

2007

Financial Report  
Corporate Governance

Preliminary Issue  
as of February 29, 2008



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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 (**Organizational Rules**), 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 a Code of Conduct and insider trading rules that require a trading preclearance for all directors, officers and employees, as well as an internal control system, and a risk management process.

The information published further below conforms to the Corporate Governance Directive (**DCG**) of the SWX Swiss Exchange (**SWX**). In order to avoid redundancies, references are inserted to other parts of the financial report and links to Santhera's website [www.santhera.com](http://www.santhera.com) 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 265 million (December 31, 2007)
Website	<a href="http://www.santhera.com">www.santhera.com</a>
Commercial register	<a href="http://www.hrabl.ch">www.hrabl.ch</a>
Duration of company	Not limited
Subsidiaries	See note "Investments/Subsidiaries" to the statutory financial statements of the Company on page 58 (DCG 1.1.3).

Santhera operates through its wholly owned subsidiaries, Santhera Pharmaceuticals (Schweiz) AG and Santhera Pharmaceuticals (Deutschland) GmbH, in a single business segment, which is research and development (**R&D**) of pharmaceutical drugs. Geographically, its R&D activities are performed in Switzerland, the EU, Asia and the US (DCG 1.1.1).

### Significant shareholders (DCG 1.2)

See note "Significant Shareholders" to the statutory financial statements of the Company on page 60.

### Cross-shareholdings (DCG 1.3)

There are no cross-shareholdings.

## 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, 2007, it had the following ordinary, authorized and conditional share capital:

Type of capital	Amount in CHF <sup>2)</sup> (as in commercial register)	As percentage of ordinary capital (as in commercial register)	Amount in CHF <sup>2)</sup> (as a consequence of exercise of 19,705 options)	As percentage of ordinary capital (as a consequence of exercise of options)	Expiry	Section in Articles
Ordinary capital	3,099,156	100.0	3,118,861	100.0	None	3
Authorized capital	561,092	18.1	561,092	18.0	October 13, 2008	3a
Conditional capital for warrants/option rights granted in connection with debt instruments <sup>1)</sup>	230,000	7.4	230,000	7.4	For conversion rights: 10 years from issue date For options: 7 years from issue date	3b I
Conditional capital for ESOP/EIP <sup>1)</sup>	371,676	12.0	351,971	11.3	None	3b II

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.

2) In the reporting period, certain holders of options exercised their rights to receive Shares which were issued from the Company's "Conditional Capital for ESOP". These 19,705 Shares, while conveying shareholders' rights, have only been registered in the commercial register on February 18, 2008. With regard to the disclosure of participations in accordance with article 20 of the Swiss Stock Exchange Act, the entry in the commercial register is relevant.

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

For details with regard to the Company's ESOP and EIP see note 18 "Stock Option Plans" to the consolidated financial statements on page 38.

### Changes in share capital (DCG 2.3)

For changes in capital that occurred in 2005 and 2006, see the Company's Annual Report 2006 which can be downloaded from [www.santhera.com/reports](http://www.santhera.com/reports). For changes that took place in 2007, see notes "Share Capital", "Authorized Share Capital", "Conditional Share Capital" to the statutory financial statements of the Company on pages 58 and 59.

### Shares, participation and dividend right certificates (DCG 2.4/2.5)

As of December 31, 2007, the Company only had one single class of registered shares with a nominal value of CHF 1 each. All Shares were 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 (DCG 2.6.1), and consequently, the Company did not grant any exception (DCG 2.6.2).

The Board may register individual 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% of the total share capital 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 (DCG 2.6.3). In the year under review, the Company granted one exception to a bank which was acting as a nominee for a pre-IPO shareholder.

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

No statutory privileges or limitations on transferability exist (DCG 2.6.4).

### 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 62 and note 18 "Stock Option Plans" to the consolidated financial statements on page 38.

## Board of Directors (DCG 3)

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

Name	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	2009	●		●	●
Hans Peter Hasler	1956	CH	2006	2009	◐	○		
Martin Gertsch	1965	CH	2006	2010	○	●		
Rudolf Gygax	1949	CH	2001	2008 <sup>4)</sup>	○	○		○
Georg Nebgen	1961	US	2004	2008 <sup>4)</sup>	○		○	○
Timothy Rink	1946	UK	2004	2009	○		○	
Klaus Schollmeier	1957	DE	2007	2010	○			
Bernd Seizinger	1956	DE	2004	2010	○		○	○

1) Audit Committee

2) Financing Strategy & Transactions Committee

3) Nomination & Compensation Committee

4) Rudolf Gygax will be proposed for re-election at the Company's 2008 Shareholders' Meeting for a term of one year, whereas Georg Nebgen has decided not to stand for re-election.

● = 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, a Boston-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 is executive vice president global neurology and head of international at Biogen Idec\*. He joined Biogen in 2001 from Wyeth-Ayerst Pharmaceuticals, a subsidiary of American Home Products (AHP) where he worked for eight years, serving since 1998 as senior vice president, head of global strategic marketing. He was also a member of the Wyeth/AHP executive committee and chair of the commercial council. From 1993 to 1998, Hans Peter Hasler served in senior management capacities including managing director of Wyeth Group, Germany; general manager of AHP/Wyeth in Switzerland; and general manager of Central Eastern Europe, based in Vienna, Austria. Prior to joining Wyeth-Ayerst, he was head of the pharma division at Abbott, Zug, Switzerland. Hans Peter Hasler holds a federal commercial diploma and received a marketing manager certificate from the Swiss Institute of Business and Economics (SIB), Zurich. Mr Hasler is also a member of the board of directors of Orexo, 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 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, Synphabase and Biocure). 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.

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

*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. Prior to this, Mr Nebgen was with Schering-Plough, 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 business 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 currently serves on the boards of Artisan Pharma, Javelin Pharmaceuticals\*, KIKA Medical, Tigris Pharmaceuticals and previously Aerovance (observer), Kourion and Omrix.

*Timothy Rink, MA, MD, ScD*

Timothy 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, 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.

*Klaus Schollmeier, PhD*

On April 23, 2007, the Company's shareholders elected Klaus Schollmeier, Chief Executive Officer (CEO), as a member of Santhera's Board. 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 Dusseldorf, Germany, and in 1991 he became an adjunct research associate professor at the Boston University Medical School, Massachusetts, US.

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

*Bernd Seizinger, Prof, MD, PhD*

Bernd 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 Seizinger is also a member of the board of BioXell\*.

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

With the exception of Klaus Schollmeier who is CEO of the Company, all Board members are non-executive and none has ever been a member of the Executive Management of the Company or any of its subsidiaries.

When at the Company's 2007 Shareholders' Meeting the Board had made the proposal that Klaus Schollmeier be elected as a member of the Board, it was aware that from a corporate governance perspective this could lead to concerns. The Board however had come to the conclusion that the advantages of having Mr Schollmeier on the Board would outweigh the potential disadvantages. At the 2007 Shareholders' Meeting, the chairman of the Board (**Chairman**) noted that it was not intended that Mr Schollmeier would become Chairman or member of any committee of the Board. It was also stated that the Board would continue to have its "Executive Sessions" where Mr Schollmeier would not be present. In the Board's view, these measures which were all followed in the year under review, would minimize the risk that any conflicts of interests could arise.

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

See note 27 "Related Party Transactions" to the consolidated financial statements on page 45.

**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.

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

According to the Company's Articles, the Board consists of no more than eight 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 terms of the Board members are staggered (two Board members are elected until 2008, three until 2009 and another three until 2010). The Board members were elected individually.

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

### 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 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. He also approves 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 (**AC**), the Financing Strategy & Transactions Committee (**FSTC**) and the Nomination & Compensation Committee (**NCC**). Committee memberships are indicated in the table on page 4.

#### *Audit Committee*

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 as well as latest estimates for the running business year. It also approves the annual budgets for all engagements of the Company's auditors.

In addition, in the year under review, the AC focused on the further development of the Company's internal control and risk management systems, the latter with a particular emphasis on financial risk management, insurances for human clinical trials, as well as supply chain management issues. It approved Risk Management Report outline, the Company's Internal Control Guidelines and the amended Laboratory Safety Guidelines. It recommended the amended Risk Management Policy, amendments to the Organizational Rules, the Guideline Competences & Responsibilities as well as the Code of Conduct to the Board for approval.

#### *Financing Strategy & Transactions Committee*

The FSTC supports the Board in its responsibilities for the financial management and corporate finance activities 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. As such, it usually only has advisory duties.

In the year under review, it was involved to a great extent in the decision making process with regard to the Company's transactions with Novartis and Takeda (see page 37) and discussed potential other licensing and mergers and acquisitions (**M&A**) opportunities.

#### *Nomination & Compensation Committee*

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 CEO and the other members of the Executive Management. It also approves salary increases, bonus payments and option pools granted to senior managers and employees on an aggregate basis. It also approves promotions of employees to direct reports of a member of 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 SWX requirements and Swiss and international corporate best practice standards.

In the year under review, both Board and NCC deliberated over the corporate goals and the amount of incentives to be paid upon achievement of the targets as well as several employment packages for senior managers and overall stock option grants to the employees. For additional information, see section on DCG 5.

#### *Board – 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 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 control (including the Company's internal control system), risk management as well as financial planning, and (iv) appoint, recall and ultimately supervise the persons entrusted with the management and representation of the Company. The nontransferable 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. The full Board approves the Company's budget and major contracts if they are not within budget. It also discusses filing strategies before regulatory authorities such as the European Medicines Agency (**EMA**) and the US Food and Drug Administration (**FDA**). It reviews and approves M&A projects including licensing transactions of a significant magnitude.

In the reporting period, the main tasks of the Board and its committees were focused on the two major transactions in 2007, the in-licensing of a compound from Novartis and the marketing agreement with Santhera's partner Takeda (see page 37). The Board also laid particular emphasis on requirements Santhera had to comply with as a consequence of its listing on the SWX, ie the Annual Report, the Shareholders' Meeting, ad hoc publicity requirements and its corporate governance organization. In addition, it introduced the Company's risk management and internal control systems as new management tools, in particular to ensure compliance with the amended provisions of the Swiss Code of Obligations regarding internal control systems for financial reporting and enterprise risk assessment. Finally, it approved a comprehensive Code of Conduct and internal rules with regard to trading preclearance and management transactions.

