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## Corporate Governance – General Information

The Company's corporate governance principles are laid out in its articles of incorporation (**Articles**), the organizational rules (Organisationsreglement), charters of the different committees of the Board of Directors (**Board**), by-laws of the Company's executive management (**Executive Management**) adopted by the Board and a comprehensive set of group directives, including insider trading rules that require a trading preclearance for all directors, officers and employees and such addressing Santhera's internal control system.

The information published further below conforms with the Corporate Governance Directive (**DCG**) of the SWX Swiss Exchange (**SWX**). In order to avoid redundancies, we have inserted references to other parts of the financial report that provide more detailed information.

## Group Structure and Shareholders (DCG 1)

### Group structure (DCG 1.1)

#### Listed company

Name	Santhera Pharmaceuticals Holding AG ( <b>Company</b> , together with its affiliates, <b>Santhera</b> )
Domicile	Hammerstrasse 47, 4410 Liestal, Switzerland
Register number	CH-270.3.012.442-0
Listing	SWX Swiss Exchange, Symbol SANN
Security no.	2714864
ISIN	CH0027148649
Market capitalization	CHF 282 million (December 29, 2006)
Website	www.santhera.com
Commercial register	www.hrabl.ch
Duration of company	Not limited

Santhera operates through its wholly owned subsidiary, Santhera Pharmaceuticals (Switzerland) AG. Santhera operates in a single business segment, which is research and development of pharmaceutical drugs. Geographically its research and development activities are performed in Switzerland, the EU and the US.

#### Subsidiaries

See note "Investments/Subsidiaries" to the statutory financial statements of the Company on page 58.

### Significant shareholders (DCG 1.2)

See note "Significant Shareholders" to the statutory financial statements of the Company on page 61.

### Cross-shareholdings (DCG 1.3)

There are no cross-holdings.

## Capital Structure (DCG 2)

### Ordinary, conditional and authorized capital (DCG 2.1/2.2)

The Company has only one class of shares, registered shares with a nominal value of CHF 1 each (**Shares**). Pursuant to its Articles, as at December 31, 2006, it had the following ordinary, authorized and conditional capital:

Type of capital	Amount	Expiry	Section in Articles	Percentage of ordinary share capital
Ordinary capital	CHF 3,099,156	–	3	100.0%
Authorized capital	CHF 561,092	October 13, 2008	3a	18.1%
Conditional capital for ESOP/EIP <sup>1)</sup>	CHF 371,676	–	3bI	12.0%
Conditional capital for warrants/option rights granted in connection with debt instruments <sup>1)</sup>	CHF 230,000	–	3bII	7.4%

1) ESOP: Employee Stock Option Plan 2004; EIP: Executive Incentive Plan; for details pertaining to the ESOP and option and/or conversion rights with regard to debt instruments, see section on DCG 2.7.

For details with regard to terms and conditions of potential issues under the Company's authorized and conditional capital, see sections 3a and 3b of the Company's Articles, which can be downloaded from [www.santhera.com](http://www.santhera.com) under "investors – corporate governance," and section on DCG 2.7 below.

For details with regard to the Company's ESOP and EIP see note 18 "Stock Option Plans" to the consolidated financial statements on pages 41 to 43.

### Changes in share capital (DCG 2.3)

For changes in capital that occurred before 2005, see the Company's Offering Circular dated November 2, 2006, which can be downloaded from [www.santhera.com](http://www.santhera.com) under "investors – reports." For changes that took place from 2005 onwards, see notes "Share Capital", "Authorized Capital", "Conditional Capital" to the statutory financial statements of the Company on pages 58 to 59.

### Shares, participation and profit-sharing certificates (DCG 2.4/2.5)

As of December 31, 2006, the Company only had one single class of registered shares with a nominal value of CHF 1 each. All 3,099,156 Shares have been fully paid in and are nonassessable. The Company has not issued any participation certificates or any profit-sharing certificates.

The Company is permanently dispensed from the obligation to issue Shares or certificates evidencing Shares in physical form (aufgehobener Titeldruck). However, a registered shareholder may, at any time, request the Company to confirm its shareholding in written form.

Subject to section 5 in its Articles on share register, transfer restrictions and nominees, each Share carries one vote (see section on DCG 2.6) and is entitled to dividends if the shareholders' meeting (**Shareholders' Meeting**) resolves in favor of a dividend payment.

### Limitations on transferability and nominee registrations (DCG 2.6)

The Company's Shares are freely transferable, provided that the acquirers declare that they acquired the Shares in their own name and for their own account. There is no percentage limitation, and consequently, the Company is not required to grant any exception.

The Board may register nominees (**Nominees**) with the right to vote in the share register up to 2% of the share capital as set forth in the commercial register. Shares in excess of 2% are entered without voting rights, unless the Nominee discloses the names, addresses and number of Shares of persons for whose account it holds such excess Shares. Nominees are persons who do not explicitly declare to hold Shares for their own account. Groups of persons who are interrelated or otherwise act in concert to circumvent the Nominee provisions are treated as a Nominee.

The Board has delegated the administration of the share register to the Chief Financial Officer (**CFO**) but may cancel registration of shareholders if such registration was based on false information and if the CFO has previously heard such shareholders or nominees.

No statutory privileges of limitations on transferability exist.

### Convertible bonds and warrants/options (DCG 2.7)

#### Convertible loans

Santhera does not have any convertible or exchangeable bonds or loans outstanding.

#### Options, warrants

See the statutory financial statements of the Company on page 59 and note 18 "Stock Option Plans" to the consolidated financial statements on pages 41 to 43.

### Board of Directors (DCG 3)

#### Board and committee memberships (DCG 3.1/3.2 and 3.4)

	Year of birth	Nationality	First elected	Elected until	Board	AC <sup>1)</sup>	FSTC <sup>2)</sup>	NCC <sup>3)</sup>
Michael Lytton	1957	US	2004	2007	●	○	●	●
Hans Peter Hasler	1956	CH	2006	2009	●	○		
Martin Gertsch	1965	CH	2006	2007	○	●		
Rudolf Gygax	1949	CH	2001	2007	○			○
Georg Nebgen	1961	US	2004	2007	○		○	○
Timothy J Rink	1946	UK	2004	2007	○		○	
Bernd R Seizinger	1956	DE	2004	2007	○		○	○

1) Audit Committee

2) Financing Strategy & Transactions Committee

3) Nomination & Compensation Committee

● = Chairman

● = Vice Chairman

○ = Member

#### Michael Lytton, JD, MSc

Michael Lytton is General Partner of Oxford Bioscience Partners. He serves also on the boards of directors of Alantos Pharmaceuticals, Claros Diagnostics, Decision Biomarkers, Enanta Pharmaceuticals, GPC Biotech\* (vice chairman), Radius Pharmaceuticals, Rib-X Pharmaceuticals and VaxInnate Pharmaceuticals. Mr Lytton is Chairman of the research and technology committee of the CBR Institute for Biomedical Research at Harvard Medical School, Massachusetts, US, where he is also a member of the board of trustees. In addition, Mr Lytton serves on the board of directors of Medicines in Need, a nonprofit organization. Prior to joining Oxford Bioscience Partners, Mr Lytton was Partner, Chairman of the Technology Group and a member of the executive committee of Palmer & Dodge LLP, a Boston-

\*The asterisk denominates a publicly listed company. It is, however, only used in connection with a current mandate of any of the Board members.

based law firm. Mr Lytton is a graduate of Princeton University and a recipient of a Fulbright Scholarship for study at the University of London. Mr Lytton received a JD degree from Harvard Law School, Massachusetts, US. Mr Lytton also received an MSc degree in epidemiology and medical statistics from the London School of Hygiene and Tropical Medicine, London, UK.

*Hans Peter Hasler*

Hans Peter Hasler has managed Biogen Idec's international business since 2003. Prior to the merger between Biogen and Idec, he led commercial operations for Biogen, based in the company's worldwide headquarters in Cambridge, Massachusetts, US. Mr Hasler joined Biogen in 2001 from Wyeth-Ayerst Pharmaceuticals, a subsidiary of American Home Products, where he worked for eight years, serving since 1998 as Senior Vice President, Head of Global Strategic Marketing. He previously held several senior management positions with American Home Products/Wyeth, including Managing Director for Germany, Austria, Switzerland and Eastern Europe. Before joining Wyeth, he was Head of Abbott Pharma, Switzerland. Mr Hasler holds a Federal Commercial Diploma from the Canton of Bern and received a Marketing Manager Certificate from the Swiss Institute of Business and Economics (SIB), Zurich, Switzerland. He is also a member of the board of directors of Orexo AB, Uppsala, Sweden.

*Martin Gertsch*

Mr Gertsch is Chief Financial Officer of ESBAtech, a drug discovery and development company focusing on therapeutic applications of its proprietary antibody fragments. From 2002 to the beginning of 2006, he was Chief Financial Officer of Straumann Group, a Swiss-based global leader in implant dentistry and oral tissue regeneration. He joined Straumann in 1997 as Head of Group Controlling and Reporting of Straumann Holding AG. Straumann Holding AG is listed on the SWX. From 1986 to 1997 Mr Gertsch worked as Audit Engagement Manager at PricewaterhouseCoopers, Basel, Switzerland. Mr Gertsch is a Swiss Certified Fiduciary and Swiss Certified Public Accountant. He has also completed several executive-level development programs at IMD (International Institute for Management Development) in Lausanne, Switzerland.

*Rudolf Gygax, PhD*

Rudolf Gygax is Managing Director of the Novartis Venture Fund since its inception in 1997. Mr Gygax represents the Novartis Venture Fund as a member on the board of directors of several start-up companies (the Genetics Company AG, Synphabase AG and Biocure Ltd). For nearly 20 years prior to joining the Novartis Venture Fund, he held various positions in the management of research and development at Ciba-Geigy (now Novartis) in the field of process safety and high-technology materials research. Mr Gygax has studied physical chemistry at the University of Basel, Switzerland, and Stanford University, California, US. Mr Gygax was awarded his PhD from the University of Basel, Switzerland.

*Georg Nebgen, PhD*

Georg Nebgen is a Managing General Partner and cofounder of NGN Capital. He joined from MPM Capital, where he had previously been Principal at MPM Capital in Boston and Managing Director of MPM Capital GmbH. Prior to this, Mr Nebgen was with Schering-Plough Corporation, as Managed Care Area Manager for New England. His responsibilities included contracting the reimbursement of Schering-Plough's ethical pharmaceutical products and services with managed care organizations as well as leading sales pull-through activities of the field forces. Prior to this, Mr Nebgen served in Schering-Plough's subsidiary in Switzerland as Business Unit Head, Oncology & Biotech, and Busi-

ness Unit Head, Cardiovascular & CNS. Mr Nebgen joined Schering-Plough from F. Hoffmann-La Roche, where as Technical Project Leader he led the global research and development team for the NDA filing, FDA approval and subsequent product launch of Invirase/Fortovase in the US. He obtained his doctorate in Pharmaceutical Technology Sciences from the University of Bonn, Germany, and his executive MBA from the University of St. Gallen, Switzerland. He is the recipient of awards in both science and business. He served as the President of the German-American Business Council in Boston. He currently serves on the boards of Artisan Pharma, Javelin Pharmaceuticals\* (JAV), KIKA Medical, Tigris Pharmaceuticals and previously Aerovance (observer), Kourion and Omrix (OMRI).

*Timothy J Rink, MA, MD, ScD*

Timothy J Rink currently serves on the boards of directors of Akubio Limited, BioVex Inc and Sepracor Inc.\*. He is a member of the scientific advisory board of Serono AG, and is Chairman of the strategy panel (board of directors) of the Technology Transfer Division of the Wellcome Trust. Mr Rink has been a board member of a number of private and public US and UK biotechnology companies (Alanex, Ciphergen, CoCensys, Gryphon Sciences, NPS Pharmaceuticals, Astex Technology, Lorantis Ltd and Solexa Ltd). He was Chairman and Chief Executive Officer of Aurora Biosciences Inc. from 1996 to 1999. Mr Rink served as President and Chief Technical Officer of Amylin Pharmaceuticals Inc. from 1990 to 1995 and presently serves as Chairman of Amylin's\* scientific advisory board. He was Vice President of research at SmithKline Beecham, UK, from 1984 to 1989. From 1976 to 1984 he was a lecturer in physiology at the University of Cambridge, UK, where he received his scientific and medical degrees.

*Bernd R Seizinger, Prof, MD, PhD*

Bernd R Seizinger joined GPC Biotech\* as President and Chief Executive Officer in 1998 from Genome Therapeutics Corporation in Waltham/Boston, Massachusetts, US, where he was Executive Vice President and Chief Scientific Officer. Previously, Mr Seizinger held the posts of Vice President of Oncology and Vice President of Corporate and Academic Alliances at Bristol-Myers Squibb Pharmaceutical Research Institute in Princeton, New Jersey, US. Mr Seizinger was formerly Associate Professor of Neuroscience at Harvard Medical School, Massachusetts, US, Director of the Molecular Neuro-Oncology Laboratory at Massachusetts General Hospital, Massachusetts, US, and held a visiting professorship at the Department of Molecular Biology at Princeton University, New Jersey, US. He was awarded his MD from the Ludwig Maximilians University and his PhD from the Max Planck Institute of Psychiatry, both in Munich, Germany. He is the recipient of numerous scientific awards and has authored over 100 publications. Bernd R Seizinger is a member of the boards of Altana AG\* (until December 31, 2006) and BioXcell SpA\*.

**Independence of Board members (DCG 3.1.b)**

All Board members are nonexecutive. None has ever been a member of the Executive Management of the Company or any of its subsidiaries.

**Other activities and vested interests (DCG 3.2)**

Other than described above, none of the members of the Board has any position in governing or supervisory bodies of any major organization, institution or foundation under private or public law, permanent management or consultancy function for major interest groups, official function or political mandate.

\*The asterisk denominates a publicly listed company. It is, however, only used in connection with a current mandate of any of the Board members.

### Business connections between Board members and the Company (DCG 3.1.c)

See note 26 "Related Party Transactions" to the consolidated financial statements on pages 48 to 51.

### Cross-involvement (DCG 3.3)

According to the relevant SWX commentary, the fact that a given person holds a seat on the boards of two listed companies is alone sufficient to invoke the obligation to disclose such a cross-involvement. Reference is therefore made to the curricula above indicating all current board memberships in publicly listed companies.

