PAION AG, Aachen

Annual Financial Report

for the Fiscal Year 2010

PAION

PAION AG, Aachen

Consolidated Financial Statements

as of 31 December 2010

Group Management Report

for the Fiscal Year 2010

PAION

Group Management Report for Fiscal Year 2010

Economic Background

1. Overall Economic Development

The year 2010 was marked by a strong recovery of the global economy after the heavy slump the year before. In most countries the economic output again reached the level it was before the financial crisis. In total the world economy increased by 3.9% in 2010. The strong increase of the world economy was driven especially by the economic growth of the emerging markets. In China for example the economy grew by 10%. The US economy also returned to the growth path; growth was 2.7%. In Germany the growth rate of 3.6% was relatively high compared to other industrial nations, especially driven by the strong export sector as a result of the robust world economy.

The recovery of the world economy had an effect on the development of the stock markets. Thus the DAX increased by 16% compared with the closing index the previous year. The development of other important indexes was similar. The Dow Jones Index increased by 11% and the S&P 500 increased by 13% compared with the closing indexes the previous year.

For 2011 and 2012 a further increase of the economy is expected, but at lower growth rates than in 2010. For the world economy a growth of 3.3% is expected. In Germany a growth of 2.2% is expected. Risks are especially the sovereign debt crisis in Europe and the USA as well as the still weak real estate and financial sectors in the USA. The forecast uncertainty remains at a high level.

2. Development of the Pharmaceutical and Biotechnology Industry

In the pharmaceutical and biotechnology industry the consolidation pressure is continuing unrelieved. This results especially from the high risks and costs associated with pharmaceutical development, the expiry of patent protection on a number of products in the years to come and in the budget cuts in the health sector by several industrial nations following the budget deficit overruns. 2010 again saw several company mergers, cooperation agreements, in-licensing and out-licensing. In addition to mergers among pharmaceutical companies, numerous biotechnology companies were again acquired by pharmaceutical companies. These acquisitions were frequently preceded by long-standing cooperations between the parties. The difficult financing conditions for small biotech companies and the still low valuations have increased the trend towards acquisitions and cooperation agreements. It is expected that the industry consolidation will continue over the next years.

The share prices of listed pharmaceutical and biotechnology companies developed differently on a regional basis. The NASDAQ Biotechnology Index increased by 15% compared with the closing index the previous year. The AMEX Biotechnology Index even increased by 38% in 2010. On the contrary the Deutsche Börse AG's DAXsubsector Biotechnology Index decreased by 4% compared with the closing index the previous year.

As a result of the crisis on the financial markets, investors became much more hesitant in 2009 and IPOs have virtually ground to a halt, both of which have considerably exacerbated especially biotechnology companies' chances of securing financing. The IPO activity has recovered slightly in 2010 but is still weak. In 2010 investors were willing in individual cases to invest in biotechnology companies, however, overall the chances of securing financing are still difficult for biotechnology companies.

Business Performance

I. Preliminary Remarks

PAION AG is a holding company that only provides management and services to its subsidiary companies. These services primarily focus on administrative tasks, including accounting, legal, human resources, public relations and controlling. In addition, PAION AG supports the financing of its subsidiaries' ongoing business activities, while the Group companies provide each other with development-related services. The activities of the PAION Group (hereinafter also referred to as "PAION") are thus mainly determined by the development operations of PAION Deutschland GmbH and PAION UK Ltd which are presented below.

PAION's portfolio comprises five candidates in clinical development. These are the substances Remimazolam (CNS 7056), M6G and Solulin in internal development and the substances Desmoteplase and GGF2 which are being developed by cooperation partners. Furthermore, Remimazolam is being developed by cooperation partner Ono for the Japanese market. Remimazolam and M6G are being developed by the subsidiary PAION UK Ltd and Solulin is being developed by the subsidiary PAION Deutschland GmbH. Desmoteplase is an asset of PAION Deutschland GmbH and GGF2 is an asset of PAION Holdings UK Ltd.

The development of the compounds CNS 5161 and Flovagatran was discontinued in the fiscal year. PAION had based the further development of CNS 5161 on third-party financing. Since such financing could not be secured by year end 2009, the existing development co-operation for CNS 5161 with Ergomed was terminated and activities discontinued at the beginning of 2010.

With the compound Flovagatran preclinical studies were conducted. After weighing the probability of commercial and clinical success, the development of Flovagatran was discontinued in December 2010, as a promising indication could not be identified.

PAION has rights to further substances which are partly out-licensed and may lead to additional success-related incomes and payments. At present the likelihood is still assessed to be low, since these substances are not a major part of PAION's or its partners' development strategy.

Fiscal year 2010 was marked by the concentration of PAION Group on the development of the substances of PAION UK Ltd, especially Remimazolam.

2. Overview of Development Activities of PAION Deutschland GmbH and PAION UK Ltd

a. Remimazolam

Remimazolam is an innovative short-acting general anaesthetic/sedative that is being developed by PAION initially for use in minor medical interventions (procedural sedation). Sedatives are used, for example, in endoscopic procedures such as colonoscopies. After intravenous administration to over 300 human volunteers/patients in the course of the clinical trials performed, Remimazolam rapidly induced the desired sedation. Importantly, for the benefit of the volunteer/patient, this sedative effect quickly disappears again. This means that the patient can be selectively sedated for the duration of the intervention and rapidly regains full consciousness after the procedure. This rapid offset of the effect of the substance is due to its metabolism by tissue esterase enzymes that are widely distributed throughout the body.

Remimazolam is currently being developed by PAION as a sedative agent for day case procedures. It has additional potential in the induction and maintenance of anaesthesia, which is the initial indication being developed by PAION's partner Ono for the Japanese market. Furthermore, Remimazolam could also be used as a sedative during artificial respiration in the Intensive Care Unit (ICU).

Clinical Development

The clinical studies performed with Remimazolam comprise two Phase I and two Phase II studies with single or multiple dose without an intervention or during endoscopy of the upper gastrointestinal tract or the colon. The patient recruitment of the Phase IIb study performed in 2010 ran from May to September; the results were reported in November 2010.

The generated data indicate a good tolerability of Remimazolam. The effect of Remimazolam can be reversed by the benzodiazepine antagonist Flumazenil. A rapid onset and offset of the sedative effect was observed during the procedures. It was also shown that it is possible to achieve the same (safety) or better (efficacy) results as compared to a single dose of the gold standard Midazolam with a single dose of Remimazolam. Furthermore, an adequate sedation level can be maintained for 30 minutes with a multiple dose regimen. This time period is usually required to perform a colonoscopy if an additional intervention is required (e.g. removal of one or more polyps). A routine, purely diagnostic colonoscopy takes approximately 10–15 minutes.

Based on the results of the Phase IIb study, the optimal dose regimen for Phase III studies can now be defined.

Cooperation Agreements

In 2007 Ono Pharmaceutical Co., Ltd. (Ono) was granted the rights to develop and market Remimazolam for the Japanese market in return for development milestone payments and royalties. Ono is developing Remimazolam in indications where continuous infusion is needed, whereas PAION initially concentrates on indications requiring single or repeated bolus dosing to sedate patients for short procedures. In this co-operation, data and information are continually shared by each other so that each party benefits from the development progress of the other party. In February 2010 Ono informed PAION about the initiation of the first Japanese Phase I study. The first subject was enrolled in April 2010. This triggered the first milestone payment of USD 1 million from Ono. Meanwhile the Phase I programme has progressed as planned. The progress that has been made will help to support and accelerate the development of Remimazolam for the indications anaesthesia and ICU sedation in the PAION territories.

PAION is exploring partnering opportunities outside Japan to advance the development of Remimazolam, preferably for multiple indications, as quickly as possible as well as to prepare the subsequent commercialisation.

b. Morphine-6-glucuronide

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

Clinical Development

PAION has performed various in-depth analyses of the available clinical data. The results support PAION's view that M6G has a wider therapeutic window than morphine at equi-analgesic dosages with a lower incidence of post-operative nausea and vomiting. Based on these findings a development plan has been agreed with the FDA for this New Chemical Entity, i.e. a novel, distinct substance. This improves the potential profitability for potential pharma partners as it provides the prospect for longer market exclusivity. The aim of the remaining Phase III programme is to prove that M6G causes significantly less post-operative nausea and vomiting compared to equi-analgesic doses of morphine.

Cooperation Agreements

The intellectual property rights for M6G are based on PAION's own development as well as rights developed by third parties. In connection with this third party intellectual property, PAION has success-related obligations in the form of milestones and royalties.

Despite the positive results of the in-depth re-analysis and the encouraging FDA consultation PAION has so far not been able to conclude a global partnership. Currently PAION is in discussions on continuing the development together with several partners in regional deal structures.

c. Desmoteplase

Desmoteplase is a recombinant protein (a so-called plasminogen activator) derived from the saliva of the vampire bat, Desmodus rotundus, which is intravenously administered to dissolve blood clots. It is currently being developed for the treatment of acute ischaemic stroke. The treatment is being carried out in a timeframe of three to nine hours post onset of stroke symptoms – a time window for which there currently is no approved drug treatment.

Clinical Development

So far Desmoteplase has been tested in two Phase II studies and one Phase III study for the treatment of acute ischaemic stroke. In 2008 PAION's licence partner H. Lundbeck A/S (Lundbeck) took on the further development of Desmoteplase. In December 2008 Lundbeck initiated a further Phase III development programme consisting of two comparable studies (DIAS-3 and DIAS-4). Furthermore, in March 2010 Lundbeck initiated a Phase II study in Japan (DIAS-J).

In current corporate communication Lundbeck reported that patient enrolment in the clinical Phase III programme with Desmoteplase was slower than anticipated (Lundbeck Annual Report 2010). Lundbeck expects to be able to file the market authorisation application by the end of 2012 (Lundbeck presentation at the SEB Nordic Seminar in January 2011).

Cooperation Agreements

PAION in-licensed Desmoteplase from Bayer AG (former Schering AG) in 2001 in return for milestones and royalties. Today Lundbeck holds the exclusive global rights for research, development, production and marketing of Desmoteplase. The licence agreement came into effect in January 2008 and was extended in October 2010, to include potential follow-up compounds. Under these agreements, Lundbeck agreed to undertake the following payments:

- Payment of a non-refundable amount of EUR 8 million upfront payment, on the date the agreement took effect (January 2008; disclosed as deferred income and being released proportionally over the probable development period),
- Payment of a non-refundable purchase price of EUR 1.5 million, on the date the extended agreement took effect (October 2010; disclosed as revenue in 2010),
- Milestone payments for Desmoteplase of up to EUR 68 million, of which up to EUR 40 million relate to milestones due before and including market approvals (regional splitting) and in total EUR 28 million are due upon commencement of marketing activities and the achievement of specific revenue targets,
- Milestone payments for the second generation molecules (follow-up compounds) of up to EUR 25 million for development and commercialisation,
- Assumption of all costs, especially for clinical development, production development, patent costs and marketing approval,
- Payment of licence fees (dependent on revenues) which amount to a low double-digit percentage following the deduction of the licence fees PAION has to pay to the original licensor, Bayer AG.

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

d. Solulin

Solulin is an improved variant of the human protein thrombomodulin, an important natural regulator of the coagulation system. One function of thrombomodulin is the stabilisation of the haemostatic fibrin clot. In contrast to natural thrombomodulin, which is an integral protein of vascular membranes, Solulin can travel through the blood stream to reach its potential site of action.

PAION decided in 2008 to investigate alternative indications for Solulin. In December 2010 positive preclinical data were reported for the indication haemophilia and PAION has decided to select haemophilia as new lead indication for Solulin. Before entering clinical development in the indication haemophilia, advanced pre-clinical experiments are planned.

e. Glial Growth Factor (GGF2)

GGF2 (Glial Growth Factor 2) is known to stimulate the growth and differentiation of a variety of cells including glial cells, the support cells of the nervous system. These glial cells form the myelin sheath that insulates nerve cells and is essential for their survival and proper functioning. In demyelinating diseases such as multiple sclerosis, the myelin sheath is damaged, leading to the degeneration of nerve cells.

In pre-clinical studies PAION's licence partner Acorda Therapeutics, Inc. (Acorda) demonstrated that GGF2 can stimulate the cell growth necessary to protect and regenerate a damaged myelin sheath. GGF2 is the lead neuregulin in Acorda's portfolio. Neuregulins have also shown the ability to restore cardiac function in preclinical models of heart failure caused by myocardial infarction, rapid pacing, viral and chemically induced cardiomyopathies. In April 2010 the FDA approved the IND (Investigational New Drug) application for GGF2 for the indication of heart failure. In July 2010 Acorda announced that the National Heart, Lung and Blood Institute (NHLBI) has awarded a USD 1 million Cardiac Translational Research Implementation Program (C-TRIP) grant to Acorda and its collaborator Vanderbilt University Heart and Vascular Institute to support the early phase clinical research on GGF2. In December 2010 Acorda announced the start of the first Phase I study.