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 R&D expertise relevant to Santhera's business. Members of the SAB meet individually 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 R&D activities. Members of the SAB do not advise the Board nor do they have any decision-making power. For curricula of the SAB members, see the Company's website [www.santhera.com/sab](http://www.santhera.com/sab).

### *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. In some instances, resolutions have been taken by circular.

### *Meetings in 2007*

With the Company's successful completion of its IPO, the Board met somewhat less often than in 2006.

Corporate body	Number of meetings*	Duration
Board	8	Usually about 4 hours, whereas the Board constitution lasted less than half an hour and telephone conferences where transactions were approved that had been reviewed and recommended by the FSTC ranged between 25 and 40 minutes.
AC	5	Between 5 and 6 hours.
FSTC	4	Depending on topics to be discussed.
NCC	7	Depending on topics to be discussed.

\* Including meetings held by teleconference.

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

As a rule, 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 R&D progress, potential new indications, in- and out-licensing projects, and to report on filing strategies and meetings held with regulatory authorities, on supply chain, and the Company's project to set up operations in North America. As the Board meetings are held at the Company's offices in Liestal, Board members frequently also take the opportunity to 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 senior members of the finance department, including the senior managers responsible for accounting/reporting, controlling, financial planning and treasury, participate in the AC's meetings for certain agenda items. From time to time, the AC also invites the Company's auditors and tax advisers to its meetings. The CEO and the Director Human Resources attend the meetings of the NCC. Usually, all members of Executive Management attend the FSTC meetings.

Extraordinary transactions and issues must be reported by the CEO to the Board immediately. The CEO also reports at least quarterly on R&D activities and achievements. Important news in 2007 included the acceptance of the filing for marketing authorization approval for the lead compound SNT-MC17 in Europe, Canada and Switzerland in the indication Friedreich's Ataxia (**FRDA**) and study results of the lead compound in the second indication Duchenne Muscular Dystrophy (**DMD**), the

in-licensing of a compound from Novartis and the partnering agreement with Takeda for the European marketing rights of the lead compound in DMD. 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.

Santhera does currently 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, the Organizational Rules and the by-laws for Executive Management.

During the Board and Board Committee meetings the Executive Management reports to the Board as well as whenever required on an ad hoc 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. The Executive Management meets biweekly for between three and five hours and otherwise as often as required. The biweekly meetings follow a strict agenda and usually cover the following topics: compounds, their development stages, the discussion of design and results of clinical studies, research strategy and resource allocation, in- and out-licensing opportunities, collaborations, potential M&A transactions, competitive situation, risk management, corporate affairs, financing, internal and external financial reporting, financial controlling, public and investor relations, human resources and taxes/legal/compliance.

#### **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*

See biographical details on page 6 of this report.

#### *Barbara Heller, MA (lic oec publ)*

Barbara Heller joined Santhera as CFO in 2005. Prior to that, she was at Bank Vontobel (**Vontobel**), 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, 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 (**CSO**), 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 in biology 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, the BioValley Basel Award 2007 and has received a long-term fellowship from the Human Frontier Science Foundation.

*Helmut Kessmann, PhD*

Helmut Kessmann, Chief Business Officer (**CBO**), joined Graffinity in 2001 as CBO, and since the combination with MyoContract, he has continued in that role for the Company. In 1996, Mr Kessmann cofounded Discovery Technologies, 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: DPII; merged 2006 with Infinity Pharmaceuticals). Prior to that, following a postdoctorate in the US, he held various research management positions at Ciba-Geigy, now Novartis. 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 Juvantia Pharma, Turku, Finland.

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

With the exception of Klaus Schollmeier, who is also a member of the Board of Santhera, 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.

**Compensation, Shareholdings and Loans (DCG 5)**

**Content and method of determining compensation and share ownership programs (DCG 5.1)**

The remuneration of the members of the Board and the total compensation of the members of the Executive Management are established according to a guideline based on a comparative analysis of compensation paid within selected peer companies. Regularly, benchmark studies are conducted by an external consultant who is awarded no additional mandates – for review and discussion by the NCC. By combining short-term incentives and long-term incentive elements, the compensation system is designed in a way that the interests of Executive Management are aligned with the interests of the Company and its shareholders. Compensation is reviewed and fixed annually. The Company compensation system does not set any unintended enticements or contain any

components that could be counterproductive to the objectives of the compensation system. Employment contracts with members of the Executive Management do not contain unusually long notice periods or contract durations. There are no agreements on severance in case of change of control in place, with the exception of those set out below in the section on DCG 7.2. In 2007, the Company has not entered into any agreements on severance pay or end of service agreements. While the corporate goals and their achievement level are determined by the Board, the impact of such achievement on the compensation is discussed in, and determined by, the NCC in a meeting where only non-executive Board members participate.

The nonexecutive members of the Board are compensated by means of a fixed Board fee which is payable in cash. In addition, Board members receive an option grant. There is no variable pay element in the compensation of the nonexecutive members of the Board.

The executive member of the Board as such is not entitled to additional remuneration besides his compensation as CEO of the Company.

The compensation system for the members of Executive Management consists of both fixed and variable elements. The fixed salaries are established according to a comparative analysis of base salaries paid within selected peer groups of international companies. The variable elements consist of cash pay and – at the full discretion of the NCC – stock options. The variable cash element may amount up to 50% of the base salary for the CEO and up to 30% for the other members of the Executive Management. The bonus payment is a one-time reward for the annual performance against the corporate goals which are set at the beginning of the year. The option element is designed as a long-term incentive to stay with the Company.

The corporate goals reflect the Company's development stage and include the achievement of milestones in clinical development (study progress, site initiation, enrollment rates, study data persuasiveness, timely regulatory submissions), in business development, the maintenance of corporate governance standards as well as other value creating performance indicators.

For additional information, see page 61.

#### **Transparency of compensation for, shareholdings of and loans to issuers domiciled abroad (DCG 5.2)**

Not applicable, as the Company is domiciled in Switzerland.

#### **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, 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.

### 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<sup>1</sup>/<sub>3</sub>% of all the Company'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 granted (e.g. with the exception of those under the EIP) contain clauses according to which all options granted under the Plans vest immediately upon a sale of more than 50% of the Shares. Other than that, as of December 31, 2007, 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, Basel, assumed the existing auditing engagement for Santhera's predecessor company MyoContract in 2002. The 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, for the 12-month period ended December 31:

	in CHF thousands	2007	2006
Audit services		189	197*
Audit-related services		38	315

\* Includes an amount of CHF 51,000 invoiced in 2007 for services rendered in 2006.

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 from reporting periods 2007 onwards the audit of the internal control

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 general accounting matters. 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 in depth the audit procedure, any findings made and recommendations proposed. The management letter is also extensively discussed with the auditors. During the reporting period, the auditors attended several meetings of the AC as well as the Board for discussions on topics on financial reporting and risk management. 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, employees, business partners and other public stakeholders 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 an increasing degree of awareness about Santhera.

The most important information tools are the Annual Reports and Interim Reports, the website [www.santhera.com](http://www.santhera.com), news releases, fact sheets, as well as the Shareholders' Meeting and the R&D day.

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

For contact details, see reverse side of the financial report 2007.

#### **Corporate events**

- Annual Shareholders' Meeting      April 21, 2008
- Interim Report                      August 22, 2008

Further events are published on the Company's website under [www.santhera.com/calendar](http://www.santhera.com/calendar).

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## Consolidated Balance Sheet

	in CHF thousands	Notes	Dec 31, 2007	Dec 31, 2006
<b>Assets</b>				
Tangible assets		5	1,363	1,931
Intangible assets		6	33,114	32,242
Financial assets long-term		9	111	87
<b>Noncurrent assets</b>			<b>34,588</b>	<b>34,260</b>
Prepaid expenses and accrued income			1,235	758
Inventories			584	462
Trade and other receivables		8	1,069	1,252
Financial assets short-term		9	81	0
Cash and cash equivalents		10	106,618	125,662
<b>Current assets</b>			<b>109,587</b>	<b>128,134</b>
<b>Total assets</b>			<b>144,175</b>	<b>162,394</b>
<b>Equity and liabilities</b>				
Share capital		11	3,119	3,099
Capital reserves and share premium		11	249,295	239,105
Retained earnings		11	-118,432	-90,561
Translation differences		11	1,532	405
<b>Total equity</b>			<b>135,514</b>	<b>152,048</b>
Long-term debt		28	0	931
Financial liabilities long-term		9	1	0
Pension liabilities		23	271	144
Deferred tax liabilities		12	0	683
<b>Total noncurrent liabilities</b>			<b>272</b>	<b>1,758</b>
Trade and other payables		13	3,659	3,481
Short-term debt		28	0	485
Financial liabilities short-term		9	112	0
Accrued expenses		14	4,267	3,942
Short-term provisions		15	351	680
<b>Total current liabilities</b>			<b>8,389</b>	<b>8,588</b>
<b>Total liabilities</b>			<b>8,661</b>	<b>10,346</b>
<b>Total equity and liabilities</b>			<b>144,175</b>	<b>162,394</b>

# Consolidated Income Statement

	For the year ended December 31, in CHF thousands	Notes	2007	2006
Revenue		19	9,226	781
<b>Gross profit</b>			<b>9,226</b>	<b>781</b>
Other operating income		20	2,439	637
Research and development		21, 22	-23,335	-17,985
Marketing and sales		21, 22	-1,170	-323
General and administrative		21, 22	-18,151	-11,729
Other operating expenses			-136	-20
<b>Operating expenses</b>		21, 22	<b>-42,792</b>	<b>-30,057</b>
<b>Operating result</b>			<b>-31,127</b>	<b>-28,639</b>
Financial income		24	4,491	1,199
Financial expenses		24	-1,918	-637
<b>Result before taxes</b>			<b>-28,554</b>	<b>-28,077</b>
Income taxes		25	683	-181
<b>Net loss</b>			<b>-27,871</b>	<b>-28,258</b>
<b>Basic and diluted loss per share (in CHF)</b>		26	<b>-8.99</b>	<b>-14.44</b>

Consolidated Cash Flow Statement<sup>1</sup>

	For the year ended December 31, in CHF thousands	Notes	2007	2006
Result before taxes			-28,554	-28,077
Depreciation of tangible assets		5	755	750
Amortization of intangible assets		6	84	114
(Gains) and losses from disposals of intangible assets		6, 20	-2,337	0
(Gains) and losses from disposals of assets			67	0
Issuance of share options		18	10,154	2,566
Issuance of warrants			0	874
Net change in fair value of derivatives		9	29	0
Change in pension liabilities		23	127	0
Change in short-term provisions		15	-329	79
Change in net working capital			305	-348
Total financial result		24	-2,573	-561
Interest paid		24	-99	-230
Interest received		24	2,417	929
<b>Cash flow from operating activities</b>			<b>-19,954</b>	<b>-23,904</b>
Investments in tangible assets		5	-456	-895
Disposal of tangible assets		5	211	56
Investments in intangible assets		6	-99	-295
Disposal of intangible assets		6, 20	2,337	10
Change in other financial assets		9	-20	-88
<b>Cash flow from investing activities</b>			<b>1,973</b>	<b>-1,212</b>
Capital increases		19	56	121,895
Repayment of debt		12	-1,445	-2,577
<b>Cash flow from financing activities</b>			<b>-1,389</b>	<b>119,318</b>
Effects of exchange rate changes on cash and cash equivalents			326	192
<b>Net increase/(decrease) in cash and cash equivalents</b>			<b>-19,044</b>	<b>94,394</b>
Cash and cash equivalents at January 1			125,662	31,268
<b>Cash and cash equivalents at December 31</b>			<b>106,618</b>	<b>125,662</b>

<sup>1</sup> The starting point for the reconciliation of cash flows from operating activities, using the indirect method, is now result before taxes.