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### Elections and terms of office (DCG 3.4)

According to the Company's Articles, the Board consists of no more than seven members. The term of office of a Board member may not exceed three years, whereby a year means the period between two ordinary Shareholders' Meetings. Directors are appointed or removed exclusively by a resolution of the shareholders. For the time of the first election and the remaining term of office for the members of the Board see the table in the section on DCG 3.1/3.2 and 3.4 above. The Company's Board is not staggered but intends to submit to its shareholders a respective motion at its Shareholders' Meeting scheduled for April 23, 2007. The Board will propose to the shareholders that each Board member be elected individually.

### Organizational structure/areas of responsibility and information flow (DCG 3.5)

See also the table in the section on DCG 3.1.

#### *Allocation of tasks within the Board (DCG 3.5.1)*

The chairman of the Board (**Chairman**) convenes and presides over the Board meetings. After consultation with the Executive Management, he decides on agenda items and motions. Other Board members may request that items be placed on the agenda. In case of urgency, the Chairman may approve transactions and measures on behalf of the full Board. In accordance with internal control system guidelines, he also approves key contracts and the Company's news releases. In the Chairman's absence, the vice chairman represents him.

#### *The Board committees (DCG 3.5.2)*

The Board has three standing Board committees, the Audit Committee, the Financing Strategy & Transactions Committee and the Nomination & Compensation Committee. Committee memberships are indicated in the table on page 4 above.

#### *Audit Committee (AC)*

The AC supports the Board in exercising its responsibilities in monitoring the integrity of the financial statements of the Company, the independent public accounting firm's qualifications and independence, the performance of the Company's internal audit function and independent public accountants, and the compliance of the Company with legal and regulatory requirements. The AC reviews the Company's financial statements, budgets and financial plans and communicates with the Company's external auditors concerning the results of their audits of the annual and interim accounts. The AC issues a recommendation to the Company's Board regarding the approval of the Company's annual and interim financial statements. It approves the annual budgets for all engagements of the Company's auditors. The AC meets at least four times per year. In the year under review, the AC focused primarily on additional compliance requirements that were necessary in view of the upcoming initial public offering (**IPO**). It also reviewed the Offering Circular on behalf of the full Board.

*Financing Strategy & Transactions Committee (FSTC)*

The FSTC supports the Board in its responsibilities for the financial management of the Company and reviews the financing policies, plans and structure of the Company. The duties of the FSTC include reviewing and making recommendations, when appropriate, to the Board with respect to matters such as financing strategy, adjustments of the Company's capital structure, debt and equity placement programs, proposed licensing transactions, mergers, acquisitions, divestitures and insurance. The FSTC meets at least four times per year. In the year under review, it was heavily involved in the financing round that took place before the IPO and the IPO process, with a particular emphasis on the financial terms of the transactions, including price range and offer price of the Shares offered in the IPO as well as discussion around the agreements with Ory Juvantia Pharma Ltd.

*Nomination & Compensation Committee (NCC)*

The NCC assists the Board in compensation- and nomination-related matters. It provides recommendations on the policies for the compensation of the members of management and other employees. It approves the Company's stock option plans, and the compensation of the Chief Executive Officer (CEO) and the other members of the Executive Management. Further, it establishes principles for the selection of candidates for election to the Board and the Executive Management, reviews and proposes candidates for membership on the Company's Board and Executive Management, and reviews the Company's regulations and charter to remain in compliance with stock exchange requirements and Swiss and international corporate best practice standards. The NCC meets at least twice per year. In the year under review, it deliberated over the corporate goals and the amount of incentives to be paid upon achievement of the targets as well employment packages for senior managers and overall stock option grants to the employees.

*Elections and areas of responsibility (DCG 3.5/3.6)*

The Board is entrusted with the ultimate direction of the Company and supervision of the Executive Management. The Board's nontransferable and inalienable duties according to the Swiss Code of Obligations include the duty to (i) ultimately manage the Company and issue the necessary directives, (ii) determine the organizational structure of the Company, (iii) organize the accounting system, financial controls as well as financial planning, and (iv) appoint, recall and ultimately supervise the persons entrusted with the management and representation of the Company. The non-transferable and inalienable duties also comprise responsibility for preparation of the annual report and the Shareholders' Meeting, carrying out shareholders' resolutions and notification to the judge in case of overindebtedness of the Company. In accordance with the Group Directive "Competences & Responsibilities," the full Board approves strategic contracts. It also discusses filing strategies before regulatory authorities such as the European Medicines Agency (EMA) and the US Food & Drug Administration (FDA). It regularly reviews and approves major mergers and acquisitions projects.

The Board has delegated the day-to-day management of the Company to the Executive Management.

*Scientific Advisory Board (SAB)*

In addition to the Board, a corporate body required by law, the Company has an SAB. The SAB provides additional research and development expertise relevant to Santhera's business. Members of the SAB meet periodically with the scientific and development personnel as well as with members of the Executive Management to discuss and advise on Santhera's present and long-term research and development activities. For curricula of the SAB members, see the Company's website [www.santhera.com](http://www.santhera.com) under "investors – corporate governance."

*Work methods of the Board (DCG 3.5.3)*

The adoption of resolutions and elections by the Board require a majority of the votes cast. To validly pass a resolution, more than half of the members of the Board must be present at the meeting. Meetings may be held by telephone. The Board meets at least four times per year. Usually, the duration of such meetings is between four and five hours.

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*Meetings in 2006*

As a result of the IPO preparations and the financing round that preceded the listing on the SWX, the Board met considerably more often than is anticipated for the future.

Corporate body	Number of meetings
Board	12
Audit Committee	5
Financing Strategy & Transactions Committee	4
Nomination & Compensation Committee	4

*Information and control instruments vis-à-vis the Executive Management (DCG 3.7)*

All Executive Management members and the Board's secretary, who is also the Company's general counsel, participate in all Board meetings and report to the Board on the current course of business and all significant issues and transactions. Usually, other members of senior management are invited for certain agenda items in their area of expertise, for example, to discuss research and development progress, potential new indications, in- and outlicensing opportunities, and to report on filing strategies and meetings held with regulatory authorities. As the Board meetings are held at the Company's offices in Liestal, Board members frequently also talk to employees before and after the meetings to obtain a more profound understanding of the Company's business and processes. Usually, the CEO and CFO and other senior members of the finance department, including the senior managers responsible for accounting/reporting, controlling, financial planning and treasury participate in the AC on certain agenda items. From time to time, the AC also invites the Company's tax advisers to its meetings. The CEO attends the meetings of the NCC.

Extraordinary transactions and issues must be reported by the CEO to the Board immediately. The CEO also reports at least quarterly on research and development activities and achievements. Each member of the Board is entitled to request and receive information on all matters of the Company and has access to the Company's and the Company's subsidiaries' property, records and personnel. Board members make use of this possibility by requesting documents, mostly in the area of financial planning and reporting. With the invitation to the meetings, the Board members also receive an executive letter which summarizes key activities, achievements and issues of each member of the Executive Management.

In the reporting period, the main tasks of the Board and its committees were focused on the financing round that occurred shortly before the IPO and all IPO-related activities, including the supervision of the due diligence process and the introduction and maintenance of a state-of-the-art corporate governance system, including the promulgation of internal policies and guidelines with regard to risk management, financial controls, insider trading and trade secrets. All employees are required to attend training with regard to these policies and to certify they are in compliance therewith. The Company is also introducing new software in the finance area and has initiated a project on internal control systems which is well on track. In 2007, it plans to introduce a comprehensive code of conduct, training modules and monitoring tools.

Santhera does not have an internal audit function, but parts of this function have been allocated to the financial controller and a quality assurance manager in the regulatory area.

#### Executive Management (DCG 4)

The Executive Management, under the responsibility of the CEO and the control of the Board, conducts the operational management of the Company pursuant to the Articles and organizational rules (Organisationsreglement), and reports to the Board on a regular basis. The members of the Executive Management are appointed by the Board upon proposal of the CEO. The Executive Management is responsible for implementation of the decisions taken by the Board and its committees. It prepares the business strategy and business plan for decision by the Board. In accordance with the Group Directive "Competences & Responsibilities," the Executive Management approves material contracts. It also allocates financial, personnel and other resources within Santhera and supervises senior management.

#### Members of the Executive Management (DCG 4.1)

Name	Year of birth	Nationality	Position
Klaus Schollmeier	1957	DE	Chief Executive Officer
Barbara Heller	1967	CH	Chief Financial Officer
Thomas Meier	1962	DE	Chief Scientific Officer
Helmut Kessmann	1960	DE	Chief Business Officer

#### *Klaus Schollmeier, PhD*

Klaus Schollmeier joined Graffinity Pharmaceuticals AG (**Graffinity**) as CEO in 2003 and became CEO of the Company when Graffinity and MyoContract AG (**MyoContract**) were combined to form Santhera in 2004. Prior to joining the biotechnology industry in 2003, he served as Managing Director of the Healthcare/Biotechnology Group at ING-BHF Bank for ING Group Europe. Prior to that, he spent 16 years in the pharmaceutical industry at BASF, Knoll and Abbott. His scientific responsibilities included Head of Oncology/Immunology research at BASF's central laboratories in Ludwigshafen, Germany, and Senior Director of Biotechnology at BASF Bioresearch Corporation in Cambridge, Massachusetts, US (1989 to 1993). His business functions included General Manager of BASF Pharma Netherlands from 1996 to 1998 and Vice President and General Manager for Western Europe thereafter. From 1994 to 1995 he led BASF's acquisition and integration of Boots Pharmaceuticals. Mr Schollmeier holds a PhD in biology from the University of Düsseldorf, Germany, and in 1991 he became an adjunct Research Associate Professor at the Boston University Medical School, Massachusetts, US.

#### *Barbara Heller, lic oec publ*

Barbara Heller joined Santhera as CFO in 2005. Prior to that, she was at Bank Vontobel AG, an independent Swiss private banking and investment banking group, as a member of the senior management team. She joined Vontobel in 1997 and held several positions in investment banking/corporate finance. In 1991, she started her professional career in international corporate banking and capital markets at Bank Leu AG, today a member of the Credit Suisse Group, where she was promoted to Head of Corporate Finance/Financial Engineering. Ms Heller received a master's degree from the University of Zurich, Switzerland, in 1991 in economics and business administration, with an emphasis on corporate finance and econometrics.

*Thomas Meier, PhD*

Thomas Meier, Chief Scientific Officer, was founder and former CEO of MyoContract prior to the combination with Graffinity that led to Santhera. In 1999, Mr Meier became an independent research group leader and lecturer in the Department of Pharmacology and Neurobiology at the Biozentrum of the University of Basel, Switzerland, where he established MyoContract. Mr Meier received his PhD from the University of Basel, Switzerland, in 1992 and subsequently joined the University of Colorado Health Sciences Center, US. He has a distinguished scientific track record and is author of several papers in the field of neuromuscular research. Mr Meier won the International Research Fellowship Award from the US National Institutes of Health (NIH), and has received a long-term fellowship from the Human Frontier Science Foundation.

*Helmut Kessmann, PhD*

Helmut Kessmann, Chief Business Officer, joined Graffinity in 2001 as Chief Business Officer, and since the combination with MyoContract, he has continued in that role for the Company. In 1996, Mr Kessmann cofounded Discovery Technologies AG, a biotechnology company in Basel, Switzerland, which was integrated into US-based Discovery Partners International in 1999 and had a successful IPO in 2000 (Nasdaq: DP11; merged 2006 with Infinity Pharmaceuticals Ltd). Prior to that, following a postdoctorate in the US, he held various research management positions at Ciba-Geigy AG, now Novartis AG. Mr Kessmann studied biology, philosophy and business administration and completed his doctorate in biochemistry 1988 at the University of Münster, Germany. Helmut Kessmann is a member of the board of directors of Oy Juvantia Pharma Ltd.

**Other activities and vested interests (DCG 4.2)**

None of the Executive Management members has any position in governing or supervisory bodies of any major organization, institution or foundation under private or public law, permanent management or consultancy function for major interest groups, official function or political post.

**Management contracts (DCG 4.3)**

There are no management contracts between the Company and companies not belonging to Santhera Group.

**Compensation, Shareholdings and Loans (DCG 5)****Content and method of determining compensation and shareholding programs (DCG 5.1)**

The NCC reviews and approves the compensation of the Board and Executive Management. In doing so, it benchmarks the Company's policy and payments made to those of companies comparable in products, market, size and development stage.

Incentives, if any, are paid to Executive Management members and other employees based on the achievement of company targets and of individual targets set at the beginning of a year by the Board. Among 2006 company targets were the IPO and the achievement of certain milestones in the clinical development processes, mostly with regard to the Company's lead compound SNT-MC17. For members of the Executive Management, incentives may on average amount to 35% of their base salary; the number of options can range considerably. The value of these options at the time of their grant cannot be calculated applying classical models, as they only fully vest on the fourth anniversary after their grant.

**Compensation for acting members of governing bodies (DCG 5.2)**

See note 26 "Related Party Transactions" to the consolidated financial statements of the Company on pages 48 to 51. Severance payment of CHF 15,000 was made to one member of the Board who left the Company in 2006 (DCG 5.2.3).

**Compensations for former members of governing bodies (DCG 5.3)**

In the year preceding the reporting period, no member of the Board or of the Executive Management left the Company. Therefore, no compensation to "former members" was made.

**Share allotment in 2006 (DCG 5.4)**

In 2006, no Shares were granted to members of the Board or of Executive Management.

**Share ownership (DCG 5.5)**

As at December 31, 2006, members of the Board and closely linked parties held a total of 683,705 Shares, while members of the Executive Management held no Shares.

**Options (DCG 5.6)**

See the statutory financial statements of the Company on page 59.

**Additional fees and remunerations (DCG 5.7)**

No additional fees or remunerations were paid other than disclosed in the notes to the consolidated financial statements.

**Loans granted to members of governing bodies (DCG 5.8)**

No loans have been granted to members of the Board or the Executive Management.

**Highest total compensation (including option allotments, DCG 5.9)**

See note 26 "Related Party Transactions" to the consolidated financial statements of the Company on pages 48 to 51.

**Shareholders' Participation (DCG 6)****Voting rights and representation restrictions (DCG 6.1)**

There are no voting rights restrictions, no statutory group clauses and hence no rules on making exceptions. As a consequence, as there are no voting rights restrictions, there is neither a procedure nor a condition for their cancellation. A shareholder may be represented by his legal representative, the corporate proxy, the independent proxy, by a depositary or by another shareholder.