Cooperation Agreements

The rights relating to the recombinant GGF2, rh GGF2, were licensed to Acorda in 2002 by PAION UK. The IND application submitted in March 2010 triggered the obligation to pay the first milestone of USD 0.5 million; the payment was received in April 2010. The IND approval communicated by Acorda in April 2010 triggered the obligation to pay the second milestone of USD 0.5 million; the payment was received in May 2010. In total, further milestone payments of USD 2.5 million prior to market approval and an additional milestone payment of USD 5 million are due upon market authorisation; after that PAION will receive revenue dependent royalties.

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

a. Results of Operations

The revenues increased by KEUR 2,941 (191.8%) compared to the previous year to KEUR 4,474, which is mainly due to the payment received from Lundbeck in connection with the extension of the Desmoteplase licence agreement (KEUR 1,500) as well as milestone payments from Ono (KEUR 749) and Acorda (KEUR 737).

Research and development expenses decreased by KEUR 1,570 (14.8%) compared to the previous year.

General administrative and selling expenses increased by KEUR 192 (4.4%) compared to the previous year.

The financial result decreased compared to the previous year on the back of lower money market interest rates as well as lower cash and cash equivalents.

In 2010, the net loss for the year decreased by KEUR 3,783 (29.0%) to KEUR -9,254. The improvement, compared to the previous year, is mainly due to the increase in revenues and the decrease in research and development expenses.

	2010 KEUR	2009 KEUR
Revenues	4,474	1,533
Cost of revenues	-19	-51
Gross profit	4,455	1,482
Research and development	-9,016	-10,586
General administrative and selling	-4,540	-4,348
Other income (expenses)	68	456
Operating expenses	-13,488	-14,478
Operating loss	-9,033	-12,996
Financial result	-660	-381
Income taxes	439	340
Loss for the year	**-9,254**	**-13,037**

Revenues in fiscal year 2010 mainly result from milestone payments received (KEUR 2,989; previous year: KEUR 0) as well as from the release of deferred income of a non-refundable upfront payment received in 2008 in connection with the licence agreement concluded with Lundbeck (KEUR 1,455; previous year: KEUR 1,455). The milestone payments relate mainly to the payment received from Lundbeck in connection with the extension of the Desmoteplase licence agreement (KEUR 1,500), a milestone payment from Ono (KEUR 749) for the start of the Phase I study with Remimazolam in Japan and two milestone payments from Acorda for the submission and subsequent approval of the IND for the compound GGF2 (KEUR 737). The revenues also include small reimbursements of development expenses from Lundbeck as well as other minor revenues.

Compared with the previous year, **research and development expenses** decreased in fiscal year 2010 by KEUR 1,570 to KEUR 9,016. The main research and development focus was on Remimazolam, althouogh research and development expenses were also incurred for M6G, Solulin and Flovagatran.

Compared with the previous year, **general administrative and selling expenses** increased in fiscal year 2010 by KEUR 192 to KEUR 4,540.

Other income decreased in fiscal year 2010 by KEUR 388 to KEUR 68 compared to the previous year which is mainly due to the repayment of a written-off loan receivable in the amount of KEUR 436 included in the previous year.

In fiscal year 2010, the **financial result** amounted to KEUR -660, equivalent to a decline of KEUR 279 compared with the previous year. The main reasons for the decrease are lower money market interest rates as well as the reduction in cash and cash equivalents compared to the previous year.

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

b. Net Assets and Financial Position

The total assets as of 31 December 2010 decreased by KEUR 8,714 compared to 31 December 2009 and amounted to KEUR 26,836. The decrease was mainly due to a lower equity through the loss of the period and lower cash and cash equivalents. As of 31 December 2010 the equity ratio is 44.6%, which means a decline compared to 31 December 2009 (54.3%). If the subordinate loan and the deferred non-refundable upfront payment from Lundbeck were recognised as economic equity, the equity ratio would increase to 83.8% (previous year: 87.9%).

	31 Dec. 2010 KEUR	31 Dec. 2009 KEUR	Change KEUR
Non-current assets	10,768	11,671	-903
Current assets	16,068	23,879	-7,811
Assets	**26,836**	**35,550**	**-8,714**
Equity	11,968	19,304	-7,336
Non-current liabilities	10,483	12,033	-1,550
Current liabilities	4,385	4,213	172
Equity and liabilities	**26,836**	**35,550**	**-8,714**

The **non-current assets** mainly comprise the development projects M6G (KEUR 6,405) and Remimazolam (KEUR 4,095).

Compared with 31 December 2009, **current assets** have declined by KEUR 7,811 to KEUR 16,068. This decline is substantially due to the decrease in cash and cash equivalents by KEUR 7,989 to KEUR 14,882. The change in cash and cash equivalents stems from the following areas:

	2010 KEUR	2009 KEUR
Cash flow from operating activities	-8,143	-12,508
Cash flow from investing activities	-44	-108
Cash flow from financing activities	170	-658
Effect of exchange rate changes	28	74
Change in Cash and cash equivalents	**-7,989**	**-13,200**

The cash flow from operating activities of KEUR -8,143 was mainly due to the loss for the year in the amount of KEUR -9,254 as well as countervailing to a cash inflow from a tax reimbursement of parts of the research and development costs for 2009 from the British tax authorities (KEUR 365). The improvement of KEUR 4,365 in the cash flow from operating activities compared to the previous year is mainly due to the milestone payments received from Lundbeck, Ono and Acorda as well as lower research and development expenses.

The cash flow from financing activities in fiscal year 2010 results from the issue of 470,765 new shares (KEUR 1,159), from payments in connection with the equity facility (KEUR -397) as well as from interest payments for the subordinated loan raised in April 2006 (KEUR -591).

The decrease of KEUR 1,550 in **non-current liabilities** is mainly attributable to the monthly release of the deferred non-refundable upfront payment in connection with the licence agreement concluded with Lundbeck (KEUR 1,455).

The **current liabilities** amount to KEUR 4,385 and are nearly unchanged compared to 31 December 2009 (KEUR 4,213).

Headcount

As of 31 December 2010, the total headcount of the PAION Group amounted to 27 employees, of whom six work for the PAION UK Group. By comparison, the headcount as of 31 December 2009 amounted to 30 employees.

Changes to the Management and Supervisory Board

The Annual General Meeting on 19 May 2010 re-elected Dr Wenninger as member of the Supervisory Board. Afterwards the Supervisory Board elected Dr Spiekerkötter as Chairman of the Supervisory Board and Dr Wenninger as Deputy Chairman of the Supervisory Board.

Compensation Report

I. Management Board

The remuneration paid to Management Board members comprises a fixed annual compensation, a variable bonus, a long-term performance-based compensation component in the form of stock options and stock appreciation rights as well as other compensation in terms of taxable payments in kind, insurance premiums and pension contributions. All stock options and stock appreciation rights granted to Management Board members so far have a ten-year term. The variable bonus depends on the achievement of long-term and sustainable financial and strategic corporate targets and personal goals which are defined by the Supervisory Board in conjunction with the Management Board at the beginning of each fiscal year. The level of target achievement and the related amount of the variable compensation is assessed and determined by the Supervisory Board at the end of each year. Bonuses are limited to a maximum amount and are paid depending on personal goal achievement. Furthermore, negative developments do have an effect on the amount of the variable bonus in terms of a malus. Performance targets are not subsequently adjusted.

Apart from Dr Kilpatrick, the compensation as board member covers the director function in the subsidiaries.

The members of the Management Board have received stock options from the Stock Option Plan 2005 approved by the Annual General Meeting on 30. December 2004. The number of shares to be allocated to the Management Board was determined by the Supervisory Board immediately after the IPO. The two- to four-year vesting period before stock options can be exercised acts as a long-term incentive to increase the company's value. The exercise price of the stock options is EUR 8.00, equivalent to the issue price of the shares at the IPO. As of 31 December 2010, the exercise hurdle was EUR 11.33.

The Supervisory Board granted the Management Board members a total of 75,000 stock appreciation rights under the Employee Participation Plan 2006. The stock appreciation rights have a two-year vesting period after which time the holder is entitled to receive a sum of money based on the PAION AG share price. In addition to an annual minimum appreciation, the Employee Participation Plan 2006 also limits the value of the amount payable. The maximum payable amount is 100% of the exercise price, which is EUR 7.89 for the stock appreciation rights granted in fiscal year 2006. As of 31 December 2010, the exercise hurdle was EUR 9.50.

From the Stock Option Plan 2008 approved by the Annual General Meeting on 5 May 2008 a total of 172,170 stock options were granted to the members of the Management Board. The Supervisory Board determined the number of stock options to be allocated to the Management Board. The two- to four-year vesting period before stock options can be exercised acts as a long-term incentive to increase the company‘s value. The exercise price is between EUR 1.11 and EUR 1.26 per stock option depending on the price of the share price at the time of allocation. As of 31 December 2010 the exercise hurdle for those options that have vested was EUR 1.40.

In January 2010 further 169,650 stock options from the Stock Option Plan 2008 with a vesting period of four years were issued to the members of the Management Board. The exercise price is EUR 1.84 per stock option and reflects the share price at the time of allocation.

In total 341,820 stock options from the Stock Option Plan 2008 were granted to members of the Management Board.

From the Stock Option Plan 2010 which was approved by the Annual General Meeting on 19 May 2010 no stock options have been issued so far.

The stock option agreements with the individual members of the Management Board limit the numbers of stock options which can be granted. With the exception of minimum increases in value, no restrictions have been imposed in respect of changes in the value of the stock options, which are directly linked to PAION’s share price performance. A maximum payable amount has been agreed in respect of the development of the value of the stock appreciation rights, which is directly related to the performance of PAION shares.

In fiscal year 2010 no stock options or stock appreciation rights were exercised by the Management Board.

Based on the agreements with the members of the Management Board, the compensation structure for fiscal year 2010 is as follows:

		Dr Wolfgang Söhngen	Dr Mariola Söhngen	Bernhard Hofer	Dr Gavin Kilpatrick[1]
Total remuneration 2010:					
Fixed salary	EUR	236,667	216,667	200,000	177,316
Variable compensation	EUR	86,616	79,398	72,180	61,014
Other compensation	EUR	25,699	16,479	11,637	26,793
Fair value of stock options issued in 2010	EUR	140,244	93,496	93,496	93,496
Status of non-exercised stock options and stock appreciation rights as of 31 December 2010:					
Stock options 2005	NO.	138,964	109,186	109,186	
Stock options 2005 – fair value[2]	EUR	494,017	388,156	388,156	
Stock options 2008	NO.	113,940	75,960	75,960	75,960
Stock options 2008 – fair value[2]	EUR	172,956	115,304	115,304	122,765
Stock Appreciation Rights (SAR)	NO.	25,000	25,000	25,000	
SAR - fair value[3]	EUR	6,250	6,250	6,250	

1 Compensation was paid by PAION AG and PAION UK Ltd
Payment in GBP; amounts converted from GBP to EUR at monthly average exchange rates
2 Applicable fair value at the time of issuance, calculated using the Black/Scholes option pricing model
3 Applicable fair value on the balance sheet date, calculated using the Black/Scholes option pricing model

The "other compensation" item contains insurance premiums and pension contributions paid by PAION as well as non-monetary benefits from the provision of company cars.

Management Board remuneration in fiscal year 2010 amounted to KEUR 1,631 (previous year: KEUR 1,429).

In the event of a change of control and the termination of employment within a certain period after the change of control, the Management Board members are each entitled to contractual severance payments. In the cases of Mr Hofer and Dr Kilpatrick the severance payment corresponds to 100% of their annual fixed basic compensation. In the cases of Drs Söhngen the severance payment corresponds to 100% of their annual fixed basic compensation

and the annual bonus. However, claims to severance payment in connection with a change of control can only be exerted if the change of control also entails a significant change in business strategy, a significant change in responsibilities or a relocation of the place of work by at least 300 kilometres. In case of Dr Kilpatrick the relocation of the place of work by at least 300 kilometres does not apply as a precondition for a severance payment.

A notice period of one year has been agreed between Dr Kilpatrick and PAION UK Ltd.

With the exception of changes of control as described above, the employment contracts of Management Board members do not contain any specific severance payment provisions in the event of early termination of employment relationships. The employment contracts of Management Board members do not provide for interim payment upon expiry.