# Consolidated Statement of Changes in Equity

	in CHF thousands	Notes	Share capital	Capital reserves and share premium	Retained earnings	Treasury shares	Translation differences	Total
<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>
Currency translation differences			0	0	0	0	1,159	1,159
Net loss			0	0	-28,259	0	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>
Capital increase September 2006 – exercise of warrants (2005)		11	33	1,904	0	0	0	1,937
Capital increase September 2006		11	191	15,609	0	0	0	15,800
Capital increase November 2006 – IPO		11	984	87,563	0	0	0	88,547
Capital increase November 2006 – Greenshoe		11	147	13,135	0	0	0	13,282
Forfeiture of treasury shares		11	0	0	0	91	0	91
Issuance of share options		18	0	2,566	0	0	0	2,566
Issuance of warrants			0	874	0	0	0	874
Cost of issuance of share capital			0	-10,096	0	0	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>Balance at January 1, 2007</b>			<b>3,099</b>	<b>239,105</b>	<b>-90,561</b>	<b>0</b>	<b>405</b>	<b>152,048</b>
Currency translation differences			0	0	0	0	1,127	1,127
Net loss			0	0	-27,871	0	0	-27,871
<b>Total recognized income and expenses for the period</b>			<b>0</b>	<b>0</b>	<b>-27,871</b>	<b>0</b>	<b>1,127</b>	<b>-26,744</b>
Issuance of share options		18	0	10,154	0	0	0	10,154
Capital increase from option exercise		11	20	36	0	0	0	56
<b>Balance at December 31, 2007</b>			<b>3,119</b>	<b>249,295</b>	<b>-118,432</b>	<b>0</b>	<b>1,532</b>	<b>135,514</b>

## 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 stock 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 February 28, 2008, and are subject to approval by the shareholders on April 21, 2008.

## 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**).

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 fair value of certain financial assets and financial liabilities.

The presentation currency is Swiss Francs (**CHF**). 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.

For the financial reporting 2007, Santhera changed the starting point of the cash flow statement to "Result before taxes" and the preceding period is presented accordingly. Additionally, marketing and sales (**M&S**) is now presented as a separate line item in the income statement and prior period information is changed accordingly. General and administrative (**G&A**) has been reduced from CHF 12.0 million by CHF 0.3 million to CHF 11.7 million.

### Consolidation

Subsidiaries in which the Company has a direct or indirect controlling interest are consolidated. Control is defined as the power to govern the financial and operating 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 (Schweiz) AG, Liestal, Switzerland, and Santhera Pharmaceuticals (Deutschland) GmbH, Lörrach, Germany.

The purchase method 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 Group'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. The Group had no business combinations in the periods reported.

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

*Santhera has adopted the following new standards and interpretations in 2007 for the first time:*

IFRS 7	Financial Instruments – disclosures
IAS 1	Amendment – presentation of financial statements: capital disclosures
IFRIC 7	Applying the restatement approach under IAS 29 “Financial reporting in hyper-inflationary economies”
IFRIC 8	Scope of IFRS 2
IFRIC 9	Reassessment of embedded derivatives
IFRIC 10	Interim financial reporting and impairment

The adoption of these standards and interpretations did not have any effect on the financial position or performance of the Group but lead to additional disclosures.

The following new or revised standards and interpretations will be adopted when becoming effective:

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.
IAS 23	Borrowing Costs: revised. Effective for annual periods beginning on or after January 1, 2009. No impacts are expected 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.

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.
IFRIC 13	Customer Loyalty Programmes: Effective for annual periods beginning on or after July 1, 2008. No impacts are expected on the Group's accounts.
IFRIC 14	The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interactions: Effective for annual periods beginning on or after January 1, 2008. Santhera is considering the changes accordingly.
IAS 1 (revised)	Presentation of Financial Statements (effective January 1, 2009): The revised standard requires that gains and losses recognized outside profit and loss are presented separately from the statement of changes in equity.

In January 2008 the IASB issued revised versions of IFRS 3 Business Combinations and IAS 27 Consolidated and Separate Financial Statements (both effective July 1, 2009) as well as an amendment to IFRS 2 Share based payments "Vesting Conditions and Cancellations" (effective January 1, 2009). The Group is currently evaluating whether these changes will have any impact.

### Segment reporting

Santhera operates in a single business segment, which is research and development (**R&D**) of pharmaceutical drugs. Currently, R&D activities are performed in Switzerland, the European Union (**EU**), Asia (India) and the United States (**US**). R&D activities in Asia and the US are done by external clinical research organizations (**CRO**).

### 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. The estimated useful life of the intangible assets is regularly reviewed, and if necessary, the future amortization charge is accelerated. For pharmaceutical products, the estimated useful life normally corresponds to the remaining lifetime of their patent or orphan drug protection.

R&D 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 intangible asset in accordance with IAS 38.

*Goodwill*

Currently no goodwill is capitalized.

*Trademarks and licenses*

Currently no trademarks or licenses are capitalized.

*IT software*

Acquired IT software licenses are capitalized on the basis of the costs incurred to acquire and implement the specific software. These costs are amortized on a straight-line basis over their estimated useful lives (two to five years).

**Tangible assets**

Tangible assets are stated at cost less accumulated depreciation and any impairment losses. 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 to 8 years
Laboratory fixtures and fittings	5 to 10 years
Equipment	4 to 10 years
Equipment for clinical studies	1 to 2 years
IT hardware	2 to 5 years
Leasehold improvements	3 to 5 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; testing for indicators of impairment is done periodically.

**Borrowing costs**

Borrowing costs are recognized as an expense when incurred.

**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 probable.

**Inventories**

Inventories are stated at the lower of cost and net realizable value using the first-in first-out (FIFO) method.

## Financial assets

Generally, Santhera classifies its financial assets in the following categories:

### *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 upon initial recognition. 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 and are measured at amortized cost using the effective interest method.

Purchases and sales of financial assets are recognized on trade date. This is the date on which Santhera commits to purchase or sell the asset. Financial assets are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets are de-recognized when the rights to receive cash flows from the financial assets have expired or have been transferred and Santhera has transferred substantially all risks and rewards of ownership. Financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables 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 are included in the income statement in the period in which they arise.

## 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 item 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 existed for the reporting period.

Leases of assets under which 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 and other short-term highly liquid investments with original maturities of three months or less.

### 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.

### 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 initially recognized in accordance with IAS 32 at fair value.

### Financial liabilities

Santhera classifies its financial liabilities in two categories:

- financial liabilities at fair value through profit and loss: this category includes derivatives with negative replacement values;
- other liabilities measured at amortized costs: this category principally covers debt instruments and trade and other payables.

### Debt instruments

Debt instruments are initially recognized at their fair value, which is the net 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 and tax authority.

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.

## Employee benefits

### *Postretirement benefits*

Santhera operates a defined pension benefit scheme which is funded through payments to an insurance company. Typically, on retirement, an employee will receive an amount of the accumulated defined benefit obligation depending on several factors such as age, years of service and compensation as a pension for life or as a lump-sum payment. The scheme also covers disability and death in service.

The liability recognized in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance-sheet date less the fair value of plan assets, taking into consideration the adjustments for unrecognized actuarial gains or losses and past service costs.

The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating the terms of the related pension liability.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions in excess of the corridor which is the greater of 10% of the value of plan assets or 10% of the defined benefit obligation are charged or credited to employee costs over the employees' expected average remaining service period.

### *Share-based compensation*

Santhera has established two stock option plans, the Employee Stock Option Plan 2004 (**ESOP 2004**) and the Executive Incentive Plan (**EIP**) to align the long-term interests of the members of the Board (**Directors**), Executive Management, employees and selected consultants (including scientific advisors) who are all eligible to participate in the stock option plans. Options granted under the ESOP 2004 and EIP are equity settled. The fair value of options is recognized as personnel expenses and is accounted for over the relevant vesting periods of each grant 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 outflows.

## 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 from out-licensing*

Out-licensing agreements are concluded with third parties, where the counter party has to pay license fees. In situations where no further performance commitment 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.

*Revenue associated with performance milestones*

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

*Revenue 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.

**Research and development**

R&D 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.

**3 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 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 outcome. The following areas involve a higher degree of judgment or complexity or are areas where assumptions and estimates can have a significant impact on the consolidated financial statements:

- Measurement and impairment testing of intangible assets (*see note 7 "Impairment Testing of Intangible Assets with Indefinite Lives"*);
- Personnel expenses in accordance with IFRS 2, i.e. estimates regarding the valuation of employee stock options (*see note 18 "Stock Option Plans"*).