**Statutory quora (DCG 6.2)**

There are no statutory quora which differ from the applicable legal provisions.

**Convocation of the Shareholders' Meeting (DCG 6.3)**

There are no statutory rules on the convocation of the Shareholders' Meeting that differ from the applicable legal provisions.

**Agenda rules (DCG 6.4)**

The Board decides on the agenda of the Shareholders' Meeting. Shareholders with voting rights whose combined holdings represent shares with a nominal value of at least CHF 1 million or 10% of the Company's share capital may, up to 60 days before the date of the meeting, demand that items

be included in the agenda. Such request must be in writing and must specify the items and the motions to be submitted.

#### Registrations in the share register (DCG 6.5)

Shareholders entered in the share register as shareholders on a specific qualifying day designated by the Board (record date), which is usually less than five business days before the meeting, are entitled to attend the Shareholder's Meeting and to exercise their votes at such meeting.

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#### Changes of Control and Defense Measures (DCG 7)

##### Duty to make an offer (DCG 7.1)

There are no statutory rules on "opting up" or "opting out." Should a shareholder reach the threshold of 33 1/3% of all Santhera's voting rights, then, pursuant to the Swiss Stock Exchange Act, it would be required to submit a public takeover offer for all outstanding Shares.

##### Clauses on changes of control (DCG 7.2)

The Stock Option Plan 2004 (**Plan**), under which most options to receive Shares have been and are granted (e.g. with the exception of those under the Executive Incentive Plan) contains a clause according to which all options granted under the Plan vest immediately upon a sale of more than 50% of the Shares. Other than that, as of December 31, 2006, agreements and plans from which members of the Board and/or the Executive Management or other members of senior management benefit or may benefit contain no clauses on changes of control.

#### Auditors (DCG 8)

##### Duration of the mandate and term of office of the lead auditor (DCG)

Ernst & Young Ltd, Basel, assumed the existing auditing engagement for Santhera's predecessor company MyoContract in 2002. The annual Shareholders' Meeting elects the Company's auditors for a term of office of one year. The auditor in charge is Mr Jürg Zürcher. He assumed his responsibility in 2006.

##### Auditing fees and additional fees (DCG 8.2/8.3)

The following fees were charged for professional services rendered by Ernst & Young Ltd, for the 12-month period ended December 31, 2006:

	in CHF thousands	2006	2005
Audit services		146	93
Audit-related services		315	80

Audit services are defined as the standard audit work that needs to be performed each year in order to issue an opinion on the consolidated financial statements of Santhera and to issue reports on the local statutory financial statements. It also includes services that can only be provided by the group auditor and includes the verification of the implementation of new or revised accounting policies and internal control review of systems. Audit-related services include those other services provided by auditors but not restricted to those that can only be provided by the auditor signing the audit report. They comprise amounts for services in relation to the issue of the Company's offering memorandum, including for due diligence-related services and comfort letters. Santhera has contracted the provision of tax services to a company other than Ernst & Young.

**Supervisory and control instruments pertaining to the audit (DCG 8.4)**

The Board performs its supervisory and control functions towards the external auditors through the AC. In particular, the AC meets with the auditors at the end of the audit to discuss indepth the audit procedure, any findings made and recommendations proposed. The management letter is also extensively discussed with the auditors. Last year, the auditors held numerous meetings with the Company where also the AC chairman and the other members of the Board were present. The primary objective of the AC is to support the Board in monitoring Santhera's internal control, accounting principles, risk management, financial reporting and auditing.

**Information Policy (DCG 9)**

Santhera reports to its shareholders, business partners, employees and the public in an open, transparent and timely manner. Equal treatment of all stakeholders is the guiding principle behind its partnership-based approach. In doing so, Santhera is able to promote an understanding of its objectives, strategy and business activities, and to ensure a high degree of awareness about Santhera.

The most important information tools are the annual reports and halfyear reports, the website ([www.santhera.com](http://www.santhera.com)), news releases, fact sheets, as well as the Shareholders' Meeting.

Investors and other parties interested in subscribing to the Company's news service may do so by registering themselves on the Company's website, [www.santhera.com](http://www.santhera.com), under "investors – news subscriptions."

For contact details, see reverse side of the financial report 2006.

**Corporate events**

- Annual Shareholders' Meeting      April 23, 2007
- Halfyear report                      August 17, 2007

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## Consolidated Balance Sheets

	in CHF thousands	Notes	Dec 31, 2006	Dec 31, 2005
<b>Assets</b>				
Tangible assets		6	1,931	1,817
Intangible assets		7	32,242	31,176
Other noncurrent assets			87	0
<b>Noncurrent assets</b>			<b>34,260</b>	<b>32,993</b>
Prepaid expenses and accrued income			758	310
Inventories			462	0
Trade and other receivables		8	1,252	1,716
Receivables from shareholders		9	0	12,425
Cash and cash equivalents		10	125,662	31,268
<b>Current assets</b>			<b>128,134</b>	<b>45,719</b>
<b>Total assets</b>			<b>162,394</b>	<b>78,712</b>
<b>Equity and liabilities</b>				
Share capital		11	3,099	1,744
Capital reserves and share premium		11	233,608	124,751
Retained earnings		11	-90,561	-62,302
Reacquired shares		11	0	-91
Share options		11	4,623	2,056
Warrants		11	874	743
Exchange differences		11	405	-754
<b>Total equity</b>			<b>152,048</b>	<b>66,147</b>
Long-term debt from related parties		12, 26	0	3,203
Long-term debt		12	931	0
Long-term accrued expenses		14	0	1,068
Pension liabilities		22	144	0
Deferred tax liabilities		13	683	502
<b>Total noncurrent liabilities</b>			<b>1,758</b>	<b>4,773</b>
Trade accounts payable			3,401	2,599
Short-term debt from related parties		12, 26	0	790
Short-term debt		12	485	0
Other liabilities			80	514
Downpayments received			0	779
Accrued expenses and deferred income		14	3,942	2,521
Short-term provisions		15	680	589
<b>Total current liabilities</b>			<b>8,588</b>	<b>7,792</b>
<b>Total liabilities</b>			<b>10,346</b>	<b>12,565</b>
<b>Total equity and liabilities</b>			<b>162,394</b>	<b>78,712</b>

## Consolidated Income Statements

	For the year ended December 31, in CHF thousands	Notes	2006	2005
Group income		19	781	15,078
Cost of goods sold			0	-1,322
<b>Gross profit</b>			<b>781</b>	<b>13,756</b>
Research and development expenses			-17,985	-14,542
General and administrative expenses			-12,052	-6,012
Other operating result			617	-4,719
<b>Operating expenses</b>		20, 21	<b>-29,420</b>	<b>-25,273</b>
<b>Operating result (EBIT)</b>			<b>-28,639</b>	<b>-11,517</b>
Financial income		23	1,199	238
Financial expenses		23	-637	-1,105
<b>Result before taxes</b>			<b>-28,077</b>	<b>-12,384</b>
Income taxes		24	-181	748
<b>Net loss</b>			<b>-28,258</b>	<b>-11,636</b>
<b>Basic and diluted loss per share (in CHF)</b>		25	<b>-14.44</b>	<b>-9.41</b>

## Consolidated Cash Flow Statements

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	For the year ended December 31, in CHF thousands	Notes	2006	2005
Operating result			-28,639	-11,517
Depreciation and amortization of tangible assets		6	750	2,840
Depreciation and amortization of intangible assets		7	114	127
Gains and losses from disposals of assets			0	11
Issuance of share options		18	2,566	1,008
Issuance of warrants			874	0
Changes in network capital			-268	1,505
Interest expenses		23	-230	-344
Interest income		23	929	238
<b>Net cash flow from operating activities</b>			<b>-23,904</b>	<b>-6,132</b>
Investments in tangible assets, net		6	-895	-562
Disposal of tangible assets		6	56	1,778
Investments in intangible assets		7	-295	-3,766
Disposal of intangible assets		7	10	8
Investments in financial assets			0	9
Change in other noncurrent assets			-88	0
Purchase of own shares		11	0	-91
<b>Cash flow from investing activities</b>			<b>-1,212</b>	<b>-2,624</b>
Capital increases			121,895	23,649
Repayment of finance lease liabilities			0	-156
Repayment of debt (from related parties)		12	-2,577	45
<b>Cash flow from financing activities</b>			<b>119,318</b>	<b>23,538</b>
Effects of exchange rate changes on cash and cash equivalents			192	184
<b>Net increase in cash and cash equivalents</b>			<b>94,394</b>	<b>14,966</b>
Cash and cash equivalents at January 1			31,268	16,302 <sup>1)</sup>
<b>Cash and cash equivalents at December 31</b>			<b>125,662</b>	<b>31,268</b>

1) Incl. restricted cash

## Consolidated Statement of Changes in Equity

in CHF thousands	Notes	Share capital	Share premium	Retained earnings	Treasury shares	Translation differences	Total	Minority interest	Total equity
<b>Balance at January 1, 2005</b>									
<b>(restated)</b>		<b>1,064</b>	<b>86,674</b>	<b>-50,666</b>	<b>0</b>	<b>-1,055</b>	<b>36,017</b>	<b>3,598</b>	<b>39,615</b>
Currency translation differences		0	0	0	0	301	301	0	301
Net loss		0	0	-11,636	0	0	-11,636	0	-11,636
<b>Total recognized income and expenses for the period</b>									
		<b>0</b>	<b>0</b>	<b>-11,636</b>	<b>0</b>	<b>301</b>	<b>-11,335</b>	<b>0</b>	<b>-11,335</b>
Capital increase January 2005	11	34	1,961	0	0	0	1,995	0	1,995
Capital increase April 2005		0	0	0	0	0	0	3,899	3,899
Capital increase June 2005	11	97	5,696	0	0	0	5,793	0	5,793
Contribution in kind June 2005	11	131	7,366	0	0	0	7,497	-7,497	0
Capital increase December 2005 <sup>1)</sup>	11	418	24,433	0	0	0	24,851	0	24,851
Acquisition of treasury shares		0	0	0	-91	0	-91	0	-91
Issuance of share options	18	0	1,008	0	0	0	1,008	0	1,008
Issuance of warrants		0	743	0	0	0	743	0	743
Cost of issuance of share capital		0	-331	0	0	0	-331	0	-331
<b>Balance at December 31, 2005</b>		<b>1,744</b>	<b>127,550</b>	<b>-62,302</b>	<b>-91</b>	<b>-754</b>	<b>66,147</b>	<b>0</b>	<b>66,147</b>
<b>Balance at January 1, 2006</b>									
		<b>1,744</b>	<b>127,550</b>	<b>-62,302</b>	<b>-91</b>	<b>-754</b>	<b>66,147</b>	<b>0</b>	<b>66,147</b>
Currency translation differences		0	0	0	0	1,159	1,159	0	1,159
Net loss		0	0	-28,259	0	0	-28,259	0	-28,259
<b>Total recognized income and expenses for the period</b>									
		<b>0</b>	<b>0</b>	<b>-28,259</b>	<b>0</b>	<b>1,159</b>	<b>-27,100</b>	<b>0</b>	<b>-27,100</b>
Capital increase September 2006 – exercise of warrants (2005)	11	33	1,904	0	0	0	1,937	0	1,937
Capital increase September 2006	11	191	15,609	0	0	0	15,800	0	15,800
Capital increase November 2006 – IPO	11	984	87,563	0	0	0	88,547	0	88,547
Capital increase November 2006 – Greenshoe	11	147	13,135	0	0	0	13,282	0	13,282
Forfeiture of treasury shares	11	0	0	0	91	0	91	0	91
Issuance of share options	18	0	2,566	0	0	0	2,566	0	2,566
Issuance of warrants		0	874	0	0	0	874	0	874
Cost of issuance of share capital	20	0	-10,096	0	0	0	-10,096	0	-10,096
<b>Balance at December 31, 2006</b>		<b>3,099</b>	<b>239,105</b>	<b>-90,561</b>	<b>0</b>	<b>405</b>	<b>152,048</b>	<b>0</b>	<b>152,048</b>

1) Whereof CHF 12,425,486 was not yet paid in as of December 31, 2005

## Notes to the Consolidated Financial Statements

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### 1 General Information

Santhera Pharmaceuticals Holding AG (the **Company** together with its subsidiaries **Santhera** or **Group**) is a specialty pharmaceutical company focused on the discovery, development and commercialization of small-molecule pharmaceutical products for the treatment of severe neuromuscular diseases, seeking to address the high unmet medical need associated with most neuromuscular diseases where few, if any, effective therapies currently exist. Santhera's vision is to become a global market leader in the treatment of neuromuscular diseases, which frequently qualify for orphan drug status.

The Company, having its primary listing of its registered shares (**Shares**) on the SWX Swiss Exchange (**SWX**), is a Swiss stockholding corporation and the parent company of Santhera. Its purpose is to acquire, dispose and manage investments. The Company has its registered office at Hammerstrasse 47 in CH-4410 Liestal, Switzerland.

These consolidated financial statements were approved by the Board of Directors (**Board**) as of March 1, 2007, and are subject to approval by the shareholders on April 23, 2007.

### 2 Summary of Significant Accounting Policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

#### Basis of preparation

The consolidated financial statements of Santhera have been prepared in accordance with International Financial Reporting Standards (**IFRS**).

Change of presentation currency: In the course of the restructuring of the activities of Santhera in Germany (Management buyout of noncore activities and consolidation of all research activities in Switzerland) as of December 31, 2005, the presentation currency was changed from EUR (**EUR**) to Swiss Francs (**CHF**) as of January 1, 2006. The financial statements 2005 were adjusted and are also reported in CHF, accordingly, to ensure comparability.

The consolidated financial statements are based on the financial statements of the individual Santhera companies prepared for the same reporting period using consistent accounting policies. The consolidated financial statements are prepared using the historical cost convention except for the revaluation to market value of certain financial assets and financial liabilities.

All figures included in these financial statements and notes to the financial statements are rounded to the nearest CHF 1,000 except where otherwise indicated.

The income statement has been prepared using the cost of sales ("function of expense") method.

As of January 1, 2006, Santhera affiliated all Swiss employees to a new multiemployer retirement defined contribution plan. However, in accordance with IAS 19, Santhera applies defined benefit accounting from January 1, 2006, onwards. An independent actuary has performed the respective calculations as required by IAS 19 as of December 31, 2006 and for the period 2006.