Pursuant to the terms of the Stock Option Plans 2008 and 2010 in the event of a change of control, the waiting period for all stock options issued to Management Board members ends two years (Stock Option Plan 2008) and four years (Stock Option Plan 2010) respectively after the day of issue in the case of those stock options whose two- or four-year waiting period has expired or, in case a longer waiting period has been defined, on the day the controlling acquisition comes into effect. In the case of issued stock options for which the two- or four-year waiting period has not yet expired, the entitlement to subscribe to shares on the basis of issued stock options is converted into an entitlement to a corresponding cash settlement based on the share price on the day the controlling acquisition comes into effect. The corresponding stock options lapse. The Company may choose to grant listed shares in the acquiring company instead of the cash settlement.

2. Supervisory Board

Supervisory Board remuneration comprises basic compensation and per-meeting fees. The members of the Supervisory Board do not currently receive performance-based remuneration. The Chairman of the Supervisory Board receives twice the basic compensation and per-meeting fee, his deputy receives one-and-a-half times these amounts. Members of the Supervisory Board who are resident in a country outside Europe receive for each Supervisory Board meeting they physically attend double the basic attendance fee. The attendance fee is paid for a maximum of six meetings per year.

The members of the Supervisory Board received the following remuneration for their activities in fiscal year 2010:

	Basic compensation EUR	Per-meeting fees EUR	Total EUR
Dr Jörg Spiekerkötter	36,192	15,750	51,942
Dr Walter Wenninger	33,808	15,750	49,558
Alan Goodman	20,000	15,000	35,000

Supervisory Board remuneration in fiscal year 2010 amounted to KEUR 137 (previous year: KEUR 131).

Disclosures Pursuant to Section 315 (4) HGB and Explanatory Report

Composition of subscribed capital
As of 31 December 2010, PAION AG had a subscribed capital of EUR 25,073,684.00, divided into 25,073,684 no-par value shares, each representing a notional share in the capital stock of EUR 1.00. The shares are issued to the bearer and are fully paid in. Shareholders are not entitled to demand share certificates for their shares under Art. 6 (2) of the Articles of Incorporation. All shares carry the same rights and duties. Each share carries the right to one vote at the Annual General Meeting and also forms the basis of the holder‘s share in profit. More information on the individual rights and duties of shareholders can be found in the German Stock Corporation Act (Aktiengesetz, AktG), in particular Sections 12, 53a et seqq., 118 et seqq. and 186.

Restrictions relating to voting rights or the transfer of shares
Pursuant to German legislation and the Articles of Incorporation of PAION AG, no restrictions are imposed on the voting rights or transferability of the shares. The Management Board of PAION AG is also not aware of any voting rights or share transfer restrictions at shareholder level.

Shareholdings which exceed 10% of voting rights
The German Securities Trading Act (Wertpapierhandelsgesetz, WpHG) stipulates that any shareholder who achieves, exceeds or falls short of specific shares in the voting rights in the Company through the purchase or sale of shares or by other means, must accordingly notify the Company and the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin). The lowest threshold for this reporting obligation is 3%. The Company has been notified by Innoven Partenaires S.A., Paris, France, that the latter owns direct

or indirect shares in the Company's capital that equal or exceed 10% of the voting rights. On 1 August 2008, Innoven Partenaires S.A., Paris, France, held 10.57% of the voting rights of PAION AG (equivalent to 2,602,953 voting rights).

Shares with special rights conferring control

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

Type of control of voting rights when employees are shareholders and do not directly exercise their control rights

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

Legal provisions and provisions of the Articles of Incorporation on the appointment and removal of members of the Management Board and amendments to the Articles of Incorporation

Members of the Management Board are appointed and removed in accordance with Sections 84 and 85 AktG and the supplementary provisions of the Supervisory Board's rules of procedure which stipulate an age limit of 65 years for Management Board members. Pursuant to Section 84 AktG, members of the Management Board can be elected for a maximum of five years by the Supervisory Board. Repeat appointments or extensions of the term of office for up to a maximum of five years at a time are permissible. Pursuant to Art. 8 (1) of the Articles of Incorporation, the Management Board must comprise at least two members. The Supervisory Board determines the number of members on the Management Board. Furthermore, pursuant to Section 84 (2) AktG and Art. 8 (2) of the Articles of Incorporation, the Supervisory Board may appoint a member of the Management Board as CEO.

Amendments to the Articles of Incorporation are effected in accordance with Sections 179 and 133 AktG in conjunction with Art. 27 of PAION AG's Articles of Incorporation. The shareholder resolution required for any amendment to the Articles of Incorporation can, under PAION AG's Articles of Incorporation, be adopted by a simple majority of the capital stock represented at the adoption of the resolution, provided this is permitted by law.

Authority of the Management Board to isue or buy back shares

The Management Board is authorised to increase the share capital on or prior to 25 May 2014, with the consent of the Supervisory Board, on one or more occasions, by up to EUR 12,300,000.00 in total by issuing up to 12,300,000 new no-par value bearer shares in return for cash contributions or contributions in kind (Authorised Capital 2009). In the case of capital increases against contributions in kind, the Management Board may also exclude

subscription rights, subject to the Supervisory Board's consent. Shareholders must be granted subscription rights if the capital is to be increased against payments in cash. The new shares may also be taken by one or more financial institutions on condition that they offer them to shareholders. The Management Board may, subject to the Supervisory Board's consent, exclude peak amounts from shareholders' subscription rights. The Management Board is also authorised to exclude shareholders' subscription rights, subject to the consent of the Supervisory Board, if the issue price of the new shares is not significantly less than the market price and the shares issued in return for cash contributions with subscription rights excluded pursuant to Section 186 (3) Sentence 4 AktG do not exceed 10% of the share capital as of 25 May 2009. The Management Board is moreover authorised to exclude shareholders' subscription rights, subject to the consent of the Supervisory Board, to the extent necessary to grant subscription rights to holders of convertible bonds, participation rights or options as defined in Section 221 AktG. To date, 470,765 issued shares of the Authorised Capital 2009 have been used.

Furthermore, subject to the consent of the Supervisory Board, the Management Board is authorised to issue on or before 18 May 2015, on one or more occasions, bearer and/or registered convertible and/or warrant bonds of up to an aggregate of EUR 98,000,000.00 with a maximum term of 20 years and to grant the holders or beneficiaries of the bonds conversion rights or options to new shares in PAION AG with a share in share capital of up EUR 9,800,000.00 in total (Conditional Capital 2010 II). Furthermore, the company is authorised to issue 858,121 shares (Conditional Capital 2004 II), 760,235 shares (Conditional Capital 2008 I) and 720,000 shares (Conditional Capital 2010 I) in connection with the Stock Option Plans 2005, 2008 and 2010.

Material arrangements dependent on a change in control in the wake of a takeover bid

The licence agreement reached with Lundbeck at the end of 2007 stipulates that Lundbeck, in certain circumstances, has the authorisation to limit PAION's information rights to a minimum in the event of a change of control at PAION, and, if required, to terminate all options exercised by PAION with regard to co-marketing. If Lundbeck exercises its termination right, PAION retains its claim to milestone payments and to a share in the joint marketing result.

Based on the agreement with H.E.A.T. Mezzanine S.A., Luxemburg regarding the subordinate loan of EUR 7,000,000, H.E.A.T. Mezzanine has the right, to terminate the loan ("extraordinary dismissal") following a change of control, if PAION after a change of control does not provide written evidence to the creditor, that as a consequence of the change of control the credit rating of PAION does not fall under a defined level.

Compensation agreements entered into by the company with members of the Management Board and employees in the event of a takeover bid

The terms of the Stock Option Plans 2008 and 2010 stipulate for both members of the Management Board and employees that in case of a change of control the vesting period for all options, whose two-year (Stock Option Plan 2008) or four-years (Stock Option Plan 2010) vesting period has expired the vesting period ends at the date of the change of control. For all options, whose two- or four-year vesting period has not expired yet at the date of the change of control, the

entitlement to subscribe to shares is converted into an entitlement to a cash settlement based on the share price on the day the change of control comes into effect; the corresponding stock options lapse. The company may choose to grant listed shares in the acquiring company instead of the cash settlement.

For information on further existing compensation agreements with Management Board members, please refer to our comments in the section "Compensation Report".

Risks and Opportunities Report

I. Risk Management

As a biopharmaceutical company, PAION is exposed to the segment and market risks that are typically associated with the development of pharmaceutical products. In accordance with the German Law on Control and Transparency in Business (Gesetz zur Kontrolle und Transparenz im Unternehmensbereich, KonTraG), PAION has implemented a Group-wide comprehensive and effective risk management system which is integrated into the operating processes and flexibly adaptable to the changing environment. The task of the risk management system is to promote the conscious and responsible handling of risks, and to enable the early identification, monitoring, analysis, evaluation and management of future developments with inherent risks and future opportunities. Involving all management levels and project management in the process of strategic and business development creates a shared awareness of the critical success factors and related risks.

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

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

The implemented internal control system includes rules for the management of business activities as well as arrangements for monitoring compliance with these rules. The primary tasks of the internal control system include determining which types of business transactions require approval, limiting the issuance of signing and banking authority, standardising workflows using procedural instructions, monitoring compliance with process steps by using checklists and establishing measures for the protection of data and IT systems. Furthermore, PAION mandated an audit company to carry out the tasks of an internal audit department. Internal Audit works on

the basis of a multi-year audit plan, which was worked out by Internal Audit in collaboration with the management based on a risk-oriented audit approach and materiality aspects.
The internal auditors report at least once per year in the context of a report about the audit procedures carried out and report promptly on potential findings. Both the audit plan and the reports are forwarded to the Supervisory Board for information and discussion.

PAION has implemented a matrix organisation which combines both project organisation and department organisation. Detailed reporting and information structures have been set up within these organisational structures to ensure the early identification and communication of risks. The individual projects are managed and monitored by project teams. The project teams regularly provide the individual department heads and management with reports – also in writing – on the current progress of projects and potential risks.

2. Accounting-Related Risk Management and Internal Control System

The risk management system and the internal control system involve also the accounting-related processes and aim to ensure the compliance and the reliability of the group financial statements and the group management report and the released interim financial statements.

The accounting-related risk management and internal control system aim at the risk of significant misstatements in the financial reporting. Essential measures and controls in financial reporting are the clear assignment of responsibilities, four-eyes principle, the segregation of duties, the use of an appropriate financial accounting system with a corresponding authorisation concept as well as the use of checklists and work instructions. Furthermore, single and consolidated financial statements are prepared every month for internal purposes. The monthly, quarterly and annual financial statements are analysed by means of the Group-wide controlling with regard to plan/actual variances and implausibilities and inconsistencies in the accounting. The monthly financial statements are forwarded to the Supervisory Board. The quarterly and annual financial statements are published. The quarterly and annual financial statements are discussed with the Supervisory Board prior to publication.

The risk management system is reviewed once per year and discussed with the Supervisory Board. The risk analysis is updated during the year and presented to the Supervisory Board; special risks are communicated ad-hoc. The internal control system is reviewed continuously with regard to the effectiveness of the controls and is adjusted if required. The risk management system and the internal control system are audited by Internal Audit in line with a multi-year audit plan.

Significant issues in context of the preparation of financial statements are discussed promptly with the audit committee. Furthermore, the audit committee determines additional audit topics and key audit procedures for the auditor.

In addition, the auditor is obligated to report to the Supervisory Board on accounting relevant risks and control deficiencies as well as other deficiencies of the risk management system and the internal control system that he becomes aware of in the course of his audit.

3. Significant Risks to Future Development

a. Drug Development Risks

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

There is a risk that the conduct of studies is approved with a delay or is denied. On occurrence of this risk, the further development can be delayed considerably or development of a specific drug candidate may be discontinued altogether.

The completion of clinical studies depends, among other things, on the ability to enrol a sufficient number of patients to participate in them. Difficulties in enrolling patients, additional requirements for the conduct of studies or a more expensive study monitoring and more expensive analyses may increase costs and negatively affect the timing of these clinical studies.