**4 Exchange Rates of Principal Currencies**

	Income statement in CHF		Balance sheet in CHF	
	2007	average rates 2006	2007	year-end rates 2006
1 Euro (EUR)	1.6432	1.5733	1.6587	1.6096
1 US Dollar (USD)	1.2004	1.2536	1.1267	1.2197

## 5 Tangible Assets

	in CHF thousands	Laboratory and other equipment	IT hardware	Leasehold improvements	2007
<b>Cost</b>					
At January 1		4,479	450	1,797	6,726
Additions		188	268	0	456
Disposals		-1,639	-134	-1,339	-3,112
Exchange differences		35	0	27	62
<b>At December 31</b>		<b>3,063</b>	<b>584</b>	<b>485</b>	<b>4,132</b>
<b>Accumulated depreciation and impairment losses</b>					
At January 1		3,266	181	1,348	4,795
Additions		503	155	97	755
Disposals		-1,365	-131	-1,339	-2,835
Exchange differences		26	1	27	54
<b>At December 31</b>		<b>2,430</b>	<b>206</b>	<b>133</b>	<b>2,769</b>
<b>Net book value</b>		<b>633</b>	<b>378</b>	<b>352</b>	<b>1,363</b>
<b>Cost</b>					
	in CHF thousands	Laboratory and other equipment	IT hardware	Leasehold improvements	2006
At January 1		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</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		3,336	246	1,270	4,852
Additions		596	116	38	750
Disposals		-719	-183	0	-902
Exchange differences		53	2	40	95
<b>At December 31</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>

The insured value of tangible assets amounts to CHF 4.5 million as of December 31, 2007 (December 31, 2006: CHF 4.5 million).

## 6 Intangible Assets

	in CHF thousands	SNT-MC17	Capitalized development costs (SNT-MC17)	IT software/ patents	2007
<b>Cost</b>					
At January 1		28,765	3,764	433	32,962
Additions		0	0	99	99
Disposals		0	0	-277	-277
Exchange differences		864	0	5	869
<b>At December 31</b>		<b>29,629</b>	<b>3,764</b>	<b>260</b>	<b>33,653</b>
<b>Accumulated amortization and impairment losses</b>					
At January 1		487	0	233	720
Additions		0	0	84	84
Disposals		0	0	-275	-275
Exchange differences		5	0	5	10
<b>At December 31</b>		<b>492</b>	<b>0</b>	<b>47</b>	<b>539</b>
<b>Net book value</b>		<b>29,137</b>	<b>3,764</b>	<b>213</b>	<b>33,114</b>
<b>Cost</b>					
	in CHF thousands	SNT-MC17	Capitalized development costs (SNT-MC17)	IT software/ patents	2006
At January 1		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</b>		<b>28,765</b>	<b>3,764</b>	<b>433</b>	<b>32,962</b>
<b>Accumulated amortization and impairment losses</b>					
At January 1		456	0	349	805
Additions		26	0	88	114
Disposals		0	0	-212	-212
Exchange differences		5	0	8	13
<b>At December 31</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>

During 2007 Santhera sold noncore intellectual property with a carrying value of nil which resulted in a gain on disposal of CHF 2.3 million, which is recorded in other operating income (see note 20).

## 7 Impairment Testing of Intangible Assets with Indefinite Lives

### SNT-MC17 (INN: idebenone) and capitalized development costs

SNT-MC17 and capitalized development costs are the primary intangible assets of Santhera, which is defined as the cash-generating unit and tested for impairment annually. The recoverable amount is based on fair value less costs to sell based on the following considerations:

- The Company is publicly listed, and therefore fair-value benchmarks are available.
- Consistency 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 and certain capitalized development costs.

- Stage of development of SNT-MC17, in particular the achieved acceptance of filing for Marketing Authorization Application (**MAA**) with the European Medicines Agency (**EMA**) in the indication Friedreich's Ataxia (**FRDA**) in August 2007.

The basis for determining the fair value of SNT-MC17 and capitalized development costs is the technology value of Santhera, which equals its market capitalization less the consolidated cash position.

#### Sensitivity to changes in assumptions

The volatility of the share price of Santhera is considered to be up to 50%. If, based on the share price per year-end, the share price was to drop to that extent still no impairment would be required. 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 projects remains.

### 8 Trade and Other Receivables

	in CHF thousands	2007	2006
Trade receivables		0	0
Other receivables (financial)		0	263
Other receivables (nonfinancial)		1,069	989
<b>Total at December 31</b>		<b>1,069</b>	<b>1,252</b>

Other receivables consist mainly of amounts due from the government (VAT) and other positions (reimbursement of expenses). They are due within 30 to 120 days and bear no interest.

No impairment was made on the receivables as management estimates that no allowance is necessary as of December 31, 2007 and 2006.

### 9 Financial Assets and Liabilities – Short- and Long-Term

Based on expected future expenses for R&D and marketing activities, the Company entered into derivative contracts for CHF versus USD. The net fair value of such contracts amounted to a liability of CHF 29,326 as per December 31, 2007 (December 31, 2006: CHF 0). The Group does not apply hedge accounting; therefore changes in fair value of the contracts are accounted for directly through profit and loss. Financial assets long-term also include deposits of CHF 107,687 (CHF 87,500 as per December 31, 2006).

### 10 Cash and Cash Equivalents

	in CHF thousands	2007	2006
Cash at banks and on hand			
In EUR		12,648	5,661
In CHF		28,856	9,625
In USD		3,974	6
Short-term money market deposits			
In EUR		1,095	1,016
In CHF		60,000	109,308
In USD		45	46
<b>Total at December 31</b>		<b>106,618</b>	<b>125,662</b>

Cash at banks earns interests at floating rates based on monthly bank deposit rates. Funds not immediately needed are kept as short-term money market deposits with a time horizon up to three months at money market rates. The fair value of these positions per year-end is CHF 106.6 million (2006: CHF 125.7 million).

## 11 Share Capital

### Ordinary share capital

As at January 1, 2006, 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 October 2006, 32,562 warrants exercisable into class B preference shares were exercised in connection with the preparations for the listing on the SWX. The related share capital increase amounted to CHF 32,562.

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.

As a preparation for the listing on the SWX, the Company eliminated the different classes of shares from the articles of incorporation 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 Initial Public Offering (IPO), increasing the share capital to CHF 3,099,156, consisting of 3,099,156 Shares without any contractual or other preferences.

During 2007, 19,705 Shares were issued from conditional capital upon the exercise of stock options under the ESOP 2004 and the EIP. As a result, as of December 31, 2007, the share capital amounted to CHF 3,118,861, divided into 3,118,861 Shares.

### Authorized share 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, and the term of the option ends on June 30, 2009.

### Conditional share capital

As of December 31, 2007, the Company had a conditional share capital, pursuant to which the share capital of the Company may be increased by:

- (i) an additional amount of CHF 351,971 by issuing up to 351,971 additional 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 Share Capital" above).

## 12 Deferred Taxes

### Net deferred taxes recorded

	in CHF thousands	2007	2006
Temporary differences on development costs		4,371	11,170
Tax loss carryforwards		-4,330	-11,170
Temporary differences on pension liabilities		-41	0
Other temporary differences		0	683
<b>Deferred tax liabilities recognized</b>		<b>0</b>	<b>683</b>
Tax loss carryforwards		149,693	128,353
Of which recorded		-28,866	-28,278
<b>Of which unrecorded</b>		<b>120,827</b>	<b>100,075</b>
Expiring			
2008		1,065	1,065
2009		3,089	3,089
2010		4,319	4,319
2011		18,289	18,289
2012		3,632	3,632
Thereafter		53,856	34,131
Without expiration		36,577	35,550
<b>Total unrecorded tax loss carryforwards</b>		<b>120,827</b>	<b>100,075</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, deferred tax assets on tax loss carryforwards were only considered to the extent that they offset taxable temporary differences within the same taxable entity.

### 13 Trade and Other Payables

	in CHF thousands	2007	2006
Trade payables		3,201	3,401
Other payables (financial)		0	0
Other payables (nonfinancial)		458	80
		<b>3,659</b>	<b>3,481</b>

All positions are non-interest-bearing and usually settled within 30 to 60 days.

### 14 Accrued Expenses

	in CHF thousands	2007	2006
R&D		2,122	763
Liabilities to employees and severance payments		1,489	1,684
Accrued interest, stamp duty, VAT, withholding tax		150	504
Remaining restructuring expenses		42	587
Other		464	404
<b>Total at December 31</b>		<b>4,267</b>	<b>3,942</b>

### 15 Short-term Provisions

	in CHF thousands	Personnel expenses	Various items	2007	2006
At January 1		540	140	680	589
Utilization		-309	-99	-408	-446
Reversal		-100	0	-100	0
Additions		0	164	164	524
Exchange differences		15	0	15	13
<b>At December 31</b>		<b>146</b>	<b>205</b>	<b>351</b>	<b>680</b>

By the end of 2005, the Board decided to initiate a reorganization of the German subsidiary and to consolidate all R&D 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 during 2005 and 2006, whereas some matters remain pending as per end of 2007. Additional provisions related to probable legal cases were accounted for in the amount of CHF 164,318 in 2007.

### 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 necessary for regulatory approval of SNT-MC17 (INN: idebenone) in the indication FRDA and licensed the exclusive marketing rights for the EU and Switzerland to Takeda. Santhera received an up-front payment of EUR 5.0 million in 2005 and a milestone payment of EUR 3.0 million for achieving the acceptance of the MAA by the EMEA in August 2007. Santhera is entitled to one further milestone payment over EUR 4.0 million upon the transfer of the granted MAA approval to Takeda. In case of commercialization, Takeda will pay a total of 30% of their net sales in the EU and Switzerland which also include payments for finished goods supplied from Santhera to Takeda.

In August 2007, Santhera and Takeda entered into another agreement granting Takeda the European marketing rights to SNT-MC17 in the indication Duchenne Muscular Dystrophy (**DMD**). Under the terms of the licensing agreement, Santhera remains responsible for the clinical development and regulatory approval in the EU and Switzerland. Takeda obtained an exclusive license to market SNT-MC17 in DMD in the EU and Switzerland. Santhera in return received an up-front payment of EUR 2.0 million from Takeda and is entitled to further milestone payments, each upon the initiation of a pivotal trial, acceptance of the filing by the EMEA and granting of marketing approval, totaling up to EUR 18.0 million. In case of commercialization, Takeda will pay a total of 30% of their net sales in the EU and Switzerland which also include payments for finished goods supplied from Santhera to Takeda.

#### Collaboration with Biovitrum

In 2005, Biovitrum AB, Stockholm, Sweden (**Biovitrum**), and Santhera 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 (eg type 2 diabetes, obesity etc.). Santhera 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.

