the management board was authorised to increase the 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 (Authorised Capital I). Authorised Capital I is still fully available for issue.

By virtue of another resolution adopted by the annual general meeting on 10 May 2006, the management board was authorised to increase capital stock 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 capital stock of up to an aggregate of EUR 6,300,000.00 (Conditional Capital I). Conditional Capital I has not yet been used.

In addition, a resolution was adopted by the annual general meeting on 30 December 2004 to conditionally increase the capital stock of PAION AG by an aggregate 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 annual general meeting on 26 August 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 value bearer shares (Conditional Capital III). Under the Stock Option Plan 2005, 884,257 stock options had been issued to management board members and employees of the PAION Group by 31 December 2007. The share options have not been exercised yet.

5. Accruals

The accruals break down as follows:

in EUR	31 Dec. 2007	31 Dec. 2006
Management bonuses	192,858.00	247,850.00
Legal fees	186,500.00	0.00
Financial statements and audit	107,700.00	129,675.00
Outstanding invoices	36,000.00	43,500.00
Other	53,542.46	38,474.89
	576,600.46	459,499.89

6. Liabilities

In mid-April 2006, PAION was granted a subordinated loan of EUR 7,000,000 from HSBC Trinkaus & Burkhardt KGaA, Düsseldorf, Germany, which is part of a structured mezzanine financing scheme entitled "H.E.A.T Mezzanine I-2006". In the meantime, HSBC Trinkaus & Burkhardt KGaA has transferred the subordinated loan to H.E.A.T Mezzanine S.A., Luxembourg. The bullet loan has a term of seven years and was disbursed with a debt discount of EUR 280,000. Interest payments are due quarterly.

All other liabilities as of the balance sheet date are due within one year.

7. Extraordinary Expenses

In fiscal year 2007, PAION AG granted PAION Deutschland GmbH a loan of EUR 8,200,000. In December, the parties agreed to a full waiver of receivables from the loan. PAION AG recognised the waiver of the loan receivable as extraordinary expense.

Other Compulsory Disclosures

1. Average Number of Employees

In fiscal year 2007 the Company had an average of five employees (prior year: five employees).

2. Stock Option Plan 2005

On 30 December 2004, the annual general meeting approved a stock option plan granting options to management board members and employees to acquire shares in PAION AG. 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 of the PAION Group. 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 after 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. As of 31 December 2007, a total of 884,257 stock options had been issued to management board members and employees of the PAION Group.

3. Employee Participation Plan 2006

The management board of PAION AG has launched, with the consent of the supervisory board, an employee participation plan granting stock appreciation rights. Under this Employee Participation Plan 2006, of the total of 560,000 stock appreciation rights, 252,000 stock appreciation rights can be issued to management board members and 308,000 stock appreciation rights can be issued to the 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 term of ten years and can only be exercised after a two-year waiting period. In addition, they may only be exercised when the stock price on the exercise date has increased by a cumulative 5% each year since their issue. As of 31 December 2007, a total of 157,750 stock appreciation rights had been issued to management board members and employees of the PAION Group. The stock appreciation rights have not been exercised yet.

PAION AG's payment obligation that is directly attributable to this employee participation plan is recognised as an accrual and measured at fair value on the balance sheet date. The expenses are recorded over the service period of two years. The fair value is determined using the Black/Scholes option pricing model. The expenses attributable to management board members and employees of PAION AG are disclosed as personnel expenses. The portion of expenses attributable to employees of PAION Deutschland GmbH is recorded under other operating expenses. Under a contractual agreement, these expenses are borne by PAION Deutschland GmbH; the corresponding refund claims against PAION Deutschland GmbH are therefore shown under other operating income. The accrual for the payment obligation resulting from the employee participation plan amounted to EUR 12,909.51 as of 31 December 2007; the corresponding refund claims against PAION Deutschland GmbH came to EUR 4,429.02.

4. Management Board and Supervisory Board

The members of the Company's management board are:

- Dr. Wolfgang Söhngen, CEO, Chairman
- Alexander Vos, COO, Deputy chairman
- Dr. Mariola Söhngen, CMO
- Bernhard Hofer, CFO

Management board remuneration totalled EUR 1,088,004 in fiscal year 2007. 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 more information on management board remuneration, please see our comments in the compensation report of the 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.

The members of the supervisory board are:

- 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 of 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 in fiscal year 2007. For more information on supervisory board remuneration, please see our comments in the compensation report of the management report.

5. Shareholdings

The Company holds all shares in PAION Deutschland GmbH, Aachen, Germany. As of 31 December 2007, PAION Deutschland GmbH reported equity of EUR 10,788,725.66. The net loss of PAION Deutschland GmbH for fiscal year 2007 is EUR 1,290,247.65.