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

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

Further there is a risk that PAION does not receive the required insurance coverage for potential damages from the conduct of clinical studies. This can result in a delay or termination of studies.

b. Risks in Relation to the Manufacture of Pharmaceutical Substances

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

Some of PAION‘s substances are produced in biological production processes. These processes are highly complex and require extensive validation. In the past, the substances have been produced in sufficient quantities for clinical development, but it is not entirely certain that the larger batches needed for commercial purposes can be produced. Problems with the production of substances could lead to higher costs, delays or even the discontinuation of the clinical development or market potential not being fully exploited.

c. Risks in Relation to the Marketing of Drugs

In the foreseeable future, PAION expects to continue to be dependent on cooperation agreements with experienced partners to complete the development of its current and future drug candidates and to market them successfully. Drug prices are more and more subject to governmental regulation. There is a risk that through governmental price regulation the development of certain drugs may become unprofitable. This could make it difficult or impossible for PAION to close cooperation agreements or to secure alternative financing for drug development. Should PAION fail to enter into cooperation agreements at favourable terms, fail to enter into cooperation agreements at all or fail to maintain existing cooperation agreements, the development and marketing of its existing and future drug candidates may be delayed or fail completely, which may increase development and marketing expenses and limit its financing ability.

d. Risks in Relation to Patents and Other Intellectual Property

PAION's business operations are largely dependent on its ability to secure extensive patent protection and other intellectual property protection for the individual substances and to defend these against third parties without violating their rights. There can be no assurance that current or future patent applications will be granted or that any patents issued or licensed to PAION will be valid and sufficiently extensive to provide PAION with adequate legal protection or any commercial advantage.

e. Competitive Risks

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

f. Risks in Relation to Additional Financing Requirements

PAION believes that the currently available cash and cash equivalents and future payments expected from the cooperations with Lundbeck, Ono and Acorda and possible future cooperation agreements will be sufficient to cover its short- and mid-term financing needs. However, it may need additional funding within this timeframe in order, for example, to license new drugs, acquire or invest in businesses, drug candidates or technologies, and to fund preclinical studies, clinical studies and production development. Funding requirements may also arise due to delays or cost increases in development and the related delays in milestone payments from cooperation partners. Milestone payments could even be cancelled altogether if agreed targets are not met. PAION's future ability to secure additional funding will depend on the success of its development activities, the situation on the capital markets and other factors. If PAION is unable to raise financing at favourable terms or unable to raise financing at all, it could be forced to reduce its operating expenses by delaying, reducing or discontinuing the development of one or more of its drug candidates. The global financial crisis has strongly exacerbated the possibilities for debt and equity funding especially for small biotechnology companies.

g. Risks in Relation to Personnel

PAION‘s management and its scientific and technical staff in key positions are crucial to the company‘s success. Many of these members of staff have substantial experience with the company and would be difficult to replace. In addition, competition for qualified personnel is intense in PAION‘s industry and PAION might be unable to attract and retain highly qualified employees.

h. Currency Risks

Some of PAION‘s contracts are based on foreign currencies, in particular on the US Dollar. PAION does maintain a small reserve of foreign currency funds consisting of amounts in US Dollars and Pound Sterling. Currency risks arise, in addition, from the conversion of the individual financial statements of the British subsidiary companies from Pound Sterling to Euro since the accounts of the British subsidiary companies are managed in Pound Sterling. Further currency risks are inherent in the loans granted by PAION AG to the British subsidiary companies as these are denominated in Euro.

Currency risks are systematically captured and monitored. With the consent of the Supervisory Board, the Management Board has drawn up clear rules governing the use of specific hedging tools to limit currency risks. Hedging contracts are transacted under certain circumstances for foreign currency items with relatively secure definition of the amount and timing of the cash flows.

i. Risk of Availability of Tax Losses Carried Forward

PAION has considerable tax losses carried forward available. PAION assumes that based on the current German and British tax legislation, these losses can be carried forward indefinitely and offset against future earnings according to the relevant tax regulations (e.g. minimum taxation). If the usage of tax losses is partly or completely disallowed, for example on the basis changes in the legislation, the change of capitalisation or ownership structure as well as other events, income tax payments would become due on the expected earnings if one or more compounds are developed successfully. These tax payments would correspondingly reduce the liquidity.

j. Risk of Insolvency

There is a risk that one or several subsidiaries could go into insolvency. The occurrence of this risk would lead to a substantial impairment on the shares in subsidiaries and the loans to subsidiaries. This would accordingly reduce the equity of PAION. Furthermore, if expected payments from subsidiaries, e.g. loan repayments, are not made, this could lead to illiquidity of PAION.

4. Market Opportunities

PAION AG and its subsidiaries are biopharmaceutical companies focusing on the clinical development of drug candidates for diseases or interventions for which there is a substantial unmet medical need. After proof of concept in humans the strategy is to out-license or co-develop the drug candidates with pharma partners. Thus revenues can be generated at an early stage, decreasing development costs and risks. The company further profits from the receipt of milestones for reaching clinical and commercial milestones and receiving royalties after market approval of the drugs. Further upside can be generated from co-commercialisation activities or marketing.

The clinical studies performed with Remimazolam comprise two Phase I and two Phase II studies with single or multiple dose without an intervention or during endoscopy of the upper gastrointestinal tract or the colon. After intravenous administration to over 300 human volunteers/patients in the course of the clinical trials performed, Remimazolam rapidly induced the desired sedation. Following the successful completion of two Phase I studies and two Phase II studies with Remimazolam, PAION is continuing the Remimazolam partnering discussions with vigour. Remimazolam also has potential in all indications where a short sedation makes the medical invasion more comfortable for the patient. From the expected out-licensing PAION anticipates significant cash inflows from milestones and royalties in case of a successful development and marketing.

With its most advanced drug candidate Desmoteplase, PAION demonstrated in two clinical Phase II studies that the timeframe for treating patients with ischaemic stroke may possibly be extended up to nine hours, and other parameters indicate the superior effectiveness of Desmoteplase compared with currently approved drugs. It was not possible to confirm these positive results in the first Phase III study (DIAS-2), but the knowledge gained from the analysis of the DIAS-2 results provides a strong rationale for the further development of Desmoteplase. The conclusion of the extended licence agreement with Lundbeck secures the continuation of the development programme with Desmoteplase and underlines the potential offered by Desmoteplase for the treatment of acute ischaemic stroke. Currently Lundbeck is conducting two further Phase III studies (DIAS-3 and DIAS-4). The clinical development for approval in Japan is currently being progressed by Lundbeck through a Phase II study. From the existing licence agreement PAION expects significant cash inflows from milestones and royalties.

In clinical Phase II and III studies, M6G, the most advanced development programme at PAION UK, demonstrated a strong analgesic effect in the treatment of moderate to severe, peri-operative pain. At the same time, the common side effects of morphine administration, such as nausea and vomiting, were significantly reduced. Partnering activities are ongoing.

So far Solulin has been tested clinically in a Phase I study. The study confirmed the substance's good safety profile. In December 2010 positive preclinical data were reported for the indication haemophilia. Before entering clinical development in haemophilia, advanced pre-clinical experiments are planned.

GGF2, which is licensed to Acorda, is being tested in clinical Phase I since the end of 2010. In case of a positive development PAION is entitled to receive milestone payments as well as revenue dependent licence fees.

If the compounds are successfully developed, PAION will have substantial earnings potential in the future.

Events After the Balance Sheet Date

No significant events occurred in the time period between the balance sheet date, 31 December 2010, and the finalisation of this report.

Forecast

PAION's major goals for 2011 are the out-licensing of Remimazolam, the production of Remimazolam study medication in preparation of a Phase III study programme, the out-licensing of M6G as well as further development of Solulin. Furthermore, PAION expects in 2011 extensive development activities by the cooperation partners Lundbeck (Desmoteplase), Ono (Remimazolam) and Acorda (GGF2), which can lead to single-digit million revenues in 2011 if the development is successful.

Based on the results of the Phase IIb study PAION intends to out-license in 2011 the development and marketing rights for Remimazolam (outside Japan) and expects to receive a substantial upfront payment, development milestone payments, a partial or complete assumption of future development costs until market approval and royalties from market approval onwards. Cooperation partner Ono started in 2010 the first clinical Phase I study in Japan. PAION benefits from the progress of development in the form of additional development data and benefits financially in the form of milestone payments and royalties from launch onwards. Triggered by the progress of the programme, a modest milestone payment may become due in 2011.

Cooperation partner Lundbeck is currently conducting two Phase III studies with Desmoteplase in stroke and expects to be able to file applications in 2012. Lundbeck bears all development costs and pays to PAION milestones of up to EUR 68 million, thereof up to EUR 40 million are due before and including market approvals, and from market entry a double-digit percentage revenue share. If the further development is successful, based on Lundbeck's development plan, further milestone payments can be expected in 2012.

Acorda started a clinical Phase I study with GGF2 at the end of 2010. Milestone payments of up to USD 7.5 million before and including approval and thereafter revenue dependent licence fees are payable to PAION.

Revenues in 2011 will include, just as last year, the monthly release of deferred income in the amount of EUR 1.5 million. This results from the non-refundable milestone payment of EUR 8 million received in 2008 from Lundbeck. From the existing licence agreements noted above, further milestone payments may become due if the development activities of our partners are successful. Furthermore, PAION expects revenues in 2011 from the intended out-licensing, in a substantial amount for Remimazolam and in a smaller amount from M6G.

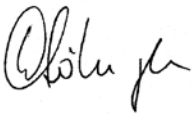
Research and development expenses are expected to be lower than the previous year but could increase if out-licensing is successful, either in connection with the out-licensing or by investing in other programmes. The out-licensing activities may lead to increased selling expenses, especially in connection with consulting services and success fees.

The budgeted expenses will lead to a significant net loss in 2011 which may be reduced by milestone payments from our partners in case of successful development. A successful out-licensing of Remimazolam and M6G could lead to a further sustainable improvement of the results.

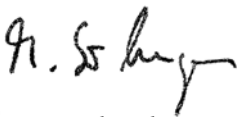
In 2011 and thereafter PAION expects significant cash inflows from the existing cooperations with Lundbeck (a total of up to EUR 68 million for the development of Desmoteplase), Ono (development of Remimazolam in Japan), Acorda (a total of up to USD 7.5 million for the development of GGF2) as well as from the intended licence agreements. Part of these expected milestone payments may be realised in 2011 and 2012. Some of the milestone payments which are expected in the future are linked to milestone obligations for PAION which would accordingly reduce the result.

As of 31 December 2010 PAION's cash and cash equivalents amounted to EUR 15 million and the remaining equity facility amounted to EUR 14 million. The cash and cash equivalents and the expected cash inflows from a partial use of the equity facility secure a cash reach until the middle of 2012. This does not account for further cash inflows from existing and future partners. Further upfront payments, milestone payments and cost reimbursements or a use of the equity facility could expand the cash reach, but may also be used fully or in part for funding of additional development activities within the existing portfolio or new strategic investments, e.g. the acquisition of new substances.

Aachen, Germany, 8 March 2011
PAION AG



Dr Wolfgang Söhngen



Dr Mariola Söhngen

Bernhard Hofer

Dr Gavin Kilpatrick

Consolidated Financial Statements

PAION AG

Consolidated Balance Sheet as of 31 December 2010

ASSETS	Note	31 Dec. 2010 EUR	31 Dec. 2009 EUR
Non-current assets			
Intangible assets	1.	10,571,204.23	11,379,527.52
Equipment	2.	196,223.77	291,559.18
Other assets		2.32	2.25
		10,767,430.32	11,671,088.95
Current assets			
Trade receivables	3.	11,129.16	94,296.78
Prepaid expenses and other assets	4.	1,175,118.30	913,168.21
Cash and cash equivalents	5.	14,881,933.89	22,871,407.20
		16,068,181.35	23,878,872.19
Total assets		**26,835,611.67**	**35,549,961.14**

EQUITY AND LIABILITIES	Note	31 Dec. 2010 EUR	31 Dec. 2009 EUR
Equity	6.		
Share capital		25,073,684.00	24,602,919.00
Capital reserve		89,737,457.61	88,639,947.78
Translation reserve		-1,142,438.22	-1,492,295.41
Loss carryforward		-92,446,174.58	-79,409,073.92
Loss for the period		-9,254,129.40	-13,037,100.66
		11,968,399.41	19,304,396.79
Non-current liabilities			
Provisions	7.	1,346,019.96	1,466,747.40
Financial liabilities	8.	6,893,418.03	6,857,666.84
Deferred income	9.	2,242,929.32	3,708,585.88
		10,482,367.31	12,033,000.12
Current liabilities			
Trade payables	10.	1,835,290.75	1,724,137.09
Provisions	7.	676,707.55	611,381.10
Other current liabilities	11.	407,190.09	391,412.96
Current portion of deferred income	9.	1,465,656.56	1,485,633.08
		4,384,844.95	4,212,564.23
Total equity and liabilities		**26,835,611.67**	**35,549,961.14**