## 17 Commitments and Contingent Liabilities

### Commitments

#### Operating lease commitments

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

	in CHF thousands	2007	2006
Within 1 year		170	163
1 year through 5 years		0	80
After 5 years		0	0
<b>Total at December 31</b>		<b>170</b>	<b>243</b>

#### Commitment for the lease of buildings (operating lease)

Santhera has lease contracts for its facilities in Liestal, Switzerland. These contracts have fixed terms and will expire as of December 31, 2008.

	in CHF thousands	2007	2006
Within 1 year		311	691
1 year through 5 years		0	53
After 5 years		0	0
<b>Total at December 31</b>		<b>311</b>	<b>744</b>

In prior years Santhera had sublease contracts in its former site in Heidelberg, Germany, reducing its lease obligations after the restructuring of the German subsidiary, which all expired. There are no further lease liabilities for the former site in Heidelberg as of December 31, 2007.

### Contingent liabilities

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

Based on a license agreement between Santhera Pharmaceuticals (Schweiz) AG and the Institut National de la Santé et de la Recherche Médicale, Paris, France (**INSERM**), Santhera has an obligation to make a milestone payment after the first New Drug Application (EUR 150,000) for SNT-MC17 in FRDA by the US Food and Drug Administration. In further consideration of the rights and licenses granted, Santhera has an obligation to pay INSERM a running royalty equal to 3% of net sales, not to exceed EUR 500,000 per year and Santhera has to pay 25% of non-royalty sublicense income received in the US and Canada.

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

The collaboration and license agreement with Takeda in the indication FRDA foresees a partial repayment of the before-mentioned up-front payment by Santhera in case Santhera does not obtain marketing approval for SNT-MC17 in FRDA in the amount of EUR 1.0 million. Under certain conditions an amount of up to EUR 2.0 million of the royalty income may not be payable by Takeda for SNT-MC17 in FRDA.

#### *Agreement with the University of Leuven*

In March 2005, Santhera entered into an agreement with Katholieke Universiteit Leuven, Leuven, Belgium (**K.U. Leuven**), whereby K.U. Leuven assigned to Santhera its worldwide rights to inventions relating to the use of SNT-MC17 to treat various forms of muscular-dystrophy-related disorders, including DMD. Based on this agreement, Santhera has filed a patent application in major countries covering the use of SNT-MC17 for the treatment of cardiomyopathy and muscle weakness in DMD.

K.U. Leuven is entitled to a success fee of up to EUR 400,000 if Santhera commercializes any product in a major market, such as Europe, US or Japan. In addition, in the event Santhera commercializes the product itself, K.U. Leuven is entitled to 5% royalties on net sales. In the event Santhera grants commercialization rights to a third party K.U. Leuven will receive 15% of the consideration received by Santhera from such third party excluding payments received to fund certain development work at K.U. Leuven. Santhera and K.U. Leuven agreed that K.U. Leuven will receive 15% of any consideration Takeda will make to Santhera at filing for MAA in the EU or at any later stage under their agreement signed in 2007 for marketing rights in DMD.

#### *License agreement with Novartis*

On June 30, 2007, Santhera entered into an agreement with Novartis Pharma AG, Basel, Switzerland (**Novartis**), regarding the in-licensing of the compound TCH 346 (now SNT-317, INN: omigapil) from Novartis. Santhera intends to develop SNT-317 for the treatment of Congenital Muscular Dystrophy (**CMD**). Additional payments will be due to Novartis a) upon start of a pivotal clinical trial, b) upon regulatory approval in major markets and c) after reaching certain commercialization milestones. Santhera will also have to pay royalties to Novartis, calculated on Santhera net sales (*see note 27 "Related Party Transactions"*).

#### *Contracts for clinical development*

Santhera has entered into contracts for clinical development with CROs. Santhera compensates the CROs for the services provided on a regular 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.

	in CHF thousands	2007	2006
Within 1 year		13,832	3,545
1 year through 5 years		3,443	779
After 5 years		0	0
<b>Total at December 31</b>		<b>17,275</b>	<b>4,324</b>

## 18 Stock Option Plans

Santhera has established stock option plans to align the long-term interests of the Directors, the Executive Management, employees and consultants, including members of the Scientific Advisory Board. Options granted under the stock option plans are equity settled.

### Executive Incentive Plan

Under the Executive Incentive Plan (**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. No further grants can be made under the EIP.

### Options outstanding, vested or exercised under the EIP

All options under the EIP were granted to the four members of the Executive Management as of November 8, 2006, and had a vesting period of 12 months (*see note 27 "Related Party Transactions"*). 4,721 options under the EIP were exercised by December 31, 2007. The remaining number of options outstanding from the EIP is 96,344 as of December 31, 2007.

### Employee Stock Option Plan

The Company has adopted an Employee Stock Option Plan 2004 (**ESOP 2004**) to provide incentives to Directors, the Executive Management, employees and consultants (including members of the SAB) and help to ensure their commitment to Santhera over the long term. 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 & Compensation Committee. 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. Each stock option entitles its holder to purchase one Share of the Company at an exercise price defined to be equal to the volume-weighted average share price in the preceding calendar quarter. 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. At the end of the option term, i.e. after a period of 10 years as from the grant date, unexercised stock options shall expire without value. The remaining number of options which can be granted is 54,462.

### Options outstanding, vested or exercised under the ESOP 2004

As of December 31, 2007, 14,984 stock options under the ESOP 2004 were exercised, 1,682 stock options were forfeited. The number of options outstanding from the ESOP 2004 is 201,165 as per December 31, 2007.

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

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:

	2007	2006
Market price of stock	CHF 77.00–135.00	CHF 59.44–90.00
Exercise prices	CHF 1.00–114.50	CHF 1.00–82.58
Expected volatility <sup>1)</sup>	40.00–50.00%	40.00%
CHF risk-free interest rate	2.65–3.50% p.a.	2.35–3.10% p.a.
Option term <sup>2)</sup>	10 years	10 years
Expected dividend yield	0.00%	0.00%

1) 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 biotech companies. The weighted-average fair value of the stock options granted during the reporting period was CHF 50.62 (CHF 69.65 in 2006).

2) After expiration of the vesting period, the options may be exercised any time until the end of the option term. The option pricing model takes into consideration certain assumptions about potential early exercises.

#### Options outstanding

	2007 Number of options	2006 Number of options
<b>At January 1</b>	<b>274,737</b>	<b>128,768</b>
Granted	44,159	151,065
Forfeited	-1,682	-4,447
Exercised <sup>1)</sup>	-19,705	0
Expired	0	0
Bought back	0	-649
<b>At December 31</b>	<b>297,509</b>	<b>274,737</b>
Options promised at the end of the year	0	30,939 <sup>2)</sup>

1) The weighted-average share price from the days when options were exercised during the reporting period was CHF 94.62.

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 2007, option grants resulted in personnel expenses of CHF 10,153,853 (CHF 416,817 related to R&D, CHF 166,910 related to M&S and CHF 9,570,126 to G&A), and in 2006 such grants resulted in personnel expenses of CHF 2,566,329 (CHF 808,048 related to R&D, CHF 41,842 to M&S and CHF 1,716,439 to G&A).

#### Terms of options outstanding at December 31, 2007

Exercise price for options (CHF)	Number outstanding	Weighted-average remaining contractual life (years)	Number exercisable
1.00	131,489	8.44	113,489
59.44	134,210	7.07	75,553
60.25	10,690	6.01	8,439
82.58	6,300	8.76	0
89.80	1,600	9.01	0
101.80	2,900	9.76	0
106.80	10,000	9.26	0
114.50	320	9.51	0
<b>Total</b>	<b>297,509</b>	<b>7.79</b>	<b>197,481</b>

## 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.

### Geographical analysis of revenue

	in CHF thousands	2007	2006
EU and Switzerland		1,007	781
Asia		8,219	0
<b>Total revenue</b>		<b>9,226</b>	<b>781</b>

The increase of revenue results from collaboration and license agreements with Takeda regarding SNT-MC17 in DMD in Europe, CHF 3.3 million (EUR 2.0 million) as up-front payment, and regarding SNT-MC17 in FRDA in Europe, CHF 4.9 million (EUR 3.0 million) as milestone payment. Furthermore, a milestone payment over CHF 1.0 million from a European pharmaceutical company was recognized.

### Geographical analysis of assets<sup>1)</sup>

	in CHF thousands	2007	2006
EU and Switzerland		144,175	162,394
<b>Total assets</b>		<b>144,175</b>	<b>162,394</b>

The geographical analysis of capital expenditure is as follows:

	in CHF thousands	2007	2006
EU and Switzerland		555	1,190
<b>Total capital expenditures</b>		<b>555</b>	<b>1,190</b>

1) Currently there are no assets nor capital expenditures in Asia and the US.

## 20 Other Operating Income

This position mainly consists of a gain of CHF 2.3 million realized on the sale of noncore intellectual property rights in 2007 and sublease income from the German subsidiary in 2006.

## 21 Operating Expenses by Function

	in CHF thousands	2007	2006
Research (preclinical)		-7,777	-7,372
Development		-15,558	-10,613
<b>Research and development expenses</b>		<b>-23,335</b>	<b>-17,985</b>
<i>Of which noncash-relevant expenses for share-based payments</i>		-417	-808
<b>Marketing and sales</b>		<b>-1,170</b>	<b>-323</b>
<i>Of which noncash-relevant expenses for share-based payments</i>		-167	-42
Business development and licensing		-2,649	-1,808
Finance and administration		-15,502	-9,410
Expenses related to IPO/equity financing <sup>1)</sup>		0	-511
<b>General and administrative expenses</b>		<b>-18,151</b>	<b>-11,729</b>
<i>Of which noncash-relevant expenses for share-based payments</i>		-9,570	-1,716
Other operating expenses		-136	-20
<b>Other operating expenses</b>		<b>-136</b>	<b>-20</b>
<b>Total operating expenses</b>		<b>-42,792</b>	<b>-30,057</b>

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

Amortization of intangibles is included in R&D as well as G&A.