6. Reportable Equity Investments in PAION AG Pursuant to Sec. 21 WpHG

In fiscal year 2007, PAION AG received the following notifications of reportable investments pursuant to Sec. 21 (1) and (1a) WpHG and published them in accordance with Sec. 25 (1) WpHG:

- Strategic European Technologies N.V., s'Hertogenbosch, Netherlands, informed us that its voting rights in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, fell below the 3% threshold on 16 February 2007 and amounted to 2.91% (488,266 shares) as of that date.
- In accordance with Sec. 21 et seq. WpHG, the law firm Freshfields Bruckhaus Deringer, Frankfurt am Main, Germany, informed us and for and on behalf of
 - Mr. Mitchell D. Kaye and Mr. David C. Cavalier, both of the USA, that their voting rights in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, both fell below the 5% threshold on 22 March 2007, and are each now at 4.09% (685,933 voting rights). All voting rights are attributable to Mr. Kaye and Mr. Cavalier in accordance with Sec. 22 (1) Sentence 1 No. 6 in conjunction with Sentence 2 WpHG; 0.95% (159,288 voting rights) is also attributable pursuant to Sec. 22 (1) Sentence 1 No. 1 WpHG. Additional voting rights accrue due to the controlling shares held by Mr. Kaye and Mr. Cavalier in Xmark Opportunity Partners, LLC and Xmark Capital Partners, LLC, who have 3% or more of the voting rights, respectively.
 - Xmark Capital Partners, LLC, Stamford, Connecticut, USA, that its voting rights in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, fell below the 5% threshold on 22 March 2007, and are now at 4.09% (685,933 voting rights). All of those voting rights are attributable in accordance with Sec. 22 (1) Sentence 1 No. 6 in conjunction with Sentence 2 WpHG; 0.95% (159,288 voting rights) is also attributable pursuant to Sec. 22 (1) Sentence 1 No. 1 WpHG. Additional voting rights accrue due to the controlling shares held by Xmark Capital Partners LLC in Xmark Opportunity Partners, LLC, who have 3% or more of the voting rights.
 - Xmark Opportunity Partners, LLC, Stamford, Connecticut, USA, that its voting rights in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, fell below the 5% threshold on 22 March 2007, and are now at 4.09% (685,933 voting rights). Of these voting rights, 2.30% (385,526 voting rights) is attributable in accordance with Sec. 22 (1) Sentence 1 No. 6 in conjunction with Sentence 2 WpHG (of which 0.95% (159,288 voting rights) is also attributable in accordance with Sec. 22 (1) Sentence 1 No. 1 in conjunction with Sentence 2 WpHG), and 1.79% (300,407 voting rights) is attributable pursuant to Sec. 22 (1) Sentence 1 No. 6 WpHG.
 - Xmark Opportunity Manager, Stamford, Connecticut, USA, that its voting rights in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, fell below the 3% threshold on 22 March 2007, and are now at 2.30% (385,526 voting rights). All voting rights are attributable in accordance with Sec. 22 (1) Sentence 1 No. 6 WpHG.

- In the name and on behalf of the following notifying parties:
 - (1) HBK Management LLC, c/o Corporation Service Company, Wilmington, Delaware, USA
 - (2) HBK Partners II L.P., c/o Corporation Service Company, Wilmington, Delaware, USA
 - (3) HBK Investments L.P., c/o Corporation Service Company, Wilmington, Delaware, USA
 - (4) HBK Services LLC, c/o Corporation Service Company, Wilmington, Delaware, USA
 - (5) HBK New York LLC, c/o Corporation Service Company, Wilmington, Delaware, USA
 - (6) HBK Master Fund L.P., c/o M&C Corporate Services Limited, George Town, Grand Cayman, Cayman Islands
 - (7) HBK Offshore Fund Ltd., c/o M&C Corporate Services, George Town, Grand Cayman, Cayman Islands
 - (8) HBK Fund L.P., c/o Corporation Service Company, Wilmington, Delaware, USA
 - (9) HBK Capital L.P., c/o Corporation Service Company, Wilmington, Delaware, USA
 - (10) HBK Partners I L.P., c/o Corporation Service Company, Wilmington, Delaware, USA

the law firm Weil, Gotshal & Manges LLP, Munich, Germany, informed us in accordance with Sec. 21 (1) WpHG that

- the voting rights in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, of the notifying party listed under (6) fell below the 3% threshold on 10 April 2007. At the time, the notifying party listed under (6) held 479,285 of a total of 16,755,552 voting rights in PAION AG, corresponding to a 2.86% share of the voting rights.
- the voting rights in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, of the notifying parties listed under (1) to (5) and (7) to (10) fell below the 3% threshold on 10 April 2007. At the time, the notifying parties listed under (1) to (5) and (7) to (10) held 479,285 of a total of 16,755,552 voting rights in PAION AG, corresponding to a 2.86% share of the voting rights.