Consolidated Statement of Comprehensive Income for Fiscal Year 2010

	Note	2010 EUR	2009 EUR
Revenues	12.	4,474,410.59	1,533,230.73
Cost of revenues		-19,486.44	-50,899.95
Gross profit		4,454,924.15	1,482,330.78
Research and development expenses		-9,016,106.24	-10,586,295.56
General administrative and selling expenses		-4,540,115.19	-4,347,507.62
Other income (expenses), net		68,437.51	456,176.29
Operating expenses		-13,487,783.92	-14,477,626.89
Operating result		-9,032,859.77	-12,995,296.11
Financial income	14.	76,539.40	354,600.69
Financial expenses	15.	-737,031.47	-735,978.11
Financial result		-660,492.07	-381,377.42
Loss for the period before taxes		-9,693,351.84	-13,376,673.53
Income taxes	16.	439,222.44	339,572.87
Loss for the period		**-9,254,129.40**	**-13,037,100.66**
of which attributable to other shareholders		0.00	0.00
of which attributable to shareholders of PAION AG		-9,254,129.40	-13,037,100.66
Foreign currency translation of subsidiaries		349,857.19	684,833.38
Other comprehensive income		349,857.19	684,833.38
Total comprehensive income		**-8,904,272.21**	**-12,352,267.28**
of which attributable to other shareholders		0.00	0.00
of which attributable to shareholders of PAION AG		-8,904,272.21	-12,352,267.28
Earnings per share (basic)	17.	-0.38	-0.53
Earnings per share (diluted)	17.	-0.38	-0.53

Consolidated Cash Flow Statement for Fiscal Year 2010

	2010 EUR	2009 EUR
Cash flows from operating activities:		
Net result for the period	-9,254,129.40	-13,037,100.66
Reconciliation of net profit (loss) for the period to cash flows from operating activities:		
Amortization/depreciation and non-cash exchange rate changes of fixed assets	888,811.14	167,793.41
Loss/Profits from the disposal of non-current assets	59,238.21	15,149.36
Interest expenses and interest income	659,022.33	381,343.64
Release of deferred income	-1,485,633.08	-1,494,864.08
Expenses from stock option plans	440,358.70	128,885.60
Change in assets and liabilities which are not attributable to investing or financing activities:		
Trade receivables	83,167.62	6,152.74
Prepaid expenses and other assets	-257,094.37	-200,840.69
Trade payables	111,188.84	132,277.27
Provisions	-165,736.91	-322,862.89
Other current liabilities	15,780.68	18,587.56
Deferred income	0.00	49,184.04
Non-cash exchange losses/gains	322,861.59	610,758.26
	-8,582,164.65	-13,545,536.44
Interest received	73,694.03	350,354.03
Tax payments received	364,651.44	686,959.55
Net cash used in operating activities	-8,143,819.18	-12,508,222.86
Cash flows from investing activities:		
Cash paid for investments in intangible assets and equipment	-44,390.72	-108,210.83
Net cash used in investing activities	-44,390.72	-108,210.83
Cash flows from financing activities:		
Capital increase	470,765.00	0.00
Contributions to the capital reserve	687,845.00	0.00
Payments in connection with the raising of capital	-397,379.60	0.00
Interest paid	-590,884.67	-595,286.64
Payment of finance lease liabilities	0.00	-62,852.00
Net cash used in financing activities	170,345.73	-658,138.64
Change in cash and cash equivalents	-8,017,864.17	-13,274,572.33
Effect of exchange rate changes on cash	28,390.86	74,088.80
Cash and cash equivalents at beginning of the period	22,871,407.20	36,071,890.73
Cash and cash equivalents at end of the period	**14,881,933.89**	**22,871,407.20**
Composition of cash and cash equivalents at the end of the period:		
Cash an cash equivalents	**14,881,933.89**	**22,871,407.20**

Consolidated Statement of Changes in Equity for Fiscal Year 2010

EUR	Share capital	Capital reserve	Translation reserve	Loss carryforward	Equity
31 December 2008	24,602,919.00	88,511,062.55	-2,177,128.79	-79,409,073.92	31,527,778.84
Total comprehensive income	0.00	0.00	684,833.38	-13,037,100.66	-12,352,267.28
Additional contribution to the capital reserve due to the issue of options	0.00	128,885.23	0.00	0.00	128,885.23
31 December 2009	24,602,919.00	88,639,947.78	-1,492,295.41	-92,446,174.58	19,304,396.79
Total comprehensive income	0.00	0.00	349,857.19	-9,254,129.40	-8,904,272.21
Issue of shares		0.00	0.00	0.00	470,765.00
Contribution to the capital reserve		687,845.00	0.00	0.00	687,845.00
Cost of raising capital		-30,693.87	0.00	0.00	-30,693.87
Additional contribution to the capital reserve due to the issue of options	0.00	440,358.70	0.00	0.00	440,358.70
31 December 2010	**25,073,684.00**	**89,737,457.61**	**-1,142,438.22**	**-101,700,303.98**	**11,968,399.41**

Consolidated Notes

PAION AG

Notes to the Consolidated Financial Statements for Fiscal Year 2010

General

The consolidated financial statements comprise PAION AG as the parent company, registered at Martinstrasse 10–12, 52062 Aachen, Germany, and the wholly-owned and fully consolidated subsidiaries:

– PAION Deutschland GmbH, Aachen/Germany
– PAION Holdings UK Ltd, Cambridge/UK
– PAION UK Ltd, Cambridge/UK
– CeNeS Drug Delivery Ltd, Irvine/UK
– TheraSci Limited, Cambridge/UK
– CeNeS Pharmaceuticals Inc., Norwood/USA

The wholly owned subsidiary CeNeS (Bermuda) Ltd, Bermuda, was dissolved on 2 July 2010 and is no longer consolidated. The derecognition did not have any effects on the Group's net assets, financial position and results of operations.

PAION AG is a holding company that provides various services to the subsidiaries. The PAION Group specialises in developing and commercializing innovative drugs for the hospital-based treatment in indications for which there is a substantial unmet medical need.

Since February 2005, PAION AG shares have been admitted to trading in the Prime Standard, a sub-segment of the Regulated Market of the Frankfurt Stock Exchange with extensive reporting obligations.

The consolidated financial statements as of 31 December 2010 and the group management report for fiscal year 2010 are scheduled for confirmation and approval for publication by the Supervisory Board in its meeting on 22 March 2011.

Basis of Accounting

The consolidated financial statements have been prepared according to Section 315a of the German Commercial Code (Handelsgesetzbuch, HGB) in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union (EU), and the interpretations of the International Financial Reporting Interpretations Committee (IFRIC). PAION applied all IFRSs that had been issued by the International Accounting Standards Board (IASB), London, UK, and were effective as of the balance sheet date of 31 December 2010, and which had been adopted by the European Commission for application in the EU at the time of preparing the consolidated financial statements. Assets and liabilities are recognised and measured using those standards that were mandatory as of 31 December 2010 according to IAS 1.

The following new and/or revised standards and interpretations were applied for the first time in fiscal year 2010. The application of these standards and interpretations did not necessitate the provision of additional disclosures and did not influence the net assets, financial position and results of the Group's operations in any way.

– In April 2009 the IASB published the collective standard "Improvements to IFRSs", which implements minor changes to the existing IFRSs. The standard contains 15 amendments to 12 standards. The majority of the amendments must be applied to fiscal years commencing on or after 1 January 2010.
– IFRS 2: In June 2009 the IASB published amendments to IFRS 2 "Share-based Payment". The amendments clarify the accounting treatment of share-based payments with cash-settlement in a group of companies. The amendments to IFRS 2 also incorporate guidance previously included in IFRIC 8 "Scope of IFRS 2" and IFRIC 11 "IFRS 2 – Group and Treasury Share Transactions". As a result, the IASB has withdrawn IFRIC 8 and IFRIC 11. The amendments are effective for fiscal years ending on or after 1 January 2010.
– IFRS 3 and IAS 27: In January 2008, the IASB published its revised IFRS 3 "Business Combinations" and IAS 27 "Consolidated and Separate Financial Statements". The amendments substantially affect the balance-sheet reporting of minority interests and company purchases involving the acquisition of less than 100% of the company's shares. The principal amendments to IFRS 3, for example, relate to the inclusion of a right to choose between the purchased goodwill method and the full goodwill method, which prescribes that the entire goodwill of the acquired company – even the portion attributable to minority shareholders – must be valued when measuring non-controlling interests. The revised standard

also addresses the revaluation of existing investment shares upon acquisition of control (step acquisitions), the mandatory measurement at the time of acquisition of a consideration that is linked to future events and the recognition of transaction costs. The amendments to IAS 27 primarily relate to the method of accounting for shares without control character (non-controlling interests) which must participate in full in the losses of a group in future, and of accounting for transactions that result in the loss of control at a subsidiary company and whose impacts must be recognised in profit or loss. By contrast, the effects of share disposals that do not result in a loss of control must accordingly be recognised in equity. The revised standards must be applied to reporting periods starting on or after 1 July 2009.

– IAS 39: The IASB published an addition to IAS 39 "Eligible Hedged Items – Amendment to IAS 39 Financial Instruments: Recognition and Measurement" in July 2008. The addition clarifies the application of the fundamental principles of hedge accounting in two special situations – the designation of inflation risks as the underlying transaction and the designation of a unilateral risk in an underlying transaction. The addition must be applied retroactively to fiscal years commencing on or before 1 July 2009.

The following standards and interpretations which have already been issued will be applied as soon as they become effective, provided they are adopted by the European Commission:

– In May 2010 the IASB published the collective standard "Annual Improvements 2010", which implements minor changes to the existing IFRS. The standard contains amendments to eight standards (IFRS/IAS) and one interpretation (IFRIC). The majority of the amendments must be applied to fiscal years commencing on or after 1 January 2011.
– IFRS 7: In October 2010 the IASB published amendments to IFRS 7 "Financial Instruments: Disclosures". The amendments relate to extended disclosures regarding the transfer of financial assets and shall allow users of financial statements to improve their understanding of the possible effects of any risks that may remain with the entity that transferred the assets. The amendments are effective for fiscal years beginning on or after 1 July 2011; earlier application would be permitted. In the first year of application comparative disclosures are not required.
– IFRS 9: In November 2009 the IASB published IFRS 9 "Financial Instruments: Recognition and Measurement". This standard is part of a project to replace IAS 39, which shall be finished in 2010. The standard governs the classification and measurement of financial assets. Through IFRS 9 the previous measurement categories "loans and receivables", "assets held to maturity", "assets available for sale" and "assets measured at fair value through profit and loss" are replaced by the categories "amortised cost" and "fair value". Whether an instrument can be classified in the category "amortised cost" is on the one hand dependent on the business model of the company and on the other hand on the characteristics of the particular instrument. Instruments that do not meet the definition criteria of the category "amortised cost" have to be measured at fair value. For some instruments a measurement at fair value through equity is allowable. The amendments are effective for fiscal years beginning on or after 1 January 2013; earlier application already in 2009 would be permitted.
– IFRS 9: In October 2010 the IASB published additions to IFRS 9 "Financial Instruments: Recognition and Measurement". The existing IFRS 9 (2009) published in November 2009 prescribed only the classification and measurement of financial assets. In addition the now published IFRS 9 (2010) includes rules regarding the classification and measurement of financial liabilities as well as rules regarding the derecognition of financial assets and financial liabilities. IFRS 9 is effective for fiscal years beginning on or after 1 January 2013.
– IAS 24: In November 2009 the IASB published the amended IAS 24 "Related party disclosures". Until now companies, that were state-controlled or under significant state influence, were obliged to disclose information related to all business transactions with companies that are controlled or significantly influenced by the same state. The amendments to IAS 24 simplify the disclosures of companies associated with governments. Furthermore, the amendments to IAS 24 clarify the definition of a related company or a related person. The amendments are effective for fiscal years beginning on or after 1 January 2011; earlier application would be permitted.

– IAS 32: On 8 October 2009 the IASB published amendments to IAS 32 "Financial Instruments: Presentation". The amendments address the accounting of issuers for rights issues, options and warrants to acquire a fixed amount of equity instruments that are denominated in a currency other than the functional currency of the issuer. The amendments are effective for fiscal years beginning on or after 1 February 2010; earlier application would be permitted.
– IFRIC 19: In November 2009 the IFRIC published IFRIC 19 "Extinguishing Financial Liabilities with Equity Instruments". IFRIC 19 clarifies the requirements of IFRSs when an entity renegotiates the terms of a financial liability with its creditor and the creditor agrees to accept the entity's shares or other equity instruments to settle the financial liability fully or partially. IFRIC 19 clarifies that:
  · the entity's equity instruments issued to a creditor are part of the consideration paid to extinguish the financial liability according to IAS 39.41;
  · the equity instruments issued are measured at their fair value. If their fair value cannot be reliably measured, the equity instruments should be measured to reflect the fair value of the financial liability extinguished;
  · the difference between the carrying amount of the financial liability extinguished and the initial measurement amount of the equity instruments issued is included in the entity's profit or loss for the period

  IFRIC 19 is effective for fiscal years beginning on or after 1 July 2010; earlier application would be permitted.