## 22 Operating Expenses by Nature

	in CHF thousands	2007	2006
External research and development expenses		-15,526	-11,018
Patent and license expenses		-491	-148
Marketing expenses		-649	0
Employee expenses		-21,409	-12,900
<i>Of which noncash-relevant expenses for share-based payments</i>		-10,154	-2,566
General and administrative expenses		-3,307	-3,952
Depreciation and amortization		-839	-864
Lease expenses		-435	-1,155
Other operating expenses		-136	-20
<b>Total operating expenses</b>		<b>-42,792</b>	<b>-30,057</b>

## 23 Employee Expenses and Benefits

### Employee expenses

	in CHF thousands	2007	2006
Wages and salaries		-9,214	-7,708
Social security and other benefit costs		-2,041	-2,626
Share-based payments		-10,154	-2,566
<b>Total employee costs</b>		<b>-21,409</b>	<b>-12,900</b>
<b>Average number of fulltime equivalents</b>		<b>60.9</b>	<b>50.4</b>
<b>Fulltime equivalents at year-end</b>		<b>65.0</b>	<b>53.5</b>
<b>Total headcount at year-end</b>		<b>72</b>	<b>56</b>

### Termination benefits

In connection with the restructuring of the activities of Santhera in Germany in the course of 2005, outstanding termination benefits of CHF 8,543 were paid in 2007 (2006: CHF 47,986).

### Pension plan

In accordance with the Swiss pension fund law, all Swiss employees of Santhera Pharmaceuticals Holding AG and Santhera Pharmaceuticals (Schweiz) 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.

An independent actuary has performed the respective calculations as required by IAS 19:

#### Changes in defined benefit obligations

	in CHF thousands	2007	2006
<b>Present value of obligation, January 1</b>		<b>3,968</b>	<b>3,051</b>
Current employer service cost		604	391
Interest cost		111	93
Employee contributions		450	392
Benefits paid/transfer payments		2,150	100
Insurance premiums		-290	-256
Actuarial (gain) loss on obligation		-133	197
<b>Present value of obligation, December 31</b>		<b>6,860</b>	<b>3,968</b>

#### Changes in plan assets

	in CHF thousands	2007	2006
<b>Fair value of assets, January 1</b>		<b>3,606</b>	<b>2,862</b>
Expected return on assets		138	110
Employer contributions		450	419
Employee contributions		450	392
Benefits paid/transfer payments		2,150	100
Insurance premiums		-290	-256
Actuarial gain (loss) on assets		17	-21
<b>Fair value of assets, December 31</b>		<b>6,521</b>	<b>3,606</b>

#### Amounts recognized in the income statement

	in CHF thousands	2007	2006
Current employer service cost		604	391
Interest cost		111	93
Expected return on plan assets		-138	-110
Recognition of actuarial (gain) loss		0	0
<b>Company's net periodic pension cost</b>		<b>577</b>	<b>374</b>

#### Amounts recognized in balance sheet

	in CHF thousands	Dec 31, 2007	Dec 31, 2006
Present value of obligations		6,860	3,968
Fair value of plan assets		-6,521	-3,606
<b>Present value of net obligation (asset)</b>		<b>339</b>	<b>362</b>
Net unrecognized actuarial (loss) gain		-68	-218
<b>Defined benefit obligation (asset) recognized in the balance sheet</b>		<b>271</b>	<b>144</b>

### History of experience adjustments

	in CHF thousands	Dec 31, 2007	Dec 31, 2006
Present value of defined benefit obligations		6,860	3,968
Fair value of plan assets		-6,521	-3,606
<b>Deficit/(surplus)</b>		<b>339</b>	<b>362</b>
Experience adjustments on plan liabilities		155	139
Experience adjustments on plan assets		-17	21
Actual return on assets		155	89

The expected contributions for fiscal year 2008 amount to ca CHF 634,000 (2007: CHF 491,000).

### Plan assets

	in %	Dec 31, 2007 Allocation	Dec 31, 2007 Expected return <sup>1)</sup>	Dec 31, 2006 Allocation	Dec 31, 2006 Expected return <sup>1)</sup>
Equity securities		15.0	6.9	15.0	6.5
Debt securities		54.0	3.1	54.0	2.5
Real estate		10.0	4.7	10.0	4.5
Other <sup>2)</sup>		21.0	4.4	21.0	3.3
<b>Total</b>		<b>100.0</b>	<b>4.1</b>	<b>100.0</b>	<b>3.5</b>

1) Expected returns on plan assets are based on market expectations.

2) This includes mortgage loans, hedge funds and liquidity.

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:

	in %	2007	2006
Discount rate		3.50	2.80
Expected return on plan assets		4.10	3.50
Expected future salary increases		1.50	1.50
Expected future pension increases		0.25	0.25

## 24 Financial Income/Expenses

### Financial income

	in CHF thousands	2007	2006
Interests on loans and receivables		2,781	930
Realized and unrealized FX gains		1,710	269
<b>Total</b>		<b>4,491</b>	<b>1,199</b>

### Financial expenses

	in CHF thousands	2007	2006
Interests on loans (financial liabilities at amortized cost)		-99	-231
Realized and unrealized FX losses		-1,790	-406
Net loss on derivatives		-29	0
<b>Total</b>		<b>-1,918</b>	<b>-637</b>

## 25 Income Taxes

	in CHF thousands	2007	2006
Current income tax expense		0	0
Deferred tax income/(expense)		683	-181
<b>Total</b>		<b>683</b>	<b>-181</b>

*The following is a theoretical reconciliation of the income taxes calculated at the Group's expected effective income tax rate:*

	in CHF thousands	2007	2006
Result before taxes		-28,554	-28,077
Tax income of applicable tax rate of 15.0% (prior year: 26.2%) <sup>1)</sup>		4,283	7,356
Unrecognized deferred taxes on tax loss carryforwards		4,966	7,175
Effective tax expense/(income)		-683	181
Effective tax rate		-2.4%	0.6%

1) The tax rate of 15% represents the Group's expected long-term tax rate based on rates applicable in those jurisdictions where taxable income should be generated in the future. The prior period tax rate of 26.2% was the weighed average tax rate calculated on current losses. Santhera believes that the 15% expected long term tax rate results in a more meaningful presentation of expected tax income and expense.

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.

## 26 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 shares issued and outstanding during the reporting period, excluding shares held as treasury shares.

	2007	2006
Net loss attributable to equity holders (in CHF)	-27,870,993	-28,258,464
Weighted-average number of shares issued and outstanding	3,100,588	1,956,853
<b>Basic and diluted loss per share (in CHF)</b>	<b>-8.99</b>	<b>-14.44</b>

For the years ended December 31, 2007 and 2006, 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 may have a dilutive effect on the net profit per Share.

## 27 Related Party Transactions

### Board of Directors and Executive Management compensation

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

	in CHF thousands	2007	2006
Short-term benefits: wages and salaries/Board compensation		1,875	1,993
Post-employment benefits (pension fund contributions)		97	91
Other long-term benefits		0	0
Termination benefits		0	15
Share-based payment expenses (fair value according to IFRS 2) <sup>1)</sup>		9,527	2,040

1) Fair values consist of option grants from 2007 and 2006, 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

	2007	2006
Wages and salaries (in CHF thousands)	1,599	1,867
Stock options (number)	29,339	101,065

The highest total remuneration paid in the year 2006 was paid to Klaus Schollmeier, Chief Executive Officer (**CEO**). He received a gross monetary compensation of CHF 673,125 and 32,845 stock options under the EIP in 2006. In 2007, he received a gross monetary compensation of CHF 561,875 and no stock options.

The highest total remuneration paid in the year 2007 was paid to Thomas Meier, Chief Scientific Officer (**CSO**). He received a gross monetary compensation of CHF 356,500 and 18,000 stock options under the ESOP 2004.

#### Board of Directors compensation

	2007	2006
Compensations (in CHF thousands)	276	126
Termination benefits (in CHF thousands)	0	15
Stock options (number)	0	18,000

In 2007, the highest compensation to a member of the Board was paid to Michael Lytton; he received a payment of CHF 72,000 and no stock options. In 2006, the highest compensation was paid to Bernd Seizinger; he received a 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 June 2007, Santhera entered into a license agreement with Novartis covering the compound TCH 346 (now SNT-317, INN: omigapil) which Santhera intends to develop for the treatment of CMD. Novartis Pharma AG is an affiliate of the Novartis Group of companies, Basel, Switzerland. Rudolf Gygax, a member of the Company's Board, is an employee of the Novartis Group. In addition, Novartis Forschungsstiftung which holds 2.7% of the Company's share capital is a part of the Novartis Group.

Under the terms of this license agreement, Santhera paid Novartis a nonrefundable up-front fee of USD 500,000. Additional payments will be due to Novartis upon reaching certain development and commercialization milestones (see note "Contingent Liabilities"). Santhera has the right to use all preclinical and clinical data generated on omigapil. Novartis retained a one-time buyback right for the program which is exercisable once the data from the pivotal clinical trial is available.

In May 2006, the Company renewed a consultancy agreement with Timothy 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 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.

*Shareholdings of members of the Board and Executive Management*

The total number of options held by the members of the Board amounted to 16,774 as of December 31, 2007 (16,774 options as of year-end 2006). By the end of 2007, the members of the Board held 1,630 Shares (1,230 Shares as of year-end 2006).

The total number of options held by the Executive Management amounted to 205,071 as of December 31, 2007 (180,453 options as of year-end 2006). As per December 31, 2007, the members of the Executive Management held 0 Shares (0 Shares as of year-end 2006).

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

Name	Total number of stock options 2007	Total number of stock options 2006
<b>Board of Directors</b>		
Michael Lytton, Chairman	0	0
Hans Peter Hasler, Vice Chairman	4,000	4,000
Martin Gertsch	4,000	4,000
Rudolf Gygax	774	774
Georg Nebgen	0	0
Timothy Rink	4,000	4,000
Klaus Schollmeier	see below	see below
Bernd Seizinger	4,000	4,000
<b>Executive Management</b>		
Klaus Schollmeier, Chief Executive Officer	66,368	66,368
Barbara Heller, Chief Financial Officer	45,418	34,079
Helmut Kessmann, Chief Business Officer	35,693	40,414
Thomas Meier, Chief Scientific Officer	57,592	39,592

In 2007, 4,721 stock options were exercised by a member of the Executive Management (0 during 2006).

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
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
2005	11,339	59.44
2006	101,065	1.00
2007	18,000	1.00
2007	11,339	59.44

The detailed disclosures regarding executive remuneration that are required by Swiss law are included in the notes to the financial statements of Santhera Pharmaceuticals Holding AG.

#### Loans of tbg Technologiebeteiligungsgesellschaft

Before the listing on the SWX, tbg Technologiebeteiligungsgesellschaft mbH, Bonn, Germany (**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.