For the financial reporting 2006, subsequent to the listing of its Shares on the SWX, Santhera has adopted certain presentation standards for reasons of better comparability with its peer companies. In particular, changes were adopted for the presentation of the income statement and tangible assets. For more detailed information, see also the respective notes.

### Consolidation

Subsidiaries in which the Company has controlling interest directly or indirectly are consolidated. Control is defined as the power to govern the financial and operation policies of an enterprise so as to obtain benefits from its activities. Control is normally evidenced when the Company owns, either directly or indirectly, more than 50% of the voting rights or potential voting rights of a company's share capital that are currently exercisable.

The consolidated financial statements of Santhera include the accounts of Santhera Pharmaceuticals Holding AG, Liestal, Switzerland, and its wholly owned subsidiaries Santhera Pharmaceuticals (Switzerland) AG, Liestal, Switzerland, and Santhera Pharmaceuticals (Germany) GmbH, Heidelberg, Germany.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Company. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair value at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the subsidiary's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the income statement.

Santhera applies the equity method of accounting for investments in companies that are considered associated companies and for which it has the ability to exercise significant influence, but not control. This generally exists when it owns between 20% and 50% of the voting rights of an associated company. The Group's share of its associates' post-acquisition profits or losses is recognized in the income statement, and its share of post-acquisition movements in reserves is recognized in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. Currently, all subsidiaries are wholly owned by the Company.

The consolidation commences from the date on which control is transferred to the Company, and subsidiaries are no longer consolidated from the date that control ceases. Intercompany balances and transactions between group companies are eliminated. Intercompany transactions solely result from providing services to other group companies.

### Changes in accounting policies

*Standards, amendments and interpretations effective from January 1, 2006 without material impact on the Group's financial statements*

– IAS 1 and IAS 19	Amendment – Actuarial gains and losses, group plans and disclosures
– IAS 21	Amendment – The effects of changes in foreign exchange rates
– IAS 39	Amendment – Cash flow hedge accounting of forecast intragroup transactions
– IAS 39	Amendment – The fair value option
– IAS 39 and IFRS 4	Amendment – Financial guarantee contracts
– IFRS 6	Exploration for and evaluation of mineral resources
– IFRIC 4	Determining whether an arrangement contains a lease
– IFRIC 5	Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds
– IFRIC 6	Liabilities arising from participating in a specific market – waste electrical and electronic equipment
– IFRIC 9	Reassessment of embedded derivatives

*International Accounting Standards and interpretations that become effective after December 31, 2006*

#### *Standards early adopted*

No standards have been early adopted by Santhera in 2006.

#### *Standards and interpretations to existing standards that are not yet effective and have not been early adopted*

The following interpretations to existing standards have been published that are mandatory for the Group's accounting periods beginning on or after May 1, 2006, or later periods and that the Group has not early adopted:

– IFRS 7	Financial Instruments: Disclosures, and the complementary amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures effective from January 1, 2007. The Group will apply IFRS 7 and the amendment to IAS 1 from annual periods beginning January 1, 2007, with no effect on the Group's accounts other than a modification of the required disclosures in the notes to the consolidated financial statements.
– IFRS 8	Operating Segments: Replaces IAS 14 and requires an entity to adopt the "management approach" to reporting on the financial performance of its operating segments. Generally, the information to be reported would be what management uses internally for evaluating segment performance and deciding how to allocate resources to operating segments. IFRS 8 applies to the annual financial statements for periods beginning on or after January 1, 2009, with no effect on the Group's accounts other than a modification of the required disclosures in the notes to the consolidated financial statements.
– IFRIC 8/Scope of IFRS 2	Effective for annual periods beginning on or after May 1, 2006. Santhera will apply IFRIC 8 from January 1, 2007, but it is not expected to have any impact on the Group's accounts.
– IFRIC 10	Interim Financial Reporting and Impairment effective for annual periods beginning on or after November 1, 2006. The Group will apply IFRIC 10 from January 1, 2007, but it is not expected to have any impact on the Group's accounts.

- IFRIC 11, IFRS 2      Group and Treasury Share Transactions effective for annual periods beginning on or after March 1, 2007. The Group will apply IFRIC 11 from January 1, 2008, but it is not expected to have any impact on the Group's accounts.
- 

*Interpretations to existing standards that are not yet effective and have no material impact on the Group's financial statements*

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The following interpretations of existing standards have been published that are mandatory for the Group's accounting periods beginning on or after May 1, 2006, or later periods but have no material impact on the Group's financial statements:

- IFRIC 7                      Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies effective from March 1, 2006. As none of the Group entities have a currency of a hyperinflationary economy as its functional currency, IFRIC 7 is not relevant to the Group's operations.
  - IFRIC 9                      Reassessment of embedded derivatives effective for annual periods beginning on or after June 1, 2006. As none of the Group entities have changed the terms of their contracts, IFRIC 9 is not relevant to the Group's operations.
  - IFRIC 12                     Service Concession Arrangements effective for annual periods beginning on or after January 1, 2008. As the Group has no public-to-private service concession arrangements, IFRIC 12 is not relevant to the Group's operations.
- 

### Segment reporting

Santhera operates in a single business segment, which is research and development of pharmaceutical drugs. Geographically the research and development activities are performed in Switzerland, the EU and the US.

### Foreign currency translations

The consolidated financial statements are presented in CHF. The functional currency of each Santhera company is the currency of the primary economic environment in which the local entity operates. Transactions in foreign currencies are accounted for at the rates prevailing at the dates of the transaction. Translation differences from financial transactions are included in the financial result.

Gains and losses resulting from the translation of foreign currency transactions and from the adjustment of foreign-currency monetary assets and liabilities at the balance-sheet date are recognized in the income statement.

Assets and liabilities of foreign entities are translated into CHF using the balance-sheet exchange rates at year-end. Income and expenses are translated into CHF at average exchange rates. The exchange differences arising on the retranslation are accounted for in equity.

### Intangible assets

Patents, licenses, trademarks and other intangible assets are capitalized as intangible assets when it is probable that future economic benefits will be generated. Such assets are amortized on a straight-line basis over their useful lives. Estimated useful life is the lower of legal duration and economic useful life, which does not exceed 20 years. The estimated useful life of the intangible assets is regularly reviewed, and if necessary, the future amortization charge is accelerated.

Research and development costs are expensed as incurred except for development costs, which relate to the design and testing of a new product line; they are recognized as an asset in accordance with IAS 38.

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Goodwill: Currently no goodwill is capitalized.

Trademarks and licenses: Currently no trademarks or material licenses are capitalized.

Computer software: Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and implement the specific software. These costs are amortized over their estimated useful lives (two to five years).

#### Impairment of nonfinancial assets

Nonfinancial assets include intangible assets with indefinite useful lives, intangible assets with finite useful lives and tangible assets. In general and in accordance with the terms of IFRS, assets with indefinite useful lives are capitalized at cost in the balance sheet and reviewed for impairment at least annually. This impairment test is performed at the same time every year. Additionally, these assets are reviewed at each reporting date to determine whether events and circumstances continue to support an indefinite useful life assessment. If they do not, the change in the useful life assessment from indefinite to finite is accounted for as a change in an accounting estimate for the respective asset. If they are finite, the useful life constitutes the duration over which the asset is amortized on a straight-line basis.

#### Tangible assets

Tangible assets are stated at cost less accumulated depreciation and any impairment in value. Depreciation is computed on a straight-line basis over the estimated useful life of the asset or the shorter lease term, as follows:

	Useful life
Laboratory equipment	5 – 8 years
Laboratory fixtures and fittings	5 – 10 years
Equipment	4 – 10 years
IT hardware	4 – 10 years
Leasehold improvements	3 – 5 years
Equipment for clinical studies	1 – 2 years

Leasehold improvements are depreciated over the lease term of the lease period.

Interest costs on borrowings to finance the construction of property, plant and equipment are capitalized during the period of time that is required to complete and prepare the property for its intended use, as part of the cost of the asset.

#### Trade and other receivables

Receivables which generally have 30 days payment terms are stated at their nominal value less an allowance for any uncollectible amount. An estimate for doubtful debts is made when collection of the full amount is no longer possible.

#### Inventories

Inventories are stated at the lower of cost or market value with cost determined by the first-in first-out ("FIFO") method.

## Investments

Generally Santhera classifies its investments in the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired.

### *Financial assets at fair value through profit and loss*

This category has two subcategories: financial assets held for trading and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short-term. Derivatives are also categorized as held for trading unless they are designated as hedges. Assets in this category are classified as current assets if they are either held for trading or are expected to be realized within 12 months of the balance-sheet date. Valuation is at fair value through profit and loss.

### *Loans and receivables*

Loans and receivables are nonderivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when Santhera provides money, goods or services directly to a debtor with no intention of trading the receivable. They are included in current assets, except for maturities longer than 12 months after the balance-sheet date. These are classified as noncurrent assets. Loans and receivables are included in trade and other receivables in the balance sheet. They are reported at amortized cost using the effective interest method.

### *Held-to-maturity investments*

Held-to-maturity investments are nonderivative financial assets with fixed or determinable payments and fixed maturities that Santhera's management has the intention and ability to hold to maturity. They are reported at amortized cost using the effective interest method.

### *Available-for-sale financial assets*

Available-for-sale financial assets are nonderivatives that are either designated in this category or not classified in any of the other categories. They are included in noncurrent assets unless management intends to dispose of the investment within 12 months of the balance-sheet date. Valuation is at fair value through equity.

Purchases and sales of investments are recognized on trade date. This is the date on which Santhera commits to purchase or sell the asset. Investments are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Investments are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and Santhera has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortized cost using the effective interest method. Realized and unrealized gains and losses arising from changes in the fair value of the financial assets at fair value through profit or loss category are included in the income statement in the period in which they arise. Unrealized gains and losses arising from changes in the fair value of investments classified as available-for-sale are recognized in equity. When securities classified as available-for-sale are sold or impaired, the accumulated fair-value adjustments are included in the income statement as gains and losses from investment securities. No such investments occurred for the reporting period.

**Derivative financial instruments**

In the reporting period, no traded derivative activities with financial instruments have been carried out.

**Leases**

Leases of assets under which Santhera essentially assumes all the rewards and risks of ownership are classified as finance leases. Finance leases are capitalized as assets and liabilities at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. The assets acquired under these contracts are depreciated over the shorter of the estimated useful life of the asset or the lease term. No such finance lease contracts occurred for the reporting period.

Leases of assets under which all the risks and rewards of ownership are effectively retained by the lessor are classified as operating leases, and payments made are charged to the income statement on a straight-line basis.

**Cash and cash equivalents**

This item includes cash in hand and at banks, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at nominal value.

The cash flow statement is based on cash and cash equivalents.

**Share capital**

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

**Debt instruments**

Debt instruments are initially recognized at their fair value, which is the proceeds received. Subsequently they are reported at amortized costs using the effective interest method. Any difference between the net proceeds received and the principal value due on redemption is amortized over the duration of the debt instrument and is recognized as part of interest expense in the income statement.

**Income taxes**

The income tax charge is based on profit for the year and includes deferred taxes. Deferred taxes are calculated using the liability method. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Deferred tax assets and liabilities are measured using the tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled based on tax rates enacted or substantially enacted at the balance-sheet date.

The amount of deferred tax liabilities and deferred tax assets reflects the tax consequences on the balance-sheet date of the Company's expectation of recovery or settlement of such carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are not discounted and are classified as noncurrent assets (liabilities) in the balance sheet. They are offset against each other if they relate to the same taxable entity.

Deferred tax assets are recognized if it is probable that sufficient taxable profits will be available against which the deferred tax assets can be utilized. At each balance-sheet date, the Company reassesses unrecognized deferred tax assets and the carrying amount of deferred tax assets. The Company recognizes a previously unrecognized deferred tax asset to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered. The Company conversely reduces the carrying amount of a deferred tax asset to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or the entire deferred tax asset to be utilized.

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### **Employee benefits**

#### *Pension obligations*

Santhera participates in a multiemployer retirement contribution plan covering all employees in Switzerland. Until December 31, 2005, Santhera participated in a defined contribution plan.

As of January 1, 2006 Santhera affiliated all Swiss employees to a new multiemployer retirement defined contribution plan. However, the risks of death and disability are fully reinsured by an insurance company, therefore, in accordance with IAS 19, Santhera applies defined benefit accounting from January 1, 2006, onwards. An independent actuary has performed the respective calculation as required by IAS 19 as of December 31, 2006 and for the period 2006.

In general, the plan provides benefits to participants at retirement or other life contingencies. The benefits vary from severance payments to retirement pensions on termination of employment. On retirement or other legitimate life contingency the employees are eligible for a lump-sum severance payment or an annuity equal to their share of the fund.

The plan is funded by contributions by both Santhera and employees, based on a fixed percentage of the basic annual salary. Payments under this scheme are recognized as an expense for each respective year. Contributions to the plan by employees are the identical amounts. There are no changes affecting comparability nor does Santhera intend to withdraw from the plan.

Any actuarial gains and losses are recognized under the corridor approach. Under this approach actuarial gains and losses – to the extent that they fall outside a corridor of 10% of the higher of the plan asset or liability value – are recognized through the profit and loss account over the average expected remaining working life of employees.

#### *Termination benefits*

Termination benefits are payable in Germany when employment is terminated before the normal retirement date or whenever an employee accepts voluntary redundancy in exchange for the benefits. Santhera recognizes termination benefits when it is demonstrably committed to either terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal or providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after the balance-sheet date are discounted to present value.

### *Share-based compensation*

The parent company has adopted stock option plans to provide long-term incentives to its directors, employees, executives and consultants (including scientific advisors), as part of the total compensation. The shareholder's meeting of the parent company has created conditional share capital for these plans.

Santhera has established an employee stock option plan (**ESOP 2004**) and an Executive Incentive Plan (**EIP**) to align the long-term interests of directors, executives, employees and consultants. Independent directors, all employees and certain consultants (including members of the Scientific Advisory Board) are eligible to participate in the ESOP 2004, whereas only executives are eligible to participate in the EIP. The fair value of options granted under these two option plans are recognized as personnel expenses and expensed over the relevant vesting periods in accordance with IFRS 2.

### **Provisions**

Provisions are recognized when Santhera has a present obligation (legal or constructive) as a result of a past event, where it is more probable than not that a cash outflow will be required to settle the obligation and where a reliable estimate can be made of the amount of the obligation.