Of these voting rights, 2.86% (479,285 voting rights) is attributable to the notifying party listed under (1) in accordance with Sec. 22 (1) Sentence 1 No. 6 in conjunction with Sentence 2 WpHG via the notifying parties listed under (2) to (5) as well as from the notifying party listed under (6) via the notifying parties listed under (7) to (10) in accordance with Sec. 22 (1) Sentence 1 No. 1 WpHG.

2.86% (479,285 voting rights) is attributable to the notifying party listed under (2) in accordance with Sec. 22 (1) Sentence 1 No. 6 in conjunction with Sentence 2 WpHG from the notifying party listed under (6) via the notifying parties listed under (3) to (5).

2.86% (479,285 voting rights) of the notifying party listed under (6) is attributable to the notifying party listed under (3) in accordance with Sec. 22 (1) Sentence 1 No. 6 WpHG.

2.86% (479,285 voting rights) of the notifying party listed under (6) is attributable to the notifying party listed under (4) via the notifying party listed under (3) in accordance with Sec. 22 (1) Sentence 1 No. 6 WpHG (due to delegated authority).

2.86% (479,285 voting rights) of the notifying party listed under (6) is attributable to the notifying party listed under (5) via the notifying party listed under (4) and (3) in accordance with Sec. 22 (1) Sentence 1 No. 6 WpHG (due to delegated authority).

2.86% (479,285 voting rights) of the notifying party listed under (6) is attributable to the notifying parties listed under (7) and (8) in accordance with Sec. 22 (1) Sentence 1 No. 6 WpHG.

2.86% (479,285 voting rights) of the notifying party listed under (6) is attributable to the notifying party listed under (9) via the notifying party listed under (8) in accordance with Sec. 22 (1) Sentence 1 No. 6 WpHG.

2.86% (479,285 voting rights) of the notifying party listed under (6) is attributable to the notifying party listed under (10) via the notifying party listed under (8) and (9) in accordance with Sec. 22 (1) Sentence 1 No. 6 WpHG.

The chain of controlled companies through which the voting rights are actually held is structured as follows:

- the notifying party listed under (1) controls the notifying party listed under (10);
 - the notifying party listed under (10) controls the notifying party listed under (9);
 - the notifying party listed under (9) controls the notifying party listed under (8);
 - the notifying parties listed under (7) and (8) control the notifying party listed under (6);
- In accordance with Secs. 21 (1), 22 (1) and (2) WpHG and Secs. 17 ff. WpAIV [Wertpapierhandelsanzeige- und Insiderverzeichnisverordnung: German Securities Trading Disclosure and Insider Register Regulation] the law firm CMS Hasche Sigle, Frankfurt am Main, Germany, informed us and for and on behalf of its clients that
- the voting rights of 3i Group Investments L.P., London, UK, in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, fell below the 5% and 3% thresholds on 16 April 2007 and are now at 2.71% (453,775 shares); these shares are held directly by 3i Group Investments L.P.
 - the voting rights of 3i 2004 GmbH & Co. KG, Munich, Germany, in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, fell below the 5% and 3% thresholds on 16 April 2007 and are now at 2.71% (453,775 shares); these shares are wholly attributable to 3i 2004 GmbH & Co. KG in accordance with Sec. 22 (1) Sentence 1 No. 1 WpHG.
 - the voting rights of 3i Deutschland Gesellschaft für Industriebeteiligungen mbH, Frankfurt am Main, Germany, in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, fell below the 5% threshold on 16 April 2007 and are now at 4.98% (833,602 shares); these shares are wholly attributable to 3i Deutschland Gesellschaft für Industriebeteiligungen mbH in accordance with Sec. 22 (1) Sentence 1 No. 1 WpHG and 2.71% (453,775 voting rights) are also attributable in accordance with Sec. 22 (1) Sentence 1 No. 6 WpHG.
 - the voting rights of 3i International Holdings plc, London, UK, in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, fell below the 5% threshold on 16 April 2007 and are now at 4.98% (833,602 shares); which are wholly attributable to this company in accordance with Sec. 22 (1) Sentence 1 No. 1 WpHG. These voting rights are attributable via the following company:
 - 3i Deutschland Gesellschaft für Industriebeteiligungen mbH, Hamburg, Germany.
- 2.71% of the voting rights (453,775 shares) is attributable to 3i International Holdings plc, in accordance with Sec. 22 (1) Sentence 1 No. 6 in conjunction with Sentence 2 WpHG.