The application of these new and/or revised standards and interpretations may, in some cases, result in additional disclosure obligations in future consolidated financial statements. The amendments will presumably not have any effects on the Group's net assets, financial position and results of operations.

The consolidated financial statements have been prepared in Euro. Amounts were stated in Euro or KEUR.

The income statement has been prepared using the cost of sales method. Research and development expenses are reported separately in the income statement in light of their material importance.

In accordance with IAS 1 "Presentation of Financial Statements", the balance sheet distinguishes between non-current and current assets and non-current and current liabilities. Assets, liabilities and provisions are deemed to be current if they mature within one year.

The consolidated financial statements do not contain any segment information as no reportable business or geographical segments could be identified.

The preparation of consolidated financial statements in accordance with IFRSs requires management to make estimates and assumptions which have an effect on the amount of recognised assets and liabilities, income and expenses and contingent liabilities. Actual amounts may differ from these estimates.

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

The consolidation principles and accounting and valuation methods adopted last year have been maintained and incorporate the new and/or revised standards and interpretations. The application of the new and/or revised standards and interpretations did not result in additional disclosure obligations and did not have an influence on the net assets, financial position and results of the Group's operations.

Consolidation Principles

The consolidated financial statements include PAION AG, its subsidiaries PAION Deutschland GmbH and PAION Holdings UK Ltd, and the latter's subsidiary companies as listed in "General". The financial statements of the companies included in the consolidated financial statements have been prepared in accordance with uniform accounting and valuation methods. Amounts receivable and payable, income and expenses and interim profits from intra-Group transactions have been eliminated.

Foreign Currency Translation

The consolidated financial statements are shown in Euro, which is the functional currency of PAION AG and the reporting currency of the Group. Each company within the Group defines its own functional currency. This is the Euro in the case of the German companies, whereas the UK-based companies use Pound Sterling as their functional currency. All items on the respective financial statements of each company are initially converted to the functional currency at the exchange rate applicable on the transaction date. Monetary assets and liabilities denominated in a foreign currency are converted to the functional currency on the reporting date at the exchange rate applicable on that date. All ensuing currency differences are recognised in profit or loss with the exception of exchange rate gains and losses from intra-Group loans classified in accordance with IAS 21 as net investments in foreign business operations; these are recognised in equity.

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

Accounting and Valuation Methods

Business combinations before 1 January 2010
Business combinations are accounted for using the purchase method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value. Acquisition costs include also the costs directly attributable to the acquisition as well as liabilities emerging from the acquisition. Assets, liabilities and contingent liabilities identifiable in the context of a business combination are measured at acquisition date fair value for first time consolidation.

There were no business combinations after 1 January 2010.

Intangible assets
Intangible assets acquired against payment are measured at acquisition cost. They are subject to scheduled linear amortisation over their respective useful life and tested for possible impairment if there are any indications that the intangible asset may be impaired. A useful life of between three and five years is defined for software, while research and marketing rights for compounds are amortised over the term of the respective patent.

Equipment
Equipment is measured at acquisition or manufacturing cost less cumulative depreciation. These assets are subject to linear depreciation over their anticipated useful life, which is between three and twenty years. The recoverability of assets is always tested when events have occurred or circumstances have changed, which could have an effect on the recoverability of the assets. The recoverability of the assets held and used by the company is measured on the basis of a comparison between the carrying amount and the higher of fair value less cost to sell and its value in use. If an asset is measured below its carrying amount, depreciation to the higher of fair value less cost to sell and its value in use is performed. These assets are written up if the reasons for the prior impairments cease to exist.

Leased equipment that meets certain requirements defined in IAS 17 “Leases” is capitalised and the present value of the leasing payment obligations is recognised as a liability. Capitalised leased objects are subject to linear depreciation over the term of the lease contract.

Financial assets
Standard market purchases or sales of financial assets are recognised on the trading date, i.e. on the day on which the Group undertakes to purchase or sell the asset.

Financial instruments are measured at fair value as of the balance sheet date. The fair value is calculated using the Black/Scholes option pricing model. Changes in fair value are recognised through profit and loss.

Receivables and other assets
Trade receivables and other assets are measured at amortised acquisition cost. Receivables denominated in a foreign currency are converted at the rate applicable on the balance sheet date. Exchange rate gains or losses are recognised in profit or loss.

Cash and cash equivalents
Cash and cash equivalents comprise cash balances, bank account balances and current deposits with an original residual term of less than three months. Cash and cash equivalents are measured at amortised acquisition cost.

Equity
The costs directly associated with the issuance of equity are not captured in the income statement but deducted straight from the added equity.

Provisions
Provisions for current obligations (legal or factual), which originated in the past and whose maturity and amount are uncertain, are formed to the extent to which these obligations will probably have to be satisfied by an outflow of resources that represent an economic benefit, and to which the amount of the obligations can be reliably estimated. Provisions with a term of more than one year are recognised at present value.

Financial liabilities
Financial liabilities are recognised at amortised acquisition cost using the effective interest method.

Trade payables/other liabilities
Trade payables and other liabilities are measured at repayment cost. Liabilities denominated in a foreign currency are measured at the exchange rate applicable on the reporting date. Exchange rate gains or losses are recognised in profit or loss.

Deferred income
Non-refundable upfront fees received in connection with out-licensing agreements are reported as deferred income which and recognised in profit over the probable development life of the products.

Revenues
Revenues are recognised as realised during the fiscal year. Income is realised upon performance of the owed service and transfer of the risk and when the amount of anticipated consideration can be reliably estimated. Payments relating to the sale or out-licensing of substances or technological expertise are recognised in profit or loss when the performance obligations pursuant to the underlying contractual agreements have been completely fulfilled for the period.

Cost of revenues
Development costs that are charged on to third parties are reported as costs of revenues.

Research and development expenses
Research costs are recognised as expenditure in the period in which they are incurred. Pursuant to IAS 38 “Intangible Assets”, development costs must be capitalised depending on the possible outcome of the development activities and when specific cumulative conditions are met. These conditions are not met at present. As such, all development costs are equally recognised as expenses in the period in which they occur.

Interest income/expenses
Interest income/expenses are recognised in the period in which they occur. Any necessary deferrals are calculated using the effective interest method.

Income taxes/deferred taxes
Deferred taxes are recognised in accordance with IAS 12 “Income Taxes”. Deferred taxes are recognised on the basis of temporary differences between the assets and liabilities as reported in the IFRS balance sheet and the tax balance sheet, taking account of any future tax rates that have already been decided and legally sanctioned. The effects of a legally sanctioned amendment to tax rates on the balance sheet recognition of deferred taxes are captured in the year in which the amendment is decided and effective. Deferred taxes are also recognised for losses carried forward. No deferred tax assets are recognised, if it is probable that some or all of the deferred tax assets may not be recoverable.

Share-based payment transactions
Stock options (share-based payment instruments paid with equity instruments) are measured at fair value at the time they are granted. The fair value of the obligations is recognised both as a personnel expense and an increase in equity over the vesting period. The obligations arising from stock appreciation rights are recognised as a provision and measured at fair value on the balance sheet date. The costs are captured as personnel expenses over the vesting period. The fair value of both the stock options and the stock appreciation rights is calculated using internationally accepted valuation methods.

Notes to the Consolidated Balance Sheet

(I) Intangible assets

Intangible assets developed as follows:

EUR	Industrial rights and similar rights and assets
Acquisition cost	
1 Jan. 2009	12,015,115.38
Additions	71,245.39
Disposals	123,837.24
Reclassifications	1,916.34
Exchange rate differences	897,205.26
31 Dec. 2009	12,861,645.13
Additions	16,768.35
Disposals	1,058.00
Reclassifications	508.09
Exchange rate differences	382,383.00
31 Dec. 2010	13,260,246.57
Accumulated amortisation, depreciation and impairment losses	
1 Jan. 2009	678,767.69
Additions	923,085.58
Disposals	120,334.25
Exchange rate differences	598.58
31 Dec. 2009	1,482,117.61
Additions	1,172,400.46
Disposals	498.00
Exchange rate differences	35,022.27
31 Dec. 2010	2,689,042.4
Carrying amounts as of 31 Dec. 2009	**11,379,527.52**
Carrying amounts as of 31 Dec. 2010	**10,571,204.23**

The intangible assets mainly comprise the development projects M6G (KEUR 6,405) and Remimazolam (KEUR 4,095). The development projects are being written off over the expected useful life based on forward-looking assumptions in respect of the expected time at which regulatory approval is obtained and the patent protection of the products. The expected useful life is until mid 2024 for M6G and until mid 2027 for Remimazolam.

Depreciation and amortisation of intangible assets relate substantially to development projects and are recognised as research and development expenses during the development period. In fiscal year 2010 an extraordinary depreciation in the amount of KEUR 220 was incurred for Flovagatran, which was discontinued end of 2010. A minor portion of the amortisation of intangible assets relates to software and is recognised partly in the research and development expenses and partly in the general administrative and selling costs.

The disposals in the fiscal year mainly relate to the derecognition of software which is no longer used.

(2) Equipment

Equipment developed as follows:

EUR	Plant and machinery	Other plant, factory and office equipment	Total
Acquisition cost			
1 Jan. 2009	665,230.87	751,143.66	1,416,374.53
Additions	35,945.72	1,263.45	37,209.17
Disposals	17,787.42	32,689.13	50,476.55
Reclassifications	0.00	-1,916.34	-1,916.34
Exchange rate differences	0.00	10,303.19	10,303.19
31 Dec. 2009	683,389.17	728,104.83	1,411,494.00
Additions	21,499.61	6,140.96	27,640.57
Disposals	398,016.67	79,236.71	477,253.38
Reclassifications	0.00	-508.09	-508.09
Exchange rate differences	0.00	3,566.84	3,566.84
31 Dec. 2010	306,872.11	658,067.83	964,939.94
Accumulated amortisation, depreciation and impairment losses			
1 Jan. 2009	494,413.36	512,490.06	1,006,903.42
Additions	97,651.64	49,042.14	146,693.78
Disposals	12,330.00	26,503.23	38,833.23
Exchange rate differences	0.00	5,170.85	5,170.85
31 Dec. 2009	579,735.00	540,199.82	1,119,934.82
Additions	26,325.01	38,819.28	65,144.29
Disposals	393,992.71	24,583.50	418,576.21
Exchange rate differences	0.09	2,213.18	2,213.27
31 Dec. 2010	212,067.39	556,648.78	768,716.17
Carrying amounts as of 31 Dec. 2009	**103,654.17**	**187,905.01**	**291,559.18**
Carrying amounts as of 31 Dec. 2010	**94,804.72**	**101,419.05**	**196,223.77**

The disposals in the fiscal year mainly relate to the derecognition of plant and machinery which is no longer used.

(3) Trade Receivables

Trade receivables are comprised mainly of reimbursement claims from the transfer of responsibility for the development costs for Desmoteplase in connection with the licence agreement with Lundbeck.

Trade receivables do not bear interest and are generally due for payment within 30 days. The trade receivables had the following age structure as of 31 December 2010:

		Neither overdue	Overdue, not impaired		
IN KEUR	Total	nor impaired	< 30 days	30–60 days	61–90 days
2010	11	11	0	0	0
2009	94	94	0	0	0

(4) Prepaid Expenses and Other Assets

Prepaid expenses and other assets substantially comprise claims for reimbursement from the British tax authorities for subsidised research and development activities (KEUR 434; previous year: KEUR 345), VAT refund claims (KEUR 72, previous year: KEUR 181) as well as prepaid expenses relating to insurance contributions, rents and other prepayments (KEUR 662; previous year: KEUR 302).

(5) Cash and Cash Equivalents

Cash and cash equivalents are comprised of the following:

	31 Dec. 2010 KEUR	31 Dec. 2009 KEUR
Current deposits	6,500	13,000
Bank account and cash balances	8,382	9,871
	14,882	**22,871**

Bank account balances earn interest at the variable rates for call money. Current deposits are transacted for periods ranging from one to three months. These earn interest at the respective applicable interest rate for current deposits.

(6) Equity

In May 2010 PAION entered into an equity facility agreement for EUR 15 million with Commerce Court Small Cap Value Fund Ltd. (CCSCVF) managed by Acqua Capital Management Inc., Toronto, Canada. This share facility has a term until May 2013 and gives PAION the right to issue new shares out of the existing authorised capital in multiple tranches to CCSCVF against a cash contribution.