If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any one item included in the same class of obligations is small.

### **Revenue recognition**

Revenue comprises the fair value of the sale of goods and services, net of value-added tax, rebates and discounts, and after eliminating intercompany sales. Revenue is recognized as follows:

#### *Revenue from out-licensing*

Out-licensing agreements are concluded with third parties, where the counterparty has to pay non-refundable up-front license fees. In situations where no further performance liability exists, revenues are recognized on the earlier of when payments are received or collection is assured. Where continuing involvement is required in the form of technology transfer or technical support, revenues are recognized over the involvement period if involvement is significant.

#### *Revenues from rendering services*

Revenues from rendering research services are recognized in the accounting period in which the services are rendered on the basis of the progress of the project in accordance with the percentage of completion ("PoC") method.

#### *Revenues associated with performance milestones*

Milestone payments are recognized based on achievement of such milestones, as defined in the relevant agreements.

#### *Revenues from royalties*

Royalty payments are recognized on an accrual basis in accordance with the respective agreements.

#### *Interest income*

Interest income is recognized on a pro rata temporis basis using the effective interest method.

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#### **Research and development**

Research and development expenses are charged to the income statement as incurred. Development expenses are capitalized as intangible assets when it is probable that future economic benefits will flow to Santhera. Such intangible assets are amortized on a straight-line basis over the period of the expected benefit, and are reviewed for impairment at each balance-sheet date.

#### **Own equity instruments**

Santhera issued warrants exercisable into common shares in connection with an option agreement. These warrants were classified as own equity instruments and were initially recognized in accordance with IAS 32 at fair value.

#### **Related parties**

A party is related if the party directly or indirectly controls, is controlled by or is under common control with the entity, has an interest in the entity that gives it significant influence over the entity, has joint control over the entity, or is an associate or a joint venture of the entity. In addition, members of the key management personnel of the entity or close members of the family are also considered related parties as well as post-employment benefit plans for the benefit of employees of the entity. Transactions with related parties are conducted on an arm's-length basis.

#### **Government grants**

Government grants are recognized at fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. Government grants that compensate Santhera for expenses incurred are recognized as deferred income and as reduction of research and development expenses in the income statement on a systematic basis in the same periods in which the expenses are incurred.

### **3 Financial Risk Management**

Santhera operates primarily in Switzerland, in the EU and in the US and is therefore exposed to a variety of financial risks, such as foreign exchange risk, credit risk, liquidity risk, cash flow and interest rate risk. Santhera's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on financial performance. Special guidelines and policies approved by the Board exist for risk management and are monitored by Santhera's Executive Management and by the Audit Committee of the Board. Certain financial risks, when deemed appropriate, could be reduced through using financial instruments. In accordance with the relevant treasury guidelines, Santhera only concludes contracts with selected high-quality financial institutions of good reputation.

#### **Foreign exchange risk**

In order to reduce its foreign exchange exposure, Santhera may enter into currency contracts (forwards, options, structured derivatives) to hedge against foreign currency exchange risks. An evaluation based on market values, is performed regularly. Any fair value hedge differences would be

recorded in the income statements. In the period under review, no hedging activities occurred. Santhera's primary exposure to financial risk is due to a fluctuation of exchange rates between EUR and CHF and to a lesser extent to the US Dollar (**USD**).

#### Credit risk

Santhera has no significant concentration of credit risk. It has policies in place to ensure that sales of products or partnerships are made to customers or with partners with an appropriate credit history.

#### Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and cash equivalents through equity financing. Currently there is no funding, with the exception of loans from the German tbg Technologiebeteiligungsgesellschaft, Bonn, Germany (**tbg**), an institution of the German Kreditanstalt für Wiederaufbau.

#### Interest rate risk

Santhera's income and operating cash flows may be influenced by changes in market interest rates. Therefore, Santhera is investing cash through money market instruments in line with its capital needs over time to avoid additional interest rate risks.

### 4 Critical Accounting Estimates and Assumptions

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires Executive Management to exercise its judgment in the process of applying Santhera's accounting policies. Santhera makes estimates and assumptions concerning the future. The resulting accounting will not necessarily equal the related actual results. The areas involving a higher degree of judgment or complexity or areas where assumptions and estimates are significant to the consolidated financial statements mainly are:

- Measurement and impairment testing of intangible assets
- Personnel expenses in accordance with IFRS 2, i.e. estimates regarding the valuation of employee stock options
- Revenue recognition
- Accruals
- Recognition of provisions

### 5 Exchange Rates of Principal Currencies

	Income statement in CHF average rates		Balance sheet in CHF year-end rates	
	2006	2005	2006	2005
1 EUR	1.5733	1.5484	1.6096	1.5585
1 USD	1.2536	1.2458	1.2197	1.3159

**6 Tangible Assets**

	in CHF thousands	Laboratory and office equipment	EDP	Leasehold improve- ments	2006
<b>Cost</b>					
At January 1, 2006		4,969	430	1,270	6,669
Additions		206	203	486	895
Disposals		-770	-188	0	-958
Exchange differences		74	5	41	120
<b>At December 31, 2006</b>		<b>4,479</b>	<b>450</b>	<b>1,797</b>	<b>6,726</b>
<b>Accumulated depreciation and impairment losses</b>					
At January 1, 2006		3,336	246	1,270	4,852
Additions		596	116	38	750
Impairment losses		0	0	0	0
Disposals		-719	-183	0	-902
Exchange differences		53	2	40	95
<b>At December 31, 2006</b>		<b>3,266</b>	<b>181</b>	<b>1,348</b>	<b>4,795</b>
<b>Net book value</b>		<b>1,213</b>	<b>269</b>	<b>449</b>	<b>1,931</b>
<b>Cost</b>					
	in CHF thousands	Laboratory and office equipment	EDP	Leasehold improve- ments	2005
At January 1, 2005		12,554	312	1,258	14,124
Additions		409	153	0	562
Disposals		-8,051	-38	0	-8,089
Exchange differences		57	3	12	72
<b>At December 31, 2005</b>		<b>4,969</b>	<b>430</b>	<b>1,270</b>	<b>6,669</b>
<b>Accumulated depreciation and impairment losses</b>					
At January 1, 2005		7,809	154	314	8,277
Additions		1,777	115	947	2,839
Impairment losses		0	0	0	0
Disposals		-6,287	-25	0	-6,312
Exchange differences		37	2	9	48
<b>At December 31, 2005</b>		<b>3,336</b>	<b>246</b>	<b>1,270</b>	<b>4,852</b>
<b>Net book value</b>		<b>1,633</b>	<b>184</b>	<b>0</b>	<b>1,817</b>

The insured value of tangible assets amounts to CHF 4.5 million as of December 31, 2006 (December 31, 2005: CHF 3.0 million).

**7 Intangible Assets**

	in CHF thousands	SNT-MC17	Capitalized development costs	Licenses	2006
<b>Cost</b>					
At January 1, 2006		27,775	3,764	441	31,980
Additions		91	0	204	295
Disposals		0	0	-222	-222
Exchange differences		899	0	10	909
<b>At December 31, 2006</b>		<b>28,765</b>	<b>3,764</b>	<b>433</b>	<b>32,962</b>
<b>Accumulated depreciation and impairment losses</b>					
At January 1, 2006		456	0	349	805
Additions		26	0	88	114
Impairment losses		0	0	0	0
Disposals		0	0	-212	-212
Exchange differences		5	0	8	13
<b>At December 31, 2006</b>		<b>487</b>	<b>0</b>	<b>233</b>	<b>720</b>
<b>Net book value</b>		<b>28,278</b>	<b>3,764</b>	<b>200</b>	<b>32,242</b>
<b>2005</b>					
	in CHF thousands	SNT-MC17	Capitalized development costs	Licenses	2005
<b>Cost</b>					
At January 1, 2005		27,520	0	1,073	28,593
Additions		0	3,764	2	3,766
Disposals		0	0	-640	-640
Exchange differences		255	0	6	261
<b>At December 31, 2005</b>		<b>27,775</b>	<b>3,764</b>	<b>441</b>	<b>31,980</b>
<b>Accumulated depreciation and impairment losses</b>					
At January 1, 2005		427	0	875	1,302
Additions		27	0	100	127
Impairment losses		0	0	0	0
Disposals		0	0	-631	-631
Exchange differences		1	0	5	6
<b>At December 31, 2005</b>		<b>455</b>	<b>0</b>	<b>349</b>	<b>804</b>
<b>Net book value</b>		<b>27,320</b>	<b>3,764</b>	<b>92</b>	<b>31,176</b>

In general and in accordance with the terms of IFRS, intangible assets with indefinite useful lives are capitalized at cost in the balance sheet and reviewed for impairment at least annually. This impairment test is performed at the same time every year. Additionally, these assets are reviewed in each reporting period to determine whether events and circumstances continue to support an indefinite useful life assessment. If they do not, the change in the useful life assessment from indefinite to finite is accounted for as a change in an accounting estimate for the respective asset. If they are finite, the useful life constitutes the duration over which the asset is amortized on a straight-line basis.

### SNT-MC17

SNT-MC17 is defined as the cash-generating unit and is tested for impairment annually. To determine the recoverable amount, a risk-adjusted net-present-value model was applied in the previous year. As from 2006, Santhera applies fair values, due to the following:

- The Group performed an initial public offering (**IPO**) in 2006. Consequently, fair values are since then available.
- Consistent with independent external sources available (e.g. analyst research reports), at least 80% of the technology value of Santhera can be allocated to SNT-MC17.

The basis for determining the fair value of SNT-MC17 is the technology value of Santhera, which equals its market capitalization less the consolidated cash position. The impairment test did not reveal a need for impairment.

Even though i) the development of the SNT-MC17 projects has shown very positive progress and ii) significant milestones could be reached from a regulatory and scientific point of view, an uncertainty remains as to whether a successful market registration will be achieved. Therefore, at the balance-sheet date a respective risk of causing a future material adjustment to the carrying amount of the SNT-MC17 project remains. Due to this current uncertainty and due to the fact that it is not yet possible to determine the effective life, SNT-MC17 is treated as an intangible asset with an indefinite useful life and measured at cost.

### Capitalized development costs

In 2006, Santhera's clinical development projects of SNT-MC17 were developed further successfully as SNT-MC17 entered a Phase III clinical program in the indication Friedreich's Ataxia (**FRDA**) and was diversified into clinical testing for two additional indications. This development supports the value of the intangible assets position in the balance sheet, and consequently no indication for impairment of the value of the intangible assets is given.

Due to the extension of indications in 2006, the inherent uncertainties increased as to whether all criteria for the capitalization of development costs are fully met. Consequently, Santhera undertook a risk reassessment with respect to the capitalization of development costs in 2006 and – based on the expanded experience in the development of SNT-MC17 – decided to tighten the accounting estimates for capitalization of development expenses.

Due to this change in accounting estimates and in accordance with IAS 8.32 et seqq., no such expenses have been capitalized in 2006 and will not be capitalized in the future. This change in accounting estimates led to profit and loss-relevant development expenses in the year 2006 of CHF 4.2 million compared with the CHF 3.8 million capitalized in the year 2005, resulting in a limited direct comparability of these expenses between the periods.

## 8 Trade and Other Receivables

	in CHF thousands	2006	2005
Public grants		0	625
Trade receivables		0	389
Other receivables		1,252	702
<b>Total at December 31</b>		<b>1,252</b>	<b>1,716</b>

## 9 Receivables from Shareholders

	in CHF thousands	2006	2005
Due from December 2005 financing round		0	12,425
<b>Total at December 31</b>		<b>0</b>	<b>12,425</b>

In December 2005, a capital increase of CHF 24,850,972 took place of which 50% was paid in until December 31, 2005. The remaining amount of CHF 12,425,486 was fully paid in by end of March 2006.

## 10 Cash and Cash Equivalents

	in CHF thousands	2006	2005
Cash at banks and on hand			
In EUR		5,661	9,636
In CHF		9,625	14,255
In USD		6	101
Short-term money market deposits			
In EUR		1,016	7,276
In CHF		109,308	0
In USD		46	0
<b>Total at December 31</b>		<b>125,662</b>	<b>31,268</b>

The weighted-average effective interest rate of the cash and cash equivalents was 2.16% in 2006 and 1.47% in 2005.

## 11 Share Capital

### Ordinary share capital

As of January 1, 2005, the share capital amounted to CHF 1,063,506 divided into 393,702 ordinary shares, 87,746 series A preference shares, 147,487 series A-I preference shares and 434,571 series B preference shares with a nominal value of CHF 1.00 each.

During 2005, the share capital was increased through the issuance of a total of 680,322 B preference shares with a nominal value of CHF 1.00 each. The other classes of shares remained unchanged. The capital increases were conducted in January 2005 (cash capital increase through issuance of 33,558 B preference shares), twice in June 2005 through a cash capital increase of the issuance of 97,445 B preference shares and through a capital increase via contribution in kind and subsequent issuance of 131,234 B preference shares, and in December 2005 (cash capital increase through the issuance of 418,085 B preference shares).

As at December 31, 2005, the share capital amounted to CHF 1,743,828, representing a total of 1,743,828 common shares divided into several different classes of shares consisting of 393,702 ordinary shares, 87,746 series A preference, 147,487 A-I preference and 1,114,893 B preference shares with a nominal value of CHF 1.00 each.

In December 2005, the Company issued warrants to be exercised into class B preference shares. These warrants were exercised in connection with the preparations for the listing on the SWX and the related share capital increase of CHF 32,562 was registered in the commercial register in October 2006.

Also in October 2006, in connection with an additional round of financing, the share capital was further increased by CHF 191,328 through the issuance of 191,328 series C preference shares.

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As a preparation for the listing on the SWX, the Company eliminated the different classes of shares from the articles of association by converting all preference shares into one class of common shares of CHF 1.00 each. The former preference rights were replaced by contractual preferences. In connection with the subsequent reallocation of Shares, the Company had to transfer the ownership of the treasury shares and consequently had to forfeit the former treasury shares in the amount of CHF 91,373. As of December 31, 2006, no more treasury shares were held.

On November 3, 2006, the Company's Shares were listed for trading on the SWX. All contractual preferences attached to the common shares were eliminated upon listing on the stock exchange.

In connection with the stock exchange listing on November 3, 2006, the Company issued 1,131,438 Shares through the IPO, increasing the share capital to CHF 3,099,156, consisting of 3,099,156 Shares without any contractual or other preferences.