## 28 Financial Risk Management Objectives and Policies

Santhera conducts R&D activities primarily in Switzerland, the EU and the US and is exposed to a variety of financial risks, such as foreign exchange rate risk, credit risk, liquidity risk, cash flow and interest rate risk. Santhera's overall financial risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the financial performance of the Group. Special guidelines and policies approved by the Board exist for overall risk management and financial internal controls and are monitored by the Executive Management and the Audit Committee of the Board. The risk of foreign exchange rate fluctuations on the expenses is managed by entering into foreign exchange derivative contracts. In accordance with the relevant treasury guidelines, Santhera only concludes contracts with selected high-quality financial institutions of good reputation and does not engage in speculative transactions.

### Foreign exchange rate risk

In order to reduce its foreign exchange exposure, Santhera entered into currency contracts (forwards, options, structured derivatives) to hedge against foreign currency exchange rate risks. An evaluation based on market values is performed regularly. Any fair value changes are recorded accordingly in the income statement. Santhera's primary exposure to financial risk is due to fluctuation of exchange rates between CHF, EUR and USD.

At December 31, 2007, the Group had hedged most of its foreign currency expenses in USD budgeted for 2008 and the first half of 2009. Future expected purchases in EUR are covered till end of first quarter 2008 by remaining cash and cash equivalents held in EUR.

The following table demonstrates the sensitivity to a reasonable possible change in USD and EUR exchange rate, with all other variables held constant, of Santhera's result before taxes and Santhera's equity:

	Increase/decrease foreign currency rate	Effect on result before taxes in CHF thousands	Effect on equity in CHF thousands
<b>USD positions</b>			
2007	+10%	386	0
	-10%	-386	0
2006	+10%	1	0
	-10%	-1	0
<b>EUR positions</b>			
2007	+5%	545	0
	-5%	-545	0
2006 <sup>1)</sup>	+5%	191	272
	-5%	-191	-272

1) The effect on equity resulted from an intercompany loan which was part of the net investment of a subsidiary.

### Interest rate risk

Santhera earns interest income on cash and cash equivalents and its profit and loss may be influenced by changes in market interest rates. Santhera is investing cash through money market instruments in line with its treasury guidelines to follow its financial needs over time. The loan from tbg was a fixed rate loan and therefore not affected by changes in interest rates.

The following table demonstrates the sensitivity to a reasonable change in interest rates, with all other variables held constant, of the Group's result before taxes. There is no impact on the Group's equity.

	Increase/decrease in basis points	Effect on result before taxes in CHF thousands
<b>2007</b>		
CHF	+50	444
CHF	-50	-444
EUR	+50	69
EUR	-50	-69
USD	+100	40
USD	-100	-40
<b>2006</b>		
CHF	+50	595
CHF	-50	-595
EUR	+50	33
EUR	-50	-33
USD	+100	1
USD	-100	-1

### Credit risk

Santhera has a certain concentration of credit risk. Short-term investments are invested as cash on deposit or in risk free money market funds, i.e. money market accounts with top tier banks or S&P A-1 rated money market investment instruments or similar ratings. No investment or contract with one counterparty, except cash on deposit subject to the criteria above, comprises more than 20% of portfolio at the date of investment.

The Company has policies in place to ensure that sales of products or partnerships are made to customers or with partners with an appropriate credit history and a commitment to ethical business practices. The maximum credit risk exposure is limited to the carrying amount of its financial assets including derivatives.

### Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and cash equivalents. Currently the Company is financed through equity and there is no funding through fixed income instruments or convertibles. Santhera's treasury calculates on a rolling basis the needs for settling the current expenses against the need for optimized financial investments. All amounts due (loans and interest) from tbg were fully paid back during 2007.

Contractual undiscounted cash flows Year ended December 31, 2007 in CHF thousands						
	On demand	Less than 3 months	3 to 12 months	1 to 5 years	Total	Book value
Long- and short-term debt	0	0	0	0	0	0
Trade payables	0	3,201	0	0	3,201	3,201
Subtotal	0	3,201	0	0	3,201	3,201
Foreign currency derivatives						
Cash outflow	0	2,370	10,103	5,051	17,524	0
Cash inflow	0	-2,254	-10,140	-5,070	-17,464	0
Subtotal	0	116	-37	-19	60	29
<b>Total</b>	<b>0</b>	<b>3,317</b>	<b>-37</b>	<b>-19</b>	<b>3,261</b>	<b>3,230</b>

Contractual undiscounted cash flows Year ended December 31, 2006 in CHF thousands						
	On demand	Less than 3 months	3 to 12 months	1 to 5 years	Total	Book value
Long- and short-term debt <sup>1)</sup>	0	0	526	976	1,502	1,416
Trade accounts payable	0	3,401	0	0	3,401	3,401
Financial liabilities long-term	0	0	0	0	0	0
Financial liabilities short-term	0	0	0	0	0	0
<b>Total</b>	<b>0</b>	<b>3,401</b>	<b>526</b>	<b>976</b>	<b>4,903</b>	<b>4,817</b>

1) Santhera Pharmaceuticals (Deutschland) GmbH has been granted loans (7% fixed interest p.a.) from tbg. These loans were fully repaid in 2007.

## Categories of financial instruments

Year ended December 31, 2007 in CHF thousands	Book value	Loans and receivables	Financial assets at FVtPL <sup>1)</sup>	Other liabilities at amortized cost	Financial liabilities at FVtPL <sup>1)</sup>
<b>Assets</b>					
Financial assets long-term	111	108	3	0	0
Financial assets short-term	81	0	81	0	0
Other receivables	0	0	0	0	0
Cash and cash equivalents	106,618	106,618	0	0	0
<b>Total</b>	<b>106,810</b>	<b>106,726</b>	<b>84</b>	<b>0</b>	<b>0</b>
<b>Liabilities</b>					
Long- and short-term debt	0	0	0	0	0
Financial liabilities long-term	1	0	0	0	1
Trade payables	3,201	0	0	3,201	0
Financial liabilities short-term	112	0	0	0	112
<b>Total</b>	<b>3,314</b>	<b>0</b>	<b>0</b>	<b>3,201</b>	<b>113</b>

1) Fair value through profit and loss

Year ended December 31, 2006 in CHF thousands	Book value	Loans and receivables	Financial assets at FVtPL	Other liabilities at amortized cost	Financial liabilities at FVtPL <sup>1)</sup>
<b>Assets</b>					
Financial assets long-term	88	88	0	0	0
Financial assets short-term	0	0	0	0	0
Other receivables	263	263	0	0	0
Cash and cash equivalents	125,662	125,662	0	0	0
<b>Total</b>	<b>126,013</b>	<b>126,013</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Liabilities</b>					
Long- and short-term debt	1,416	0	0	1,416	0
Financial liabilities long-term	0	0	0	0	0
Trade payables	3,401	0	0	3,401	0
Financial liabilities short-term	0	0	0	0	0
<b>Total</b>	<b>4,817</b>	<b>0</b>	<b>0</b>	<b>4,817</b>	<b>0</b>

1) Fair value through profit and loss

The fair values of all financial instruments approximate their carrying amount.

### **Capital Management**

First priority of Santhera's capital management is to provide adequate cash funds to ensure the financing of successful research, development and marketing activities so that future profits can be generated by gaining marketing authorization approvals for pharmaceutical products. As a company with currently no products on the market, the capital management is focused on the cash and cash equivalents position and is governed by specific Group treasury guidelines.

The available funds raised in a private financing round and the subsequent IPO in 2006, as well as generated through revenues in 2007, ensure that the Group can continue as a going concern.

No changes in goals and policies of our treasury management during the past two reporting years have been made.

### **29 Events After the Balance-Sheet Date**

On February 19, 2008, Juvantia investors exercised their 9,818 warrants (see note 11 "Share Capital").



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

Basel, February 28, 2008

As group auditors, we have audited the consolidated financial statements (balance sheet, income statement, cash flow statement and notes, pages 18 to 52) of Santhera Pharmaceuticals Holding AG for the year ended December 31, 2007.

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, 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 AG

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

Daniel Geiger  
Swiss Certified Accountant

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## Balance Sheet of Santhera Pharmaceuticals Holding AG

	in CHF thousands	Dec 31, 2007	Dec 31, 2006
<b>Assets</b>			
Tangible assets		25	48
Intangible assets		121	145
Investments in group companies		1,105	7,095
Loans to group companies		48,216	24,409
<b>Noncurrent assets</b>		<b>49,467</b>	<b>31,697</b>
Prepaid expenses and accrued income		540	501
Other receivables from group companies		11	345
Other receivables from third parties		595	576
Cash and cash equivalents		103,797	120,703
<b>Current assets</b>		<b>104,943</b>	<b>122,125</b>
<b>Total assets</b>		<b>154,410</b>	<b>153,822</b>
<b>Equity and liabilities</b>			
Share capital		3,119	3,099
Capital reserves and share premium		1,780	119,089
Free reserves		146,000	41,491
Accumulated profit/loss		2,393	-12,836
– Net profit/loss for the period		2,393	-12,836
<b>Total equity</b>		<b>153,292</b>	<b>150,843</b>
Trade accounts payable from group companies		22	63
Trade accounts payable from third parties		157	1,616
Other accounts payable from third parties		203	116
Accrued expenses		736	1,184
<b>Total current liabilities</b>		<b>1,118</b>	<b>2,979</b>
<b>Total liabilities</b>		<b>1,118</b>	<b>2,979</b>
<b>Total equity and liabilities</b>		<b>154,410</b>	<b>153,822</b>

	For the year ended December 31, in CHF thousands	
	2007	2006
Revenue from group companies	9,500	3,815
<b>Gross profit</b>	<b>9,500</b>	<b>3,815</b>
Other operating income	45	7
General and administrative expenses	-2,788	-13,212
Employee costs	-2,089	-2,649
Depreciation and amortization	-58	-30
Allowance on investment and intercompany loans	-5,990	-1,667
Other operating expenses	-19	0
<b>Total operating expenses</b>	<b>-10,944</b>	<b>-17,551</b>
<b>Operating result</b>	<b>-1,399</b>	<b>-13,736</b>
Financial income	4,717	916
Financial expenses	-925	-16
<b>Financial result</b>	<b>3,792</b>	<b>900</b>
<b>Result before taxes</b>	<b>2,393</b>	<b>-12,836</b>
Income tax expenses	0	0
<b>Net profit/loss</b>	<b>2,393</b>	<b>-12,836</b>

## 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

	Share capital at December 31	2007	2006
<b>Santhera Pharmaceuticals (Deutschland) GmbH</b>			
Lörrach, Germany	EUR	668,930	668,930
<b>Santhera Pharmaceuticals (Schweiz) AG</b>			
Liestal, Switzerland	CHF	125,000	125,000

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

## Guarantees

### Joint security to Key Equipment Finance International

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 (Schweiz) AG. As of December 31, 2007, the remaining outstanding amount was CHF 68,475 (CHF 217,875 as of year-end 2006).