- the voting rights of 3i Holdings plc, London, UK, in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, fell below the 5% threshold on 16 April 2007 and are now at 4.98% (833,602 shares); these shares are wholly attributable to this company in accordance with Sec. 22 (1) Sentence 1 No. 1 WpHG. These voting rights are attributable via the following companies:
 - 3i Deutschland Gesellschaft für Industriebeteiligungen mbH
 - 3i International Holdings plc
 2.71% of the voting rights (453,775 shares) is attributable to 3i Holdings plc, in accordance with Sec. 22 (1) Sentence 1 No. 6 in conjunction with Sentence 2 WpHG.
 - the voting rights of 3i Group plc, London, UK, in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, fell below the 5% threshold on 16 April 2007 and are now at 4.98% (833,602 shares); these shares are wholly attributable to 3i Group plc company in accordance with Sec. 22 (1) Sentence 1 No. 1 WpHG. These voting rights are attributable via the following companies:
 - 3i Deutschland Gesellschaft für Industriebeteiligungen mbH
 - 3i International Holdings plc
 - 3i Holdings plc
 2.71 % of the voting rights (453,775 shares) is attributable to 3i Group plc. in accordance with Sec. 22 (1) Sentence 1 No. 6 in conjunction with Sentence 2 WpHG.
 - the voting rights of Nordrhein-Westfalen Fonds GmbH, Frankfurt am Main, Germany, in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, fell below the 5% and 3% thresholds on 16 April 2007 and are now at 2.27%, (379,827 shares); the shares are held directly by Nordrhein-Westfalen Fonds GmbH.
 - the voting rights of 3i General Partner 2004 GmbH, Munich, Germany, in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, fell below the 5% and 3% thresholds on 16 April 2007 and are now at 0% (0 shares).
 - the voting rights of TH Technologieholding GmbH, Munich, Germany, in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, fell below the 5% and 3% thresholds on 8 December 2006 and are now at 0% (0 shares).
- For and on behalf of its clients, Luther Rechtsanwaltsgesellschaft mbH, Cologne, Germany, informed us, in accordance with Sec. 21 (1), as well as in accordance with Sec. 24 WpHG in the case of the funds mentioned , that
 - the voting rights of Omega Fund Management Limited, St. Peter Port, Guernsey, UK, in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, exceeded the 3% threshold on 16 April 2007 and are now at 3.32% (555,754 shares). 3.32% (555,754 shares) is attributable to Omega Fund Management Limited pursuant to Sec. 22 (1) Sentence 1 No.1 WpHG.
 - the voting rights of Sigma Holding Limited, St. Peter Port, Guernsey, UK, in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, exceeded the 3% threshold on 16 April 2007 and is now at 3.32% (555,754 shares). 3.32% (555,754 shares) is attributable to Sigma Holding Limited pursuant to Sec. 22 (1) Sentence 1 No.1 WpHG. Voting rights are attributable to Sigma Holding Limited from the following shareholder, whose voting rights in PAION AG are 3% or more:

- Omega Fund Management Limited
- the voting rights of Mr. Otello Stampacchia, Switzerland, in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, exceeded the 3% threshold on 16 April 2007 and are now at 3.32% (555,754 shares). 3.32% (555,754 shares) is attributable to Mr. Stampacchia pursuant to Sec. 22 (1) Sentence 1 No.1 WpHG. Voting rights are attributable to the latter from the following shareholders, whose voting rights in PAION AG are 3% or more per shareholder, respectively:
 - Omega Fund Management Limited
 - Sigma Holding Limited
- In accordance with Secs. 21 ff. WpHG, the law firm Freshfields Bruckhaus Deringer, Frankfurt am Main, Germany, informed us on behalf of
 - Mr. Mitchell D. Kaye and Mr. David C. Cavalier, both of the USA, that their voting rights in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, both fell below the 3% threshold on 22 May 2007, and were each at 2.27% (380,933 voting rights) on that day. All voting rights are attributable to Mr. Kaye and Mr. Cavalier in accordance with Sec. 22 (1) Sentence 1 No. 6 in conjunction with Sentence 2 WpHG; 0.48% (80,833 voting rights) is also attributable pursuant to Sec. 22 (1) Sentence 1 No. 1 WpHG.
 - Xmark Capital Partners, LLC, Stamford, Connecticut, USA, that its voting rights in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, fell below the 3% threshold on 22 May 2007, and stood at 2.27% (380,933 voting rights) on that day. All voting rights are attributable in accordance with Sec. 22 (1) Sentence 1 No. 6 in conjunction with Sentence 2 WpHG; 0.48% (80,833 voting rights) is also attributable pursuant to Sec. 22 (1) Sentence 1 No. 1 WpHG.
 - Xmark Capital Opportunity Partners, LLC, Stamford, Connecticut, USA, that its voting rights in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, fell below the 3% threshold on 22 May 2007, and stood at 2.27% (380,933 voting rights) on that day. Of these voting rights, 1.17% (195,646 voting rights) is attributable in accordance with Sec. 22 (1) Sentence 1 No. 6 in conjunction with Sentence 2 WpHG (of which 0.48% (80,833 voting rights)) is also attributable in accordance with Sec. 22 (1) Sentence 1 No. 1 in conjunction with Sentence 2 WpHG) and 1.11% (185,287 voting rights) is attributable pursuant to Sec. 22 (1) Sentence 1 No. 6 WpHG.
 - notified its clients that the voting rights have been at 0% (0 voting rights) since 6 June 2007 for all notifying parties named in this report.