#### **Authorized capital**

The Board is authorized, at any time until October 13, 2008, to increase the share capital in an amount not to exceed CHF 561,092 through the issuance of up to 561,092 registered Shares with a nominal value of CHF 1.00 each. An increase in partial amounts shall be permitted. The Board shall determine the issue price, the type of payment, the date of issue of new Shares, the conditions for the exercise of pre-emptive rights and the beginning date for dividend entitlement.

As per July 12, 2006, Santhera entered into a cooperation agreement with Oy Juvantia Pharma Ltd, Turku, Finland (**Juvantia**), for the clinical development of Juvantia's product candidate JP-1730 (INN: fipamezole) to generate additional clinical data required for commencement of pivotal clinical trials. At the same time Santhera and the Juvantia investors entered into an option agreement that effectively grants Santhera the right to purchase Juvantia. If Santhera exercises the option, it shall either issue 105,973 Shares to the Juvantia investors (the preferential subscription rights of the existing shareholders are excluded) or, if for any reason, such Shares shall not be issued, a cash payment of EUR 9.0 million shall be made to them. Based on the current agreements, the option cannot be exercised before July 1, 2008.

#### **Conditional capital**

As of December 31, 2006, the Company had a conditional capital, pursuant to which the share capital of the Company may be increased by:

- (i) a maximum amount of CHF 371,676 by issuing a maximum of up to 371,676 Shares, under the exclusion of shareholders' pre-emptive rights, for option rights being exercised under the EIP and ESOP 2004 (see note 18 "Stock Option Plans"); and

- (ii) a maximum amount of CHF 230,000 by issuing up to 230,000 Shares, through the exercise of warrants and/or notes granted in connection with bonds or similar debt instruments or options granted by the Company. Included in this amount are 9,818 warrants, issued to the Juvantia investors as a consideration for the grant of the above-mentioned option agreement (see "Authorized capital" on page 37).

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## 12 Long-term and Short-term Debt (From Related Parties)

Santhera Pharmaceuticals (Germany) GmbH has been granted loans from tbg. The outstanding loans have the following maturities:

	in CHF thousands	2006	2005
Within 1 year		485	790
1 year through 5 years		931	3,203
After 5 years		0	0
<b>Total loan amount at December 31</b>		<b>1,416</b>	<b>3,993</b>

In 2006, there was a payback in three installments in January, April and December totaling CHF 2,923,783. The difference between loan amount end of 2005, less repayments, and the amount at year end 2006 results from final remuneration of CHF 310,250, accrued interest payments of CHF 19,224 and currency differences of CHF 17,309. The interest expenses for the loans amounted to CHF 186,780 (CHF 250,852 in 2005). (See note 23 "Financial Income/Expenses" and note 26 "Related Party Transactions".) The transactions were executed in the normal course of business on an arm's-length basis.

## 13 Deferred Taxes

### Net deferred taxes recorded

	in CHF thousands	2006	2005
Temporary differences on development costs		28,278	28,765
Tax loss carryforwards		-28,278	-28,765
Other temporary differences		683	502
<b>Deferred tax liabilities recognized</b>		<b>683</b>	<b>502</b>
Tax loss carryforwards		121,628	83,295
Of which recorded		-28,278	-28,765
<b>Of which unrecorded</b>		<b>93,350</b>	<b>54,530</b>
Expiring			
2007		0	0
2008		0	0
2009		0	0
2010		0	0
2011		0	0
Thereafter		34,466	0
Without expiration		58,884	54,530
<b>Total unrecorded tax loss carryforwards</b>		<b>93,350</b>	<b>54,530</b>

Due to the uncertainty surrounding the future results of operations and the uncertainty as to whether Santhera can use the loss carryforwards for tax purposes, tax loss carryforwards were only considered to the extent that they offset taxable temporary differences within the same taxable entity.

#### 14 Accrued Expenses and Deferred Income

	in CHF thousands	2006	2005
<b>Long-term</b>			
Accrued Interest		0	601
Remaining restructuring expenses		0	343
Remaining MBO expenses		0	76
Other		0	48
<b>Total long-term</b>		<b>0</b>	<b>1,068</b>
<b>Short-term</b>			
Liabilities to employees and severance payments		1,684	1,189
Accrued interest, tax capital increase, VAT, withholding tax		504	330
Research and development		763	0
Remaining restructuring expenses		587	500
Remaining MBO expenses		0	151
Other		404	351
<b>Total short-term</b>		<b>3,942</b>	<b>2,521</b>
<b>Total at December 31</b>		<b>3,942</b>	<b>3,589</b>

#### 15 Short-term Provisions

	in CHF thousands	Personnel expenses	Various items	Total 2006	Total 2005
At January 1		157	432	589	0
Utilization		-154	-292	-446	0
Reversal		0	0	0	0
Additions		524	0	524	589
Exchange differences		13	0	13	0
<b>At December 31</b>		<b>540</b>	<b>140</b>	<b>680</b>	<b>589</b>

By the end of 2005 the Board decided to initiate a reorganization of the site in Heidelberg, Germany, and to consolidate all research and development activities in Liestal, Switzerland. Consequently, certain employees from Germany were laid off by the end of 2005 and beginning of 2006. Most of the restructuring activities were concluded in 2005, whereas some matters remain pending as per end of 2006. Furthermore, additional personnel-related liabilities occurred in 2006, leading to further additions.

#### 16 Contingent Assets

##### Collaboration with Takeda

In 2005, Takeda Pharmaceutical Company Ltd, Osaka, Japan (**Takeda**), and Santhera concluded a license agreement under which Santhera will conduct all clinical development work for regulatory approval of SNT-MC17 in the indication FRDA and licensed the exclusive marketing rights for the EU and Switzerland to Takeda. Santhera has received an up-front payment of EUR 5.0 million in 2005

and will receive further milestone payments in case of EMEA filing and transfer of the EMEA approval. In case of commercialization Santhera will supply the drug product in finished goods form to Takeda and will receive royalty payments on the sales of Takeda.

#### Collaboration with Biovitrum

In 2005, Biovitrum AB, Stockholm, Sweden (**Biovitrum**), and Santhera have concluded a license agreement that grants Biovitrum the exclusive worldwide rights to Santhera's DPP-IV inhibitor program to select and develop compounds and sell future drugs for a range of metabolic diseases (e.g. type 2 diabetes, obesity etc.). Santhera has received an up-front payment of EUR 3.0 million in 2005 as well as a staff funding of EUR 1.0 million. Further payments from Biovitrum will be due upon the achievement of certain milestones in clinical development. After market launch, Santhera will be entitled to royalty payments and/or will participate in proceeds Biovitrum might receive through the further partnering of a compound arising from this development program.

#### Option agreement with Prosidion

An option agreement has been finalized between Prosidion Ltd, Oxford, UK (**Prosidion**), and Santhera for MC<sub>4</sub>-Agonists, a "by-product" of the MC<sub>4</sub>-Receptor Antagonist program. If Prosidion exercises the option, the parties intend to enter into a license, development and commercialization agreement. In consideration of the grant to Prosidion of the option, Prosidion shall pay to Santhera an option fee of up to EUR 220,000. Santhera grants Prosidion the exclusive right to use selected Santhera compounds and information relating thereto for the purpose of conducting an evaluation. Depending on the results of the various evaluation steps and the respective delivery of compounds, Santhera will receive milestone payments. The option period was extended by mutual agreement until March 31, 2007.

## 17 Commitments and Contingent Liabilities

### Commitments

#### *Operating lease commitments*

Santhera has leasing contracts mainly for equipment used in its clinical trials and one vehicle. The future minimum lease payments under these noncancelable operating leases are as follows:

	in CHF thousands	2006	2005
Within 1 year		163	26
1 year through 5 years		80	25
After 5 years		0	0
<b>Total at December 31</b>		<b>243</b>	<b>51</b>

#### *Commitment for the rent of buildings*

Santhera has rental contracts for its facilities in Liestal, Switzerland, and Heidelberg, Germany. These contracts have fixed terms and will expire as of June 30, 2008, and June 30, 2007, respectively.

	in CHF thousands	2006	2005
Within 1 year		691	1,191
1 year through 5 years		53	517
After 5 years		0	0
<b>Total at December 31</b>		<b>744</b>	<b>1,708</b>

Santhera has subleasing contracts in Germany of which the future income sums up to CHF 0.3 million (2005: CHF 0.7 million).

### Contingent liabilities

#### *License agreement with Institut National de la Santé et de la Recherche Médicale*

Based on a license agreement between the former MyoContract and the Institut National de la Santé et de la Recherche Médicale, Paris, Santhera must make milestone payments of EUR 70,000 after the approval of the first Investigational New Drug (**IND**) and EUR 150,000 after the first New Drug Application (**NDA**) for SNT-MC17 in FRDA by the US Food and Drug Administration (**FDA**). In further consideration of the rights and licenses granted, Santhera has the obligation to pay a running royalty equal to 3% of net sales, not to exceed EUR 500,000 per year. In addition, Santhera has to pay 25% of nonroyalty sublicense income received.

#### *Collaboration and license agreement with Takeda*

The collaboration and license agreement with Takeda foresees a partial repayment of the before-mentioned up-front payment by Santhera in the case where Santhera does not obtain marketing approval for SNT-MC17 in FRDA in the amount of EUR 1.0 million.

#### *Contracts for clinical development*

Santhera has entered into contracts for clinical development with clinical research organizations (**CRO**). Santhera compensates the CROs for the services provided on a monthly basis. It has the right to terminate the agreements at any time at its sole discretion. In case of early termination Santhera must pay for all cost, incurred by the respective counterparty. The payments for these contracts have not been provided for and are as follows:

	in CHF thousands	2006	2005
Within 1 year		3,545	1,899
1 year through 5 years		779	1,101
After 5 years		0	0
<b>Total minimum commitment obligations</b>		<b>4,324</b>	<b>3,000</b>
Interest		-195	-156
<b>Present value of minimum commitment obligations</b>		<b>4,129</b>	<b>2,844</b>

### 18 Stock Option Plans

Santhera has established stock option plans to align the long-term interests of executives, directors, employees and consultants; independent directors, employees and certain consultants are eligible to participate in the stock option plan. Options granted under the stock option plans are only equity settled.

#### **Executive Incentive Plan**

Under the Executive Incentive Plan 2006 (**EIP**), the members of the Executive Management have been granted stock options to acquire 101,065 shares, as a management incentive. Each of these stock options entitles its holder to purchase one share at an exercise price of CHF 1.00. The vesting period of the options is one year. At the end of the option term, i.e. after a period of 10 years as from the grant day, all unexercised stock options shall expire without value. The plan contains provisions in respect of adjustment or cancellation of options upon termination of employment, disloyalty, severe breach of duties, retirement, death, disability and certain corporate transactions. The EIP is administered under the responsibility of the Board.

### Options outstanding, vested, exercisable under the EIP

All options under the EIP were granted to the four members of the Executive Management as of November 8, 2006, and have a vesting period of 12 months, i.e. cannot be exercised during this period (see note 26 "Related Party Transactions").

No options under the EIP were exercised, cancelled, bought back or forfeited by December 31, 2006.

### Employee Stock Option Plan

The Company has adopted an employee stock option plan (**ESOP 2004**) to provide incentives to directors, executives, employees and consultants (including scientific advisors of Santhera) and help to ensure their commitment to Santhera over the longterm. Grants of stock options under the ESOP 2004 are made from time to time at the discretion of the Board (or as contractually agreed with senior employees) based on a proposal of the nomination and compensation committee. Each stock option entitles its holder to purchase one Share of the Company at an exercise price determined by the Board on the date of grant of the stock options. In general, 50% of the stock options shall vest on the second anniversary, 25% on the third anniversary and the remaining 25% on the fourth anniversary of the grant date.

### Options outstanding, vested, exercisable under the ESOP 2004

As of December 31, 2006, 77,699 stock options are vested, but are not exercisable during the lock-up period applicable to the shareholders who were invested in the Company prior to its IPO. The ESOP 2004 contains customary provisions in respect of the adjustment or cancellation of stock options upon termination of employment, retirement, death, disability, certain corporate transactions, and events or changes in the Company's shareholder base. The ESOP 2004 is administered under the responsibility of the Board. The exercise price is determined by the Board. As a rule, subject to exceptions, going forward, the Board intends to set the exercise price of options granted at the weighted-average share price in the calendar quarter preceding the grant date.

As of December 31, 2006, the Company has not issued shares upon the exercise of stock options by directors, executives, employees or consultants. The Company had a total of 206,977 stock options outstanding (including 30,939 stock options that have contractually been granted as per January 1, 2007), but excluding 101,065 stock options that have been granted under the EIP out of conditional capital of 371,676.

### Fair value calculations for stock options granted under the ESOP 2004 and the EIP

The fair value of stock options is determined at each grant date by using the Hull-White option pricing model. The calculation of the option value was performed by applying the following parameters:

	2006	2005
Market price of stock	CHF 59.44 – 90.00	CHF 59.44
Exercise prices	CHF 1.00 – 82.58	CHF 59.44
Expected volatility	40.00%	40.00%
CHF risk-free interest rate	2.35 – 3.10% p.a.	2.50% p.a.
Option term	10 years	10 years
Expected dividend yield	0.00%	0.00%

The expected volatility was determined on the basis of the historical volatility of relevant equity indices and implied volatilities of warrants on shares of selected biotechnology companies. The weighted-average fair value of the stock options granted during the reporting period is CHF 69.65.

**Options granted, exercised, cancelled, forfeited and outstanding under the ESOP 2004<sup>1)</sup>:**

	2006 Number of options	2005 Number of options
<b>Outstanding at the beginning of the year</b>	<b>128,768</b>	<b>117,485</b>
Granted during the period	50,000	11,339
Forfeited during the period	-4,447	-56
Exercised during the period	-	-
Expired during the period	-	-
Bought back during the period	-649	-
<b>Granted at the end of the year</b>	<b>173,672</b>	<b>128,768</b>
Promised at the end of the year	30,939 <sup>2)</sup>	-

1) This table does not include 101,065 stock options granted under the EIP in November 2006.

2) Options were contractually granted under the terms and conditions of the ESOP 2004 to be allocated with a delayed grant date as of January 1, 2007.

The options granted are recognized as personnel expenses over their vesting period. In 2006, option grants resulted in personnel expenses of CHF 2,566,329 (CHF 808,048 related to research and development expenses and CHF 1,758,281 to general and administrative expenses), and in 2005 such grants resulted in personnel expenses of CHF 1,008,392 (CHF 495,983 related to research and development expenses and CHF 512,409 related to general and administrative expenses).