### 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 2007, Santhera Pharmaceuticals Holding AG had an intercompany income of a dividend in kind in the amount of CHF 6.5 million from Santhera Pharmaceuticals (Deutschland) GmbH. Santhera Pharmaceuticals Holding AG does not plan to pay any dividends to its shareholders for the foreseeable future.

## Share Capital

During 2007, the share capital was increased by the amount of CHF 19,705 to an amount of CHF 3,118,861 as of December 31, 2007, (CHF 3,099,156 as of year-end 2006) through the exercise of employee stock options (using conditional share capital).

## 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 clin-

ical 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, the Juvantia investors are entitled to a cash payment in the amount of EUR 9.0 million. Based on the current agreements, the option cannot be exercised before July 1, 2008, and the term of the option to acquire Juvantia ends on June 30, 2009.

### Conditional Share Capital

As of December 31, 2007, 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 351,971 by issuing a maximum of up to 351,971 Shares, under the exclusion of shareholders' pre-emptive rights, for option rights being exercised under the Executive Incentive Plan (EIP) and Employee Stock Option Plan 2004 (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 Share Capital" above).

### Treasury Shares

No treasury shares were held during the reporting period.

### Additional Information

	in CHF thousands	2007	2006
Lease commitments not recorded in the balance sheet			
– Operational lease		13	18
Property insurance value of buildings and equipment			
– Equipment and furniture		250	250
Liabilities to pension funds/social insurance		4	5
Subordinated loans to group companies		48,216	24,409

Subordinated loans to group companies consist of loans to Santhera Pharmaceuticals (Schweiz) AG. As of December 31, 2007, the financial statements of this company disclose an over-indebtedness of CHF 42,977,829. The recoverability of the loans from Santhera Pharmaceuticals Holding AG is ensured by the fair value of its subsidiary, whose accounts are kept on a going-concern basis. The fair value of Santhera Pharmaceuticals (Schweiz) 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 a dividend in kind in 2007 of Santhera Pharmaceuticals (Deutschland) GmbH.

The Finnish Funding Agency for Technology and Innovation, Helsinki, Finland (**Tekes**), has 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, 2007, the loan amounted to EUR 5,488,468 including capitalized interest of 3% p.a. (EUR 5,342,384 as of December 31, 2006). In connection with the potential acquisition of Juvantia by Santhera, Tekes has agreed to restructure those loans. Juvantia will repay Tekes an amount of EUR 500,000 upon the closing of the exercise of the option by Santhera to acquire Juvantia. 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 repayments, subject to the closing of the acquisition.

### Significant Shareholders (>3%)

As far as can be ascertained from the information available, the following shareholders owned 3% or more of the Company's share capital at December 31:

Shareholder's name	Country	2007 Shares	%	2006 Shares	%
NGN	US/DE	379,102	12.23	379,102	12.23
Merlin	UK	239,592	7.73	239,592	7.73
Oxbio Bioscience Partners	US	220,090	7.10	220,090	7.10
3i	UK	213,278	6.88	213,278	6.88
Schroders <sup>1)</sup>	UK	173,560	5.60	104,177	3.36
GIMV	BE	156,192	5.04	156,192	5.04
Varuma	CH	146,932	4.74	146,932	4.74
Cominvest	DE	141,043	4.55	178,000	5.74
Heidelberg Innovation	DE	128,234	4.14	128,234	4.14
Carnegie	SE	118,873	3.84	118,873	3.84
Neomed	NO	98,445	3.18	98,445	3.18
Deka	DE	89,838	2.90	177,500	5.73

1) 2006 figure as per November 3, 2006

On November 12, 2007, the Company was notified by certain pre-IPO shareholders that their lock-up undertaking vis-à-vis Deutsche Bank had expired and that as a consequence thereof, they no longer formed a "group acting in concert" within the meaning of Article 20 of the Swiss Federal Stock Exchange Act as disclosed in Santhera's Offering Memorandum dated November 2, 2006. Additional details are available in the news release which can be downloaded from [www.santhera.com/newsreleases](http://www.santhera.com/newsreleases).

## Compensations to the Board of Directors and the Executive Management

Disclosure of compensation of members of the Board of Directors for the year 2007

	in CHF	Cash compen- sation fix	Social security	Compen- sation total
<b>Board of Directors</b>				
Michael Lytton, Chairman		72,000	5,714	77,714
Hans Peter Hasler, Vice Chairman		32,100	2,548	34,648
Martin Gertsch		45,090	3,579	48,669
Rudolf Gygax		24,000	0	24,000
Georg Nebgen		24,000	1,905	25,905
Timothy Rink		45,244	3,591	48,835
Klaus Schollmeier <sup>1)</sup>		0	0	0
Bernd Seizinger		34,167	2,712	36,879
<b>Total</b>		<b>276,601</b>	<b>20,049</b>	<b>296,650</b>

No option grants, nor any other payments, allowances or loans were made to the members of the Board in 2007.

1) Board member Klaus Schollmeier received no compensation for him being a member of the Board. All his compensations were paid for his function as CEO which is part of the disclosure of compensation of members of the Executive Management.

## Disclosure of compensation of members of the Executive Management

	Cash compen- sation fix CHF	Cash compen- sation variable CHF	Car leasing CHF	Stock options <sup>1)</sup> CHF	Social security CHF	Total CHF	Stock options granted number <sup>2)</sup>
Executive Manage- ment excl. CSO	927,950	314,325	7,263	581,712	234,279	2,065,529	11,339
CSO	286,750	69,750	0	1,620,656	57,989	2,035,145	18,000
<b>Total</b>	<b>1,214,700</b>	<b>384,075</b>	<b>7,263</b>	<b>2,202,368</b>	<b>292,268</b>	<b>4,100,674</b>	<b>29,339</b>

1) Reflects value of share-based payments in accordance with IFRS 2 at grant, i.e. the value of unvested stock options attributable at grant; tax value of such options is 0 until options are exercised. Such option values are theoretical values and do not reflect income tax values and do also take into consideration certain vesting provisions.

For information about the underlying stock option plans see note "Stock Option Plans" in the consolidated financial statements. For information about the Company's compensation procedures consult the Corporate Governance Report.

2) 18,000 options vest over a period of two years on one hand (50% after 12 months, 25% after 18 months and 25% after 24 months after grant date) and 11,339 options vest over four years on the other hand (50% after two years, 25% after three years and 25% after four years after grant date).

*Disclosure of Shares and stock options held by members of the Board of Directors and Executive Management as of December 31, 2007*

Name	Number of Shares	Number of vested stock options	Number of unvested stock options	Total number of stock options
<b>Board of Directors</b>				
Michael Lytton, Chairman	0	0	0	0
Hans Peter Hasler, Vice Chairman	0	0	4,000	4,000
Martin Gertsch	1,230	0	4,000	4,000
Rudolf Gyax	400	774	0	774
Georg Nebgen	0	0	0	0
Timothy Rink	0	3,000	1,000	4,000
Klaus Schollmeier	see below	see below	see below	see below
Bernd Seizinger	0	3,000	1,000	4,000
<b>Executive Management</b>				
Klaus Schollmeier, Chief Executive Officer	0	66,368	0	66,368
Barbara Heller, Chief Financial Officer	0	28,409	17,009	45,418
Helmut Kessmann, Chief Business Officer	0	31,288	4,405	35,693
Thomas Meier, Chief Scientific Officer	0	36,306	21,286	57,592

No other payments, allowances or loans were made to neither the members of the Board, members of the Executive Management or related parties in 2007.

**Events After the Balance-Sheet Date**

On February 19, 2008, Juvantia investors exercised their 9,818 warrants (see note "Conditional Share Capital" above).

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

	in CHF	2007	2006
Profit/loss carried forward		0	0
Net profit/loss of the year		2,392,555	-12,836,478
<b>Accumulated profit/loss</b>		<b>2,392,555</b>	<b>-12,836,478</b>
Appropriation to free reserves		2,392,555	0
Compensation with capital reserves and share premium		0	12,836,478
<b>Profit/loss to be carried forward</b>		<b>0</b>	<b>0</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, 2007	146,000,000
Appropriation of the profit for the period to free reserves	2,392,555
<b>Free reserves</b>	<b>148,392,555</b>



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

Basel, February 28, 2008

As statutory auditors, we have audited the accounting records and the financial statements (balance sheet, income statement and notes, pages 56 to 63) of Santhera Pharmaceuticals Holding AG for the year ended December 31, 2007.

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 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 the business plans and expected future cash flows. Even though the development of the products has shown favorable trend, a material uncertainty remains as to whether successful market launch of the products in development will attain the expected results.

Ernst & Young AG

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

Daniel Geiger  
Swiss Certified Accountant

**Forward-looking Statements**

This Annual Report is not and under no circumstances to be construed as a solicitation, offer or recommendation to buy or sell securities issued by Santhera Pharmaceuticals Holding AG. Santhera Pharmaceuticals Holding AG makes no representation (either express or implied) that the information and opinions expressed in this Annual Report are accurate, complete or up to date. Santhera Pharmaceuticals Holding AG disclaims, without limitation, all liability for any loss or damage of any kind, including any direct, indirect or consequential damages, which might be incurred in connection with the information contained in this Annual Report.

This Annual Report expressly or implicitly contains certain forward-looking statements concerning Santhera Pharmaceuticals Holding AG and its business. Certain of these forward-looking statements can be identified by the use of forward-looking terminology such as "believe", "expect", "may", "are expected to", "will", "will continue", "should", "would be", "seek" or "anticipate" or by discussions of strategy, plans or intentions. 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 expected results, performance or achievements expressed or implied by such forward-looking statements. There can be no guarantee that any of the research and/or 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 preclinical and clinical trial results; unexpected regulatory actions or delays or government regulation generally; the ability of Santhera Pharmaceuticals Holding AG 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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