CCSCVF has committed to buy these shares at a price calculated based on a daily volume weighted average share price over a five day period (pricing period) less a discount of 5%. CCSCVF guarantees a minimum investment amount per tranche within a range from EUR 150,000 to EUR 1,300,000 dependent on the share price (within a range from EUR 1.00 to and exceeding EUR 8.00). Both parties can agree on higher amounts per tranche. Furthermore, PAION has the right to determine for every tranche a floor price below which PAION is not obliged to issue shares. After the end of the pricing period PAION will announce on its website the number of subscribed shares as well as the achieved placement price.

In 2010 470,765 new shares were issued to CCSCVF leading to a cash inflow of EUR 1,158,610. The share capital increased accordingly by EUR 470,765 and the capital reserve increased by EUR 687,845.

As of 31 December 2010 the share capital amounts to EUR 25,073,684.00 and is divided into 25,073,684 no-par value shares (unit shares).

By virtue of a resolution adopted by the Annual General Meeting on 25 May 2009, the Management Board was authorised to increase the share capital on or prior to 25 May 2014, with the consent of the Supervisory Board, on one or more occasions, by up to an aggregate of EUR 12,300,000.00 by issuing up to 12,300,000 new no-par value bearer shares in return for cash contributions or contributions in kind (Authorised Capital 2009). Furthermore, the Management Board was authorised to use up to EUR 2,460,291 out of the Authorised Capital 2009 to issue new shares for cash by excluding pre-emptive rights. The Authorised Capital 2009 and the authorisation to issue shares by excluding pre-emptive rights were called upon in the amount of EUR 470,765 in connection with the usage of the equity facility. As of 31 December 2010 the remaining Authorised Capital 2009 is EUR 11,829,235 and the authorisation to issue shares by excluding pre-emptive rights is EUR 1,989,526.

By virtue of another resolution adopted by the Annual General Meeting on 19 May 2010, the Management Board was authorised to increase the capital stock on or before 18 May 2015, on one or more occasions by up to an aggregate amount of EUR 98,000,000.00 by issuing registered and/or bearer convertible or warrant-linked bonds with a maximum term of 20 years and to grant the holders or beneficiaries of the bonds conversion or option rights to new shares in PAION AG with a proportionate share in the capital stock of up to EUR 9,800,000.00 in total (Conditional Capital 2010 II). Conditional Capital 2010 II has not yet been used. Furthermore, the Annual General Meeting revoked Conditional Capital I which has not yet been used.

The Annual General Meeting of 5 May 2008 adopted a resolution to reduce Conditional Capital 2004 II to EUR 858,121.00. The conditional capital increase may be executed only to the extent that the holders of options granted by PAION AG in connection with the Stock Option Plan 2005 exercise their options. Under the Stock Option Plan 2005, 845,343 stock options have been issued to current and former Management Board members and employees of the PAION Group as of 31 December 2010. The stock options have not yet been exercised.

A resolution was adopted by the Annual General Meeting on 5 May 2008 to conditionally increase the capital stock of PAION AG by an aggregate of up to EUR 815,000.00 by issuing an aggregate of up to 815,000 new no-par value bearer shares (Conditional Capital 2008 I). A resolution was adopted by the Annual General Meeting on 19 May 2010 to adjust the Conditional Capital 2008 I to EUR 760,235.00. The conditional capital increase may be executed only to the extent that the holders of options granted by PAION AG in connection with the Stock Option Plan 2008 exercise their options. Under the Stock Option Plan 2008, 740,755 stock options have been issued to current and former Management Board members and employees of the PAION Group as of 31 December 2010. The stock options have not yet been exercised.

A resolution was adopted by the Annual General Meeting on 19 May 2010 to conditionally increase the capital stock of PAION AG by an aggregate of up to EUR 720,000.00 by issuing an aggregate of up to 720,000 new no-par value bearer shares (Conditional Capital 2010 I). The conditional capital increase may be executed only to the extent that the holders of options granted by PAION AG in connection with the Stock Option Plan 2010 exercise their options. Under the Stock Option Plan 2010 no stock options have been issued to Management Board members and employees of the PAION Group as of 31 December 2010.

Exchange rate gains and losses amounting to KEUR -1,142 are recognised in equity. Of these, KEUR -947 relate to the conversion of the financial statements of the British subsidiaries from GBP into EUR whereas KEUR -195 relate to exchange rate losses incurred on loans from PAION AG to the British subsidiaries. As of 31 December 2010 these loans amount to KEUR 19,780.

(7) Provisions

Provisions developed as follows:

KEUR	Onerous Contracts	Premiums/Management bonuses	Other	Total
31 Dec. 2009	1,722	294	62	2,078
Utilisation	259	254	0	513
Addition	0	302	20	322
Release	0	7	0	7
Addition of accrued interest	110	0	0	110
Exchange rate differences	32	1	0	33
31 Dec. 2010	**1,605**	**336**	**82**	**2,023**

The provision for onerous contracts relates to unused premises that have been rented long-term by PAION UK Group. Of the amount shown, KEUR 1,346 is classified as non-current.

The discounted anticipated cash outflows for the provisions formed as of 31 December 2010 are as follows:

KEUR	Onerous Contracts	Premiums/Management bonuses	Other	Total
2011	259	302	20	581
2012	253	0	0	253
2013	248	11	0	259
2014	244	11	0	255
2015	239	12	0	251
2016 and later	362	0	62	424
31 Dec. 2010	**1,605**	**336**	**82**	**2,023**

(8) Financial Liabilities

The financial liabilities relate to a subordinate loan in an amount of EUR 7,000,000 that was borrowed in April 2006. The subordinate loan was granted by HSBC Trinkaus & Burkhardt KGaA, Düsseldorf, and forms part of the structured mezzanine financing managed under the title of "H.E.A.T Mezzanine I-2006". HSBC Trinkaus & Burkhardt KGaA has meanwhile transferred the subordinate loan to H.E.A.T Mezzanine S.A., Luxembourg. The bullet loan has a term of seven years and was disbursed with a debt discount of EUR 280,000. Following a downgraded credit rating, interest of 8.433% p.a. is being charged on the financial liability since the second quarter 2008. This interest rate of 8.433% is fixed for the residual term of the loan and is therefore not exposed to any risk of interest rate changes. The effective interest rate is 9.428% p.a. Interest payments are due quarterly. The interest rate can only be lowered to 7.933% in the event of a sustained improvement in credit rating.

(9) Deferred Income

Of the deferred income reported as of 31 December 2010, the non-refundable payment of EUR 8 million in total received from Lundbeck at the beginning of 2008 accounts for KEUR 3,636 and is being released over the probable development period of Desmoteplase. Of this amount, KEUR 2,181 is non-current and KEUR 1,455 current.

(10) Trade Payables

Trade payables amounted to KEUR 1,835 as of 31 December 2010 (previous year: KEUR 1,724). These liabilities do not bear interest and are generally due for payment within 30 days.

(11) Other Current Liabilities

Other current liabilities comprise the following:

	31 Dec. 2010 KEUR	31 Dec. 2009 KEUR
Wage taxes	191	168
Supervisory board remuneration	137	131
Holiday allowances	58	66
Other	21	26
	407	**391**

Notes to the Consolidated Statement of Comprehensive Income

(12) Revenues

Revenues of the fiscal year mainly comprise the milestone payments received (KEUR 2,989; previous year: KEUR 0) as well as the systematic release of the upfront payment received beginning of 2008 from Lundbeck (KEUR 1,455; previous year: KEUR 1,455), which is being released over the anticipated development period for Desmoteplase. The milestone payments relate mainly to the payment received from Lundbeck in connection with the extension of the Desmoteplase licence agreement (KEUR 1,500), a milestone payment from Ono (KEUR 749) for the start of the Phase I study with Remimazolam in Japan and two milestone payments from Acorda for the submission and subsequent approval of the IND for the compound GGF2 (KEUR 737). Furthermore, the revenues include to a small extent reimbursements of development expenses from Lundbeck as well as other revenues.

(13) Other Income (Expenses), Net

This figure comprises income from smaller effects that cannot be attributed to any specific function.

(14) Financial Income

Financial income consists of the following:

	2010 KEUR	2009 KEUR
Interest income based on amortised costs (bank credit balances and current deposits)	77	355
	77	**355**

(15) Financial Expenses

Financial expenses consist of the following:

	2010 KEUR	2009 KEUR
Expenses based on amortised cost (subordinate loan)	626	623
Addition of accrued interest	110	107
Finance lease expenses and other interest expenses	1	6
	737	**736**

(16) Income Taxes/Deferred Taxes

As of 31 December 2010, the tax losses carried forward by the PAION Germany group amounted to about EUR 83 million (previous year: EUR 81 million). According to current German tax legislation, these losses can be carried forward indefinitely and offset against future earnings according to the relevant tax regulations (e.g. minimum taxation). In the fiscal year tax losses of KEUR 618 were used.

The tax losses carried forward by the British subsidiaries amount to GBP 76 million (equivalent to EUR 88 million, if converted at the exchange rate applicable on the reporting date). In the previous year these amounted to GBP 71 million or EUR 80 million, respectively. According to British tax legislation, these can be carried forward indefinitely and a large portion of them offset against future earnings. In the fiscal year tax losses of KGBP 621 were used.

Overall, the losses carried forward within the Group amount to EUR 171 million (previous year: EUR 161 million). No deferred tax assets were recognised regarding a partial amount of EUR 161 million (previous year: EUR 150 million) of the total tax losses carried forward.

The combined German corporate income tax rate is 31.4% resulting from a corporate income tax rate of 15.0%, the solidarity surcharge of 5.5% that is levied on corporate income tax, and the trade earnings tax rate of 15.58%. The income tax rate in Great Britain is 28% and will be reduced to 27% from 1 April 2011 onwards. The weighted tax rate for the Group overall is 30%.

Intangible assets were capitalised in an amount of KEUR 13,844 as part of the purchase price allocation of PAION UK Group, which was acquired in 2008. The measurement of these development projects produces deferred tax liabilities in an amount of KEUR 3,876 based on the British income tax rate of 28%. These were offset by the same amount of deferred tax assets on losses carried forward. Deferred tax assets and liabilities are written down in line with the scheduled depreciation of the development projects. Deferred taxes are reported as net balances in both the balance sheet and the statement of comprehensive income. As of the balance sheet date, deferred tax assets and liabilities amounted each to KEUR 2,835 (previous year: KEUR 3,095) based on the reduced future income tax rate and after currency translation.

If the combined income tax rate that is currently applicable in Germany was applied to the tax losses carried forward in Germany as of 31 December 2010, the resulting deferred tax assets would amount to EUR 26 million (previous year: EUR 25 million). Based on the future income tax rate of 27% that is applicable in Great Britain, the losses carried forward in Great Britain as of 31 December 2010 would produce deferred tax assets in an amount of GBP 21 million (equivalent to EUR 24 million if converted at the rate applicable on the reporting date). In the previous year these amounted to GBP 20 million or EUR 22 million, respectively. The temporary differences between the tax base and the IFRS carrying amount would produce a net balance as of 31 December 2010 of deferred tax assets in an amount of KEUR 141 (previous year: KEUR 189), of which Germany accounts for KEUR 56 (previous year: KEUR 61) and Great Britain for KEUR 85 (previous year: KEUR 128). Total deferred tax assets would amount to EUR 53 million (previous year: EUR 50 million).

In the fiscal year the subsidiaries PAION Deutschland GmbH and PAION Holdings UK Ltd showed a small net income due to one-off payments. In coming years further losses are expected to be generated. As such it is not yet considered likely enough to realise the mentioned deferred tax assets. In line with IAS 12.34 “Income Taxes” the excess assets of the deferred tax assets on losses carried forward and the excess assets of deferred taxes on temporary differences are therefore not recognised.

Because of the negative results of the PAION Group and the existing tax losses carried forward, the small net income of single subsidiaries do not lead to income taxes. In the reporting period the Other Comprehensive Income (foreign currency translation of foreign subsidiaries) does not have any tax effects.

Based on an anticipated Group tax rate of 30%, the reconciliation of anticipated and actual income taxes is as follows:

	2010 KEUR	2009 KEUR
Loss for the period before taxes	-9,694	-13,377
Anticipated tax expense (+)/income (-)	-2,908	-4,013
Difference between anticipated Group tax rate and actual local tax rates	108	139
Non-recognition of deferred taxes on tax losses	2,598	3,662
Expenses in connection with stock options	136	37
Non-deductible expenses	29	28
Non-recognition of deferred taxes on temporary differences	-27	3
Costs in connection with capital increases	-49	0
Tax losses used	-203	-24
Other	-123	-172
Actual tax expense (+)/income (-)	**-439**	**-340**

The actual tax income results from the reimbursement of research and development costs through British tax authorities. The tax losses were reduced accordingly.