**Terms of options outstanding at December 31, 2006**

Exercise price for options (CHF)	Number outstanding	Weighted-average remaining contractual life (years)	Number exercisable <sup>1)</sup>
1.00	132,580	9.00	-
59.44	124,553	8.12	-
60.25	11,304	6.95	-
82.58	6,300	9.76	-

1) As of December 31, 2006, no stock options were exercisable. Vested and unvested stock options will remain unexercisable during the term of the lock-up period that is applicable to the pre-IPO shareholders, ending on November 2, 2007.

**19 Information by Geographical Area**

Santhera has only one business segment, namely the discovery, development and commercialization of small-molecule pharmaceutical products for the treatment of severe neuromuscular diseases. The geographical analysis of income is as follows:

	in CHF thousands	2006	2005
EU and Switzerland		781	6,909
Asia		0	7,785
Other		0	384
<b>Total income</b>		<b>781</b>	<b>15,078</b>

The geographical analysis of assets is as follows:

	in CHF thousands	2006	2005
EU and Switzerland		162,394	78,712
Asia		0	0
Other		0	0
<b>Total assets</b>		<b>162,394</b>	<b>78,712</b>

The geographical analysis of capital expenditure is as follows:

	in CHF thousands	2006	2005
EU and Switzerland		1,190	4,328
Asia		0	0
Other		0	0
<b>Total capital expenditures</b>		<b>1,190</b>	<b>4,328</b>

## 20 Operating Expenses by Function

	in CHF thousands	2006	2005
Research (preclinical)		-7,372	-10,040
Development		-10,613	-4,502
<b>Total research and development expenses</b>		<b>-17,985</b>	<b>-14,542</b>
Marketing and sales		-323	-863
Business development and licensing		-1,808	-473
Finance and administration		-9,410	-4,676
Expenses related to IPO/equity financing <sup>1)</sup>		-511	0
<b>Total general and administrative expenses</b>		<b>-12,052</b>	<b>-6,012</b>
Expenses from MBO		0	-2,628
Expenses from restructuring		0	-2,363
Other operating income/expenses		617	272
<b>Total other operating income/expenses</b>		<b>617</b>	<b>-4,719</b>
<b>Total operating expenses</b>		<b>-29,420</b>	<b>-25,273</b>

1) Expenses related to IPO/equity financing which cannot be considered as directly attributable transaction costs according to IAS 32.37.

The operating expenses of CHF 4,990,901 (EUR 3,223,222) in 2005 consisted of the management buyout (**MBO**) of the Graffinity discovery technology business and the subsequent restructuring of Santhera Pharmaceuticals (Germany) GmbH.

### Government grants

In 2006, Santhera received no government grants. In 2005 government grants amounted to CHF 1,294,859 reflected in the income statement as a reduction of research and development expenses.

## 21 Operating Expenses by Nature

	in CHF thousands	2006	2005
Other operating income		617	368
External research and development costs		-11,018	-7,092
Patents and licenses		-148	-301
Employee costs		-12,900	-9,371
General and administrative expenses		-5,107	-1,963
Depreciation		-864	-1,827
MBO expenses		0	-2,628
Restructuring expenses		0	-2,363
Other operating expenses		0	-96
<b>Total operating expenses</b>		<b>-29,420</b>	<b>-25,273</b>

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## 22 Personnel Expenses and Benefits

### Personnel expenses

	in CHF thousands	2006	2005
Wages and salaries		-7,708	-7,308
Social security and other benefit costs		-2,626	-1,055
Employee stock options		-2,566	-1,008
<b>Total employee costs</b>		<b>-12,900</b>	<b>-9,371</b>
<b>Average number of fulltime employees</b>		<b>50</b>	<b>66</b>
<b>Fulltime employees at year-end</b>		<b>53</b>	<b>67</b>

### Termination benefits

In the course of the restructuring of the activities of Santhera in Germany termination benefits over CHF 47,986 were paid in 2006 (2005: CHF 290,651).

Since July 1, 2006, there are no longer any employees at the German subsidiary, and therefore no further such termination benefits will be payable in the foreseeable future.

### Pension plan

In accordance with the mandatory pension fund law, all Swiss employees of Santhera Pharmaceuticals (Switzerland) AG and Santhera Pharmaceuticals Holding AG are affiliated with the collective pension foundation "Vita" of Zurich Financial Services. Whereas the risks of death and disability are fully reinsured by the insurance company, the savings plan must be qualified as a defined benefit plan.

As of December 31, 2006, and for the period 2006, an independent actuary has performed the respective calculations as required by IAS 19:

*Changes in obligations*

	in CHF thousands	Jan 1 to Dec 31, 2006
<b>Present value of obligation, beginning of period</b>		<b>3,051</b>
Current employer service cost		391
Interest cost		93
Employee contributions		392
Benefits paid		100
Insurance premiums		-256
Actuarial (gain) loss on obligation (balancing figure)		197
<b>Present value of obligation, end of period</b>		<b>3,968</b>

*Changes in assets*

	in CHF thousands	Jan 1 to Dec 31, 2006
<b>Fair value of assets, beginning of period</b>		<b>2,862</b>
Expected return on assets		110
Employer contributions		419
Employee contributions		392
Benefits paid		100
Insurance premiums		-256
Gain (loss) on assets (balancing figure)		-21
<b>Present value of obligation, end of period</b>		<b>3,606</b>

*Amounts recognized in the income statement*

	in CHF thousands	Jan 1 to Dec 31, 2006
Current employer service cost		391
Interest cost		93
Expected return on plan assets		-110
Recognition of actuarial (gain) loss		0
<b>Company's net periodic pension cost</b>		<b>374</b>

*Amounts recognized in balance sheet*

	in CHF thousands	Dec 31, 2006
Present value of obligations		3,968
Fair value of plan assets		-3,606
<b>Present value of net obligation (asset)</b>		<b>362</b>
Unrecognized actuarial (loss) gain		-218
<b>Defined benefit obligation (asset) recognized in the balance sheet</b>		<b>144</b>

*Development of net obligation (asset)*

	in CHF thousands	Jan 1 to Dec 31, 2006
Net pension liability beginning of period		189
Company's net periodic pension cost		374
Employer contributions		-419
<b>Net pension liability end of period</b>		<b>144</b>

The expected contributions for fiscal year 2007 amount to ca. CHF 491,000.

*History of experience gains and losses*

	in CHF thousands	Jan 1 to Dec 31, 2006
Actual return on assets		89
Difference between the expected and actual return on assets		21
Experience losses (gains) on plan liabilities (amount)		139

*Plan assets*

	in %	Allocation	Dec 31, 2006 expected return
Equity securities		15.0	6.50
Debt securities		54.0	2.50
Real estate		10.0	4.50
Other		21.0	3.25
<b>Total</b>		<b>100.0</b>	<b>3.46</b>

There are no assets invested in Shares of Santhera.

*The principal actuarial assumptions used to calculate the net liability and net periodic pension cost were as follows:*

	2006
Discount rate	2.80%
Expected return on plan assets	3.50%
Expected future salary increases	1.50%
Expected future pension increases	0.25%

**23 Financial Income/Expenses**

Financial income of CHF 1,198,618 (2005: CHF 238,429) results from interests received from cash at banks, from money market deposits as well as from unrealized foreign-exchange gains. Financial expenses of CHF 637,341 (2005: CHF 1,105,788) result mainly from interest payments for loans and from unrealized foreign-exchange losses (*see also note 12 "Long-term and Short-term Debt" and note 26 "Related Party Transactions"*).

In 2005, Santhera issued warrants to be exercised into class B preference shares. These warrants were exercised in connection with the listing on the SWX. In 2005, the valuation of the warrants amounted to CHF 743,478 and was charged against financial expenses.

In 2006, the net financial result added up to CHF 561,277 (CHF -867,360 in 2005).

## 24 Income Taxes

	in CHF thousands	2006	2005
Current income tax expense		0	0
Deferred tax income/expense		181	-748
<b>Total</b>		<b>181</b>	<b>-748</b>

The following is a theoretical reconciliation of the income taxes calculated at the domestic tax rate to the effective income tax expense:

	in CHF thousands	2006	2005
Result before taxes		-28,077	-12,384
Tax income of applicable tax rate of 26.2% (prior year: 28.2%)		7,356	3,492
Unrecognized deferred taxes on tax loss carryforwards		7,175	4,240
Effective tax expense		-181	748
Effective tax rate		0.6%	-6.1%

According to currently applicable Swiss tax law, the period to offset tax loss carryforwards against taxable profit is limited to seven years. According to currently applicable German tax law, tax loss carryforwards can, besides other conditions, be offset against taxable profit for an unlimited period but only to an amount of EUR 1.0 million and in addition for 60% of further amounts beyond this threshold per annum.

## 25 Earnings per Share

Basic earnings/(loss) per share is calculated by dividing the net profit/(net loss) attributable to equity holders by the weighted average number of ordinary shares issued and outstanding during the reporting period, excluding shares held as treasury shares.

	2006	2005
Net loss attributable to equity holders (CHF)	-28,259,064	-11,635,706
Weighted average number of shares issued and outstanding	1,956,853	1,235,873
<b>Basic and diluted loss per Share (CHF)</b>	<b>-14.44</b>	<b>-9.41</b>

For the years ended December 31, 2006 and 2005, loss per basic and diluted shares is based on the weighted average number of Shares outstanding and excludes Shares to be issued upon the future exercise of employee stock options or warrants, as they would be anti-dilutive. In case Santhera shows a profit in the future, options have a dilutive effect on the net profit per Share.

## 26 Related Party Transactions

### Board of Directors and Executive Management compensation

#### Total compensation of Board of Directors and Executive Management

	in CHF thousands	2006	2005
Short-term benefits: wages and salaries/board compensation		1,993	1,404
Post-employment benefits		0	0
Other long-term benefits		0	0
Termination benefits		15	0
Share-based payment (fair value acc. to IFRS 2) <sup>1)</sup>		2,040	581

1) Fair values consist of option grants from 2006 and 2005, respectively, as well as option grants from earlier years whose vesting periods include the reporting periods. Employee stock options are expensed over their vesting periods in accordance with IFRS 2, and the fair values included in above table are comparable to the disclosed fair values of issued stock options as accounted for in the consolidated equity statement.

*Executive Management compensation*

	2006	2005
Wages and salaries (in CHF thousands)	1,867	1,340
Stock options (number)	101,065	11,339

The highest remuneration for the years 2005 and 2006 was paid to Klaus Schollmeier, CEO. In 2006, he received a gross monetary compensation of CHF 673,125, and under the EIP he was granted 32,845 stock options. Mr Schollmeier received a gross monetary compensation of CHF 530,000 and was granted no stock options in 2005.

*Board of Directors compensation*

	2006	2005
Compensation (in CHF thousands)	126	64
Termination benefits (in CHF thousands)	15	0
Stock options (number)	18,000	0

In 2006, the highest compensation to a member of the Board was paid to Bernd R Seizinger. Mr Seizinger received payment of CHF 33,511 and 4,000 stock options.

*Transactions with members of the Board and Executive Management*

There are no loans outstanding or guarantee commitments granted to members of the Board and Executive Management. There are no interests of any member of the Board or the Executive Management in transactions effected by Santhera.

In May 2006, the Company renewed a consultancy agreement with Timothy J Rink, member of the Board, whereby Mr Rink has agreed to render independent advisory and consulting services to the Company and to serve as a member of the Scientific Advisory Board (**SAB**). As remuneration, Mr Rink is entitled to a flat consulting fee of EUR 20,000 per year. The consultancy agreement can be terminated by either party upon one month's prior written notice without cause. The agreement with Mr Rink is a transaction at arm's length.

*Shareholdings of members of the Board and Executive Management*

The total number of options held by the Executive Management amounted to 180,453 as of December 31, 2006 (79,388 as of year-end 2005). For accounting purposes, IFRS 2 rules were applied for share-based compensation through grants of stock options.

An additional 29,339 stock options have contractually been granted to two members of the Executive Management as of January 1, 2007 (see note 18 "Stock Option Plans"). The members of the Executive Management do not hold any Shares.

The total number of options held by the members of the Board amounted to 16,774 as of December 31, 2006 (774 as of year-end 2005). For accounting purposes, IFRS 2 rules were applied for share-based compensation through grants of stock options. By the end of 2006, the members of the Board held 1,230 Shares.

The table below sets forth the number of stock options individually held or controlled by members of the Board and members the Executive Management.

Name	Total number of stock options
Michael Lytton, Chairman	0
Hans Peter Hasler, Vice Chairman	4,000
Martin Gertsch	4,000
Rudolf Gygax	774
Georg Nebgen	0
Timothy J Rink	4,000
Bernd R Seizinger	4,000
Klaus Schollmeier, Chief Executive Officer	66,368
Barbara Heller, Chief Financial Officer	34,079
Helmut Kessmann, Chief Business Officer	40,414
Thomas Meier, Chief Scientific Officer	39,592

The stock options all have a term of 10 years after grant. One option gives the right to be exercised into one registered share of the Company. In 2006, no stock options were exercised by members of the Board, former members of the Board or members of the Executive Management.

One former member of the Board holds 537 Shares and 3,594 stock options.

The tables below show the total number of options granted to the members of the Board in the three preceding years and the respective exercise prices.

Year of grant	Total number of options	Exercise prices in CHF
2004	774	1.00
2006	14,000	59.44
2006	4,000	82.58

The tables below show the total number of options granted to the members of the Executive Management in the three preceding years and the respective exercise prices.

Year of grant	Total number of options	Exercise prices in CHF
2004	1,155	1.00
2004	26,288	59.44
2004	4,474	60.25
2005	11,339	59.44
2006	101,065	1.00

**tbg loans**

Before the listing on the SWX, tbg was a shareholder of the Company. In accordance with the former shareholder's agreement and in connection with the listing of the Shares on the SWX, the former various classes of preference shares were replaced with a single share structure. As a consequence of the subsequent reallocation of shares, tbg had to transfer the ownership of these shares and is no longer a shareholder since November 8, 2006.

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**Transactions with associates***Management buyout of the drug discovery technology business*

As per the year-end 2005, Santhera Pharmaceuticals (Germany) GmbH sold the assets related to its drug discovery technology business in an MBO to Graffinity Pharmaceuticals GmbH, a company owned by former Santhera employees for a price of up to EUR 1.5 million to be paid by Graffinity Pharmaceuticals GmbH in the future depending on its profits.