- Fidelity Investments, Tadworth, UK, notified us on behalf of and by authority of Fidelity International Limited, Hamilton, Bermuda, that the voting rights of Fidelity International Limited in PAION AG, Martinstrasse 10-12, 52062 Aachen, Germany, fell below the 3% threshold on 14 August 2007 and now total 2.79% (467,288 voting rights). The voting rights are attributable to Fidelity International Limited pursuant to Sec. 22 (1) Sentence 1 No. 6 WpHG.

In accordance with the present notifications pursuant to Sec. 21 WpHG, as of 31 December 2007 the following companies or individuals held voting rights of more than 3% in PAION AG:

- Varuma AG
- Omega Fund Management Limited / Sigma Holding Limited
- Innoven Partenaires S.A.
- 3i Group
- Merrill Lynch & Co, Inc.
- Mr. Wolfgang Söhngen and Mrs. Mariola Söhngen

7. 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 has received or will invoice the following fees for services rendered to PAION AG and its subsidiary PAION Deutschland GmbH in fiscal year 2007 or in the prior year:

in EUR	2007	2006
Audits	51,500	55,800
Tax advisory	2,358	8,345
Other services	19,825	20,550
	73,683	84,695

The other services mainly comprise fees for the review of quarterly financial statements.

8. Corporate Governance

The supervisory board and management board of PAION AG declare that they are committed to responsible and transparent management and control of the Company focused on adding value in the long term.

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. This declaration of compliance is published on PAION AG's website (www.paion.de).

Aachen, 29 February 2008

PAION AG

(signed) Dr. Wolfgang Söhngen
(signed) Bernhard Hofer

(signed) Alexander Vos
(signed) Dr. Mariola Söhngen

Responsibility Statement (Bilanzeid) in accordance with section 37v (1) and (2) of the Wertpapierhandelsgesetz (WpHG - German Securities Trading Act) in conjunction with sections 264(2) sentence 3 and 289(1) sentence 5 of the Handelsgesetzbuch (HGB - German Commercial Code)

“To the best of our knowledge, and in accordance with the applicable reporting principles, the financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of PAION AG, and the management report includes a fair review of the development and performance of the business and the position of PAION AG, together with a description of the principal opportunities and risks associated with the expected development of PAION AG”

Aachen, 29 February 2008
PAION AG

(signed) Dr. Wolfgang Söhngen
(signed) Bernhard Hofer

(signed) Alexander Vos
(signed) Dr. Mariola Söhngen

Audit opinion

We have audited the annual financial statements, comprising the balance sheet, the income statement and the notes to the financial statements, together with the bookkeeping system, and the management report of PAION AG, Aachen, Germany, for the fiscal year from 1 January 2007 to 31 December 2007. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law are the responsibility of the Company's management. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

We conducted our audit of the annual financial statements in accordance with Sec. 317 HGB ["Handelsgesetzbuch": German Commercial Code] and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with [German] principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the annual financial statements and management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the annual financial statements comply with the legal requirements and give a true and fair view of the net assets, financial position and results of operations of the Company in accordance with [German] principles of proper accounting. The management report is consistent with the annual financial statements and as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks relating to future development.

Cologne, Germany, 3 March 2008

Ernst & Young AG
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

(signed) Gockel	(signed) Schlöder
Wirtschaftsprüfer	Wirtschaftsprüfer
[German Public Auditor]	[German Public Auditor]

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