**27 Events After the Balance-Sheet Date**

No events have been identified after the balance-sheet date that qualify in accordance with IAS 10 either as adjusting or material non-adjusting events that need to be disclosed.



## Report of the Group Auditors

### To the Annual Shareholders' Meeting of Santhera Pharmaceuticals Holding AG, Liestal

Basel, March 1, 2007

As group auditors, we have audited the consolidated financial statements (balance sheet, income statement, cash flow statement, statement of changes in equity and notes, pages 18 – 51) of Santhera Pharmaceuticals Holding AG for the year ended December 31, 2006.

These consolidated financial statements are the responsibility of the Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with Swiss Auditing Standards and with the International Standards on Auditing (ISA), which require that an audit be planned and performed to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the consolidated financial statements. We have also assessed the accounting principles used, significant estimates made and the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the financial position, the results of operations and the cash flows in accordance with International Financial Reporting Standards (IFRS) and comply with Swiss law.

We recommend that the consolidated financial statements submitted to you be approved.

Without qualifying our opinion, we refer to note 7, which describes material uncertainties regarding the valuation of the related intangible assets, which is characteristic for a biotech company at this stage of development.

Ernst & Young Ltd

Jürg Zürcher  
Swiss Certified Accountant  
(in charge of the audit)

Markus B Blaser  
Swiss Certified Accountant

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## Balance Sheets of Santhera Pharmaceuticals Holding AG

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	in CHF thousands	Dec 31, 2006	Dec 31, 2005
<b>Assets</b>			
Tangible assets		48	49
Intangible assets		145	0
Investments in group companies		7,095	8,671
Loans to group companies		24,409	586
Treasury shares		0	91
<b>Noncurrent assets</b>		<b>31,697</b>	<b>9,397</b>
Prepaid expenses and accrued income		501	8
Other receivables from group companies		345	2,313
Other receivables from third parties		576	127
Other receivables from shareholders		0	12,425
Cash and cash equivalents		120,703	21,274
<b>Current assets</b>		<b>122,125</b>	<b>36,147</b>
<b>Total assets</b>		<b>153,822</b>	<b>45,544</b>
<b>Equity and Liabilities</b>			
Share capital		3,099	1,744
Capital reserves and share premium		119,089	65,960
Reserves for treasury shares		0	91
Free reserves		41,491	0
Accumulated loss		-12,836	-23,681
– Loss carried forward		0	-21,924
– Net loss for the period		-12,836	-1,756
<b>Total equity</b>		<b>150,843</b>	<b>44,114</b>
Trade accounts payable from group companies		63	417
Trade accounts payable from third parties		1,616	189
Other accounts payable from third parties		116	115
Accrued expenses and deferred income		1,184	709
<b>Total current liabilities</b>		<b>2,979</b>	<b>1,430</b>
<b>Total liabilities</b>		<b>2,979</b>	<b>1,430</b>
<b>Total equity and liabilities</b>		<b>153,822</b>	<b>45,544</b>

## Income Statements of Santhera Pharmaceuticals Holding AG

	For the year ended December 31, in CHF thousands	
	2006	2005
Operating income from group companies	3,815	2,244
<b>Total operating income</b>	<b>3,815</b>	<b>2,244</b>
General and administrative expenses	-13,212	-1,925
Employee costs	-2,649	-1,754
Depreciation and amortization	-30	-13
Allowance on investment and intercompany loans	-1,667	-2,063
Other operating result	7	9
<b>Total operating expenses</b>	<b>-17,551</b>	<b>-5,746</b>
<b>Operating result (EBIT)</b>	<b>-13,736</b>	<b>-3,502</b>
<b>Reversal on allowance on investments</b>	<b>0</b>	<b>1,721</b>
Financial income	916	34
Financial expenses	-16	-9
<b>Financial result</b>	<b>900</b>	<b>25</b>
<b>Result before taxes</b>	<b>-12,836</b>	<b>-1,756</b>
Income tax expenses	0	0
<b>Net loss</b>	<b>-12,836</b>	<b>-1,756</b>

## Notes to the Statutory Financial Statements

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### Introduction

The financial statements of Santhera Pharmaceuticals Holding AG (**Company**) have been prepared in accordance with the requirements of the Swiss Code of Obligations.

### Investments/Subsidiaries

Santhera Pharmaceuticals Holding AG has the following subsidiaries:

	Share capital at December 31	2006	2005
<b>Santhera Pharmaceuticals (Germany) GmbH</b>			
Heidelberg, Germany	EUR	668,930	668,921
<b>Santhera Pharmaceuticals (Switzerland) AG</b>			
Liestal, Switzerland	CHF	125,000	125,000

Both companies are 100% controlled by Santhera Pharmaceuticals Holding AG.

### Guarantees

#### Santhera Pharmaceuticals (Germany) GmbH/tbg

The Company granted tbg Technologiebeteiligungsgesellschaft, Bonn, Germany (**tbg**), an unconditional and irrevocable guarantee for the loans including accrued interest provided to Santhera Pharmaceuticals (Germany) GmbH. As of December 31, 2006, the loans outstanding and the respective guarantee amounted to CHF 1,501,303.

#### Joint security to Key Equipment Finance International Inc.

The Company provided Key Equipment Finance International Inc., Darmstadt, Germany, with an unconditional and irrevocable joint security for equipment leased on behalf of its subsidiary Santhera Pharmaceuticals (Switzerland) AG. As of December 31, 2006, the remaining outstanding amount was CHF 217,875.

#### Swiss VAT authorities

The Company is part of the value-added tax group of the Swiss affiliated companies of Santhera Pharmaceuticals and is therefore jointly and severally liable to the Swiss federal tax administration for their value-added tax liabilities.

### Dividends

In 2006, Santhera Pharmaceuticals Holding AG had no intercompany dividend income and does not plan to pay any dividends to its shareholders for the foreseeable future.

### Share Capital

During 2006, the share capital was increased by the amount of CHF 1,355,328 to an amount of CHF 3,099,156 as of December 31, 2006 (CHF 1,743,828 as of year-end 2005).

### Authorized Share Capital

The Board of Directors (**Board**) is authorized, at any time until October 13, 2008, to increase the share capital in an amount not to exceed CHF 561,092 through the issuance of up to 561,092 fully paid in registered shares (**Shares**) with a nominal value of CHF 1.00 each. An increase in partial amounts shall be permitted. The Board shall determine the issue price, the type of payment, the date of issue of new Shares, the conditions for the exercise of pre-emptive rights and the beginning date for dividend entitlement.

As per July 12, 2006, Santhera entered into a cooperation agreement with Oy Juvantia Pharma Ltd, Turku, Finland (**Juvantia**), for the clinical development of Juvantia's product candidate JP-1730 (INN: fipamezole) to generate additional clinical data required for commencement of pivotal clinical trials. At the same time Santhera and the Juvantia investors entered into an option agreement that effectively grants Santhera the right to purchase Juvantia. If Santhera exercises the option, it shall either issue 105,973 Shares to the Juvantia investors (the preferential subscription rights of the existing shareholders are excluded), or if for any reason such Shares shall not be issued, a cash payment of EUR 9.0 million shall be made to them. Based on the current development plan it has been agreed that the option will not be exercised before July 1, 2008.

### Conditional Capital

As of December 31, 2006, the Company had a conditional capital, pursuant to which the share capital of the Company may be increased by:

- (i) a maximum amount of CHF 371,676 by issuing a maximum of up to 371,676 Shares, under the exclusion of shareholders' pre-emptive rights, for option rights being exercised under the EIP and ESOP 2004; and
- (ii) a maximum amount of CHF 230,000 by issuing up to 230,000 Shares, through the exercise of warrants and/or notes granted in connection with bonds or similar debt instruments or options granted by the Company. Included in this amount are 9,818 warrants, issued to the Juvantia investors as a consideration for the grant of the above-mentioned option agreement (see "Authorized capital").

### Treasury shares

	Number of shares	in CHF thousands
<b>At January 1, 2006</b>	2,015	91
Change	-2,015	-91
<b>At December 31, 2006</b>	<b>0</b>	<b>0</b>

In connection with the listing of the Shares on the SWX Swiss Exchange, the former various classes of preference shares were replaced with a single share structure. With the subsequent reallocation of shares, the Company had to transfer the ownership of the treasury shares and consequently had to forfeit the former treasury shares. As of December 31, 2006, no further treasury shares were held.

**Additional Information**

	in CHF thousands	2006	2005
Other receivables from shareholders			
– 50% of capital increase of December 2005		0	12,425
Lease commitments not recorded in the balance sheet			
– Operational lease		18	23
Property insurance value of buildings and equipment			
– Equipment and furniture		250	250
Liabilities to pension funds/social insurance		5	36
Subordinated loans to group companies		24,409	0

Subordinated loans to group companies consist of loans to Santhera Pharmaceuticals (Switzerland) AG. As of December 31, 2006, the financial statements of this company disclose an overindebtedness of CHF 20,859,954. The recoverability of the loans to Santhera Pharmaceuticals (Switzerland) AG is ensured by the fair value of the counterparty, whose accounts are kept on a going-concern basis. The fair value of Santhera Pharmaceuticals (Switzerland) AG depends on the future market success of the developed products. Even though the development of these products has shown very positive progress, an uncertainty remains as to whether a successful market launch of the products in development can be achieved.

The decrease in book value of investments results from continued losses at Santhera Pharmaceuticals (Germany) GmbH.

As the format of the income statement was adjusted in 2006, some parts of the financial statement as per December 31, 2006, are not comparable with the previous year.

The Finnish Funding Agency for Technology and Innovation (**Tekes**) originally funded Juvantia with an amount of EUR 4,674,686 for its research and development work with regard to JP-1730. As of December 31, 2006, the loan amounted to EUR 5,342,384 including capitalized interest of 3% p.a. In connection with the potential acquisition of Juvantia by Santhera, Tekes has agreed to restructure those loans as follows: Juvantia will repay Tekes an amount of EUR 500,000 upon exercise of the option by Santhera and subsequent closing of the acquisition. The remaining amount will be payable in two installments plus accrued interest of 3% p.a. at each of a) 90 days from receipt of product marketing approval and b) the first anniversary of such marketing approval at the latest. Santhera will have to provide Tekes with a guarantee for such re-payments, subject to the closing of the acquisition.

**Significant Shareholders (>5%)**

Shareholder's name	Country	Total number of shares	%
NGN	US/DE	379,102	12.23
Merlin	UK	239,592	7.73
Oxford Bioscience Partner	US	220,090	7.10
3i	UK	213,278	6.88
Cominvest	DE	178,000	5.74
Deka	DE	177,500	5.73
GIMV	BE	156,192	5.04

## Proposal of the Board of Directors to the Annual Shareholders' Meeting

### Proposal of the Board of Directors for the Appropriation of Available Earnings, Subject to the Approval of the Annual Shareholders' Meeting

	in CHF	2006	2005
Loss carried forward		0	-21,924,260
Net loss of the year		-12,836,478	-1,756,310
<b>Accumulated loss</b>		<b>-12,836,478</b>	<b>-23,680,570</b>
Compensation with capital reserves and share premium		12,836,478	23,680,570
<b>To be carried forward</b>		<b>0</b>	<b>0</b>

### The Board of Directors Requests the Approval of the Annual Shareholders' Meeting for the Following Release and Transfer from Capital Reserves and Share Premium:

	in CHF
Capital reserves and share premium at December 31, 2006	119,088,589
Compensation with capital reserves and share premium	-12,836,478
Subtotal	106,252,111
Transfer from capital reserves and share premium to free reserves	-104,508,627
<b>Net capital reserves and share premium</b>	<b>1,743,484</b>

No further appropriations to the legal reserves are necessary which already amount to the required 20% of the share capital.

### Subject to approval by the Annual Shareholders' Meeting, the Free Reserves Develop as Follows:

	in CHF
Free reserves at December 31, 2006	41,491,373
Transfer from capital reserves and share premium to free reserves	104,508,627
<b>Free reserves</b>	<b>146,000,000</b>



## Report of the Statutory Auditors

### To the Annual Shareholders' Meeting of Santhera Pharmaceuticals Holding AG, Liestal

Basel, March 1, 2007

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As statutory auditors, we have audited the accounting records and the financial statements (balance sheet, income statement and notes, pages 56 to 62) of Santhera Pharmaceuticals Holding AG for the year ended December 31, 2006.

These financial statements are the responsibility of the Board of Directors. Our responsibility is to express an opinion on these financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with Swiss Auditing Standards, which require that an audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the financial statements. We have also assessed the accounting principles used, significant estimates made and the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accounting records and financial statements and the proposed appropriation of available earnings and utilization of reserves comply with Swiss law and the Company's articles of incorporation.

We recommend that the financial statements submitted to you be approved.

Without qualifying our opinion, we refer to the additional information in the notes according to which loans to an overindebted subsidiary have been assessed as recoverable by the management and the Board of Directors based on business plans and expected future cash flows. Even though the development of the products has shown a favorable trend, a material uncertainty remains as to whether a successful market launch of the products in development will attain the expected results.

Ernst & Young Ltd

Jürg Zürcher  
Swiss Certified Accountant  
(in charge of the audit)

Markus B Blaser  
Swiss Certified Accountant

**Forward-looking Statements**

This annual report expressly or implicitly contains certain forward-looking statements concerning Santhera Pharmaceuticals Holding AG and its business. Such statements involve certain known and unknown risks, uncertainties and other factors, which could cause the actual results, financial condition, performance or achievements of Santhera Pharmaceuticals Holding AG to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. There can be no guarantee that any of the development projects described will succeed or that any new products or indications will be brought to market. Similarly, there can be no guarantee that Santhera Pharmaceuticals Holding AG or any future product or indication will achieve any particular level of revenue. In particular, management's expectations could be affected by, among other things, uncertainties involved in the development of new pharmaceutical products, including unexpected clinical trial results; unexpected regulatory actions or delays or government regulation generally; the Company's ability to obtain or maintain patent or other proprietary intellectual property protection; competition in general; government, industry, and general public pricing and other political pressures. Santhera Pharmaceuticals Holding AG is providing the information in this annual report as of the date of the publication, and does not undertake any obligation to update any forward-looking statements contained herein as a result of new information, future events or otherwise.

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