(17) Earnings per Share

In accordance with IAS 33 “Earnings per Share”, the earnings per share were calculated on the basis of the net result for the year and the weighted average number of shares outstanding. The underlying weighted average number of ordinary shares is derived as follows:

	2010 KEUR	2009 KEUR
Shares outstanding as of 1 January 2010	24,602,919	24,602,919
Weighted average number of shares issued in 2010	65,436	0
Weighted average number of ordinary shares	**24,668,355**	**24,602,919**

The calculation of undiluted and diluted earnings per share is based on the following figures:

	2010 KEUR	2009 KEUR
Net result for the year in EUR	-9,254,129.40	-13,037,100.66
Weighted average number of ordinary shares for undiluted earnings per share	24.668.355	24,602,919
Weighted average number of ordinary shares for diluted earnings per share	24,923,831	24,617,448
Earnings per share (in EUR):		
Undiluted	**-0.38**	**-0.53**
Diluted	**-0.38**	**-0.53**

Potential ordinary shares from the exercise of stock options are dilutive only if the new ordinary shares from the exercise of stock options would increase the loss per share. Because of the negative results of the PAION Group there is currently no dilution from potential new ordinary shares from the stock option programmes.

Notes to the Consolidated Cash Flow Statement

The consolidated cash flow statement shows how additions and disposals have changed the cash and cash equivalents held by PAION over the course of the fiscal year. In accordance with IAS 7 “Cash Flow Statements”, a distinction is made between cash flows from operating activities, from investing activities and from financing activities. The cash and cash equivalents reported in the consolidated cash flow statement are comprised of cash and bank account balances, together with current deposits that mature within three months from investment.

Other Notes

Stock Option Plan 2005

On 30 December 2004, the Annual General Meeting of PAION AG approved a stock option plan granting options to Management Board members and employees to acquire shares in PAION AG. One stock option entitles the holder to subscribe to one share from the dedicated Conditional Capital 2004 II. The stock options have a ten-year term and can only be exercised after a vesting period (two to four years), which has been fulfilled for all options. Options can only be exercised when the stock price on the exercise date has increased by a cumulative 5% each year since their issue.

Development of the stock options granted:

	No. of stock options	Weighted average exercise price in EUR
Stock options outstanding as of 1 Jan. 2009	845,343	8.02
Granted	0	0.00
Lapsed	0	0.00
Stock options outstanding as of 31 Dec. 2009	845,343	8.02
Granted	0	0.00
Lapsed	0	0.00
Stock options outstanding as of 31 Dec. 2010	**845,343**	**8.02**

No more options can be issued out of the Stock Option Plan 2005. No stock options were exercised in fiscal year 2010. As of 31 December 2010, 836,631 of the outstanding stock options could have been exercised following expiry of the waiting period. The exercise prices of the outstanding stock options range from EUR 8.00 to EUR 9.55. The weighted average exercise price for these options was EUR 8.02. The minimum increase in value required for exercise had not, however, been achieved by the balance sheet date. As of 31 December 2010, the exercise hurdle was EUR 9.50. The weighted residual term of these stock options was 4.2 years on average on the balance sheet date.

The accounting procedures for the stock options comply with the regulations of IFRS 2 “Share-Based Payment”. The fair value of the stock options was calculated using the Black/Scholes option pricing model at the time they were awarded and is recognised in profit or loss as personnel expenses over the waiting period of two to four years. Personnel expenses of KEUR 8 (previous year: KEUR 56) were recognised in fiscal year 2009 for the stock options granted from the Stock Option Plan 2005 and the capital reserve increased accordingly at the same time.

Employee Participation Plan 2006

With the consent of the Supervisory Board, the Management Board of PAION AG has launched an employee participation plan granting stock appreciation rights. A stock appreciation right entitles the holder to receive a sum of money based on the PAION AG share price. The maximum amount payable on a stock appreciation right is limited to 100% of the exercise price. The stock appreciation rights have a term of ten years and can only be exercised after a two-year waiting period, which has been fulfilled for all options. In addition, they may only be exercised when the stock price on the exercise date has increased by a cumulative 5% each year since issuance.

Development of the stock appreciation rights granted:

	No. of stock appreciation rights granted	Weighted average exercise price in EUR
Outstanding stock appreciation rights as of 1 Jan. 2009	134,000	7.89
Granted	0	0.00
Lapsed	0	0.00
Outstanding stock appreciation rights as of 31 Dec. 2009	134,000	7.89
Granted	0	0.00
Lapsed	0	0.00
Outstanding stock appreciaton rights as of 31 Dec. 2010	**134,000**	**7.89**

No more stock appreciation rights can be issued out of the Employee Participation Plan 2006. No stock appreciation rights were exercised in fiscal year 2010. As of 31 December 2010, all stock appreciation rights have vested. The exercise price and the weighted average exercise price for the outstanding stock appreciation rights is EUR 7.89. The minimum increase in value required for exercise had not, however, been achieved by the balance sheet date. As of 31 December 2010, the exercise hurdle was EUR 9.50. The weighted residual term of these stock options was six years on average on the balance sheet date.

The obligations arising from these stock appreciation rights are recognised at fair value on the balance sheet date in accordance with the regulations of IFRS 2 “Share-Based Payment”. The fair value is calculated using the Black/Scholes option pricing model. The calculation was based on an exercise price of EUR 7.89, a share price of EUR 2.24 on the balance sheet date, an average residual term of four years for the stock appreciation rights and a risk-free interest rate of 1.85%. Since the vesting period for all stock appreciation rights has expired, no staff fluctuation was recognised in the calculations. Dividends were not considered in the calculation. Volatility was assumed to be 80.35% based on the historical volatility of PAION AG shares. Separate option values were calculated to reflect the requisite conditions for increased value and the value cap; these were then combined with the value of the actual exercise option. Based on these parameters and assumptions, the fair value of every granted stock appreciation right was EUR 0.25 as of 31 December 2010. The ensuing potential payment obligation arising from this employee participation plan resulted in personnel income of KEUR 6 in fiscal year 2010 (previous year: personnel expenses: KEUR 37). The corresponding accrual amounts to KEUR 34 as of 31 December 2010 (previous year: KEUR 40).

Stock Option Plan 2008

On 5 May 2008, the Annual General Meeting approved a stock option plan granting options to Management Board members and employees to acquire shares in PAION AG. In total, 815,000 options may be granted under the Stock Option Plan 2008, of which up to 366,750 to Management Board members and up to 448,250 to employees. Each option entitles the owner to purchase one share out of the Conditional Capital 2008, which was set up for this purpose. The options have a term of ten years and can be exercised only after a vesting period. The vesting period for beneficiaries receiving options for the first time starts with the date of issue and ends for 50% of the options two years after the date of issue; for 25% of the options the vesting period ends three or four years, respectively, after the issue date. For all other beneficiaries the vesting period ends two years after the issue date. The Supervisory and Management Board may decide to extend the waiting periods. Moreover, the options may only be exercised if the share price on the exercise date has increased by a cumulative 5% p.a. since issuance. In the fiscal year 2010 371,150 options with a waiting period of four years were granted to Management Board members (169,650) and to employees (201,500) of the PAION Group, thereof 364,650 options at an exercise price of EUR 1.84 and 6,500 options at an exercise price of EUR 2.69. As of 31 December 2010, a total

of 740,755 options from the Stock Option Plan 2008 were granted, thereof 366,735 to current and former Management Board members and 374,020 to employees of the PAION Group.

Development of the stock options granted:

	No. of stock options	Weighted average exercise price in EUR
Stock options outstanding as of 1 Jan. 2009	395,180	1.26
Granted	38,260	1.11
Lapsed	-44,355	1.26
Stock options outstanding as of 31 Dec. 2009	389,085	1.25
Granted	371,150	1.86
Lapsed	-19,480	1.65
Stock options outstanding as of 31 Dec. 2010	**740,755**	**1.54**

No more options can be issued out of the Stock Option Plan 2008. As of 31 December 2010, 313,145 of the outstanding stock options could have been exercised following expiry of the waiting period. The increase in value required for exercise had been achieved by the balance sheet date. No stock options were exercised in fiscal year 2010. As of 31 December 2010, the exercise hurdle for those options that have vested was between EUR 1.23 and EUR 1.40 depending on the date of issue. The weighted residual term of these stock options was 8.9 years on average on the balance sheet date. The exercise price for the outstanding stock options is between EUR 1.11 and EUR 2.69.

The accounting procedures for the stock options comply with the regulations of IFRS 2 “Share-Based Payment”. The fair value of the stock options was calculated using the Black/Scholes option pricing model at the time they were awarded and is recognised in profit or loss as a personnel expense over the waiting period of two to four years.

The fair value of the stock options granted in 2010 was measured on the basis of an exercise price of EUR 1.84 and EUR 2.69 respectively per option and a share price of EUR 3.26 and EUR 2.71 respectively on the day of issue. The waiting period before the options can be exercised is five years. Depending on the waiting period, a risk-free interest rate of 2.50% to 2.67% was assumed for the stock options. Volatility was assumed to be 83.31%. Dividends were not considered in the calculation. Moreover, an annual staff fluctuation of 10.0% was assumed. Based on these parameters and assumptions, the fair value of the stock options granted in 2010 ranged between EUR 1.81 and EUR 2.48, depending on the underlying term.

Personnel expenses of KEUR 432 (previous year: KEUR 73) were recognised in fiscal year 2010 for the stock options granted from the Stock Option Plan 2008 and the capital reserve increased accordingly at the same time.

Stock Option Plan 2010

On 19 May 2010, the Annual General Meeting approved a stock option plan granting options to Management Board members and employees to acquire shares in PAION AG. In total, 720,000 options may be granted under the Stock Option Plan 2010, of which 324,000 to Management Board members and 396,000 to employees. Each option entitles the owner to purchase one share out of the Conditional Capital 2010 I, which was set up for this purpose. The options have a term of ten years and a vesting period of two years. The options can be exercised only after a waiting period of four years. The Supervisory and Management Board may decide to extend the vesting periods and waiting periods. Moreover, the options may only be exercised if the share price on the exercise date has increased by a cumulative 5% p.a. since issuance. So far no options from the Stock Option Plan 2010 were issued.

Other financial obligations/Contingent liabilities

PAION has rented office premises and leased cars and parts of its factory and office equipment. The rental contracts for the office premises include an automatic extension of the respective contract unless it is terminated by one of the two contract parties at a certain point in time prior to its expiry. The minimum future rental and lease obligations arising from these contracts are as follows:

	31 Dec. 2010 KEUR	31 Dec. 2009 KEUR
2011	405	326
2012	237	2
2013	156	0
Total	**798**	**328**

Rental and lease expenses in connection with these contracts amounted to KEUR 475 in fiscal year 2010 (previous year: KEUR 496). No rental or lease obligations exist beyond 2013 with the exception of the obligations arising from the premises that have been rented long-term but are no longer occupied; these are recognised as provisions.

In addition, PAION has payment commitments arising from various licence and purchase agreements governing PAION's acquisition of rights to specific patents. Contingent upon the occurrence of specific events, PAION will have to pay milestone payments amounting to up to EUR 13 million in total to its contract partners in connection with the licensing rights for Desmoteplase, M6G and Solulin. PAION has agreed to pay licencing fees based on the future net revenues generated with Desmoteplase, M6G and Solulin. Further success-related obligations of milestone payments and royalties could, be incurred as part of project developments that do currently not, however, form part of the current development strategy of PAION or its development partners.

Headcount and personnel expenses

In fiscal year 2010, PAION employed an average of 28 people (previous year: 30 employees). Of these 28 employees, 13 worked in development and 15 in administration and selling. PAION UK Group has a headcount of seven employees. As of 31 December 2010 the headcount was 27 (previous year: 30).

The following personnel expenses were incurred in fiscal years 2010 and 2009:

	2010 KEUR	2009 KEUR
Wages and salaries	4,067	3,904
Social contributions	373	346
	4,440	**4,250**

The personnel expenses stated above include expenses from granting of stock options in connection with the Stock Option Plans 2005 and 2008, respectively the Employee Participation Plan 2006, in an amount of KEUR 440 (previous year: KEUR 165). The figures also include contributions to the German and British national pension schemes in an amount of KEUR 226 (previous year: KEUR 214).

Related parties

In accordance with IAS 24 "Related Party Disclosures", information must be provided on relationships with affiliated companies and individuals. Members of both the Management Board and the Supervisory Board, and shareholders, are classified as related parties in the context of IAS 24.9. As far as the remuneration paid to, and shareholdings owned by, the members of the Management and Supervisory Board are concerned, please refer to the explanations in the sub-sections "Members of the Management Board" and "Members of the Supervisory Board" in this section.

No relationships with related parties existed otherwise.

Objectives of and procedures for managing financial risks

PAION's business activities currently focus on the production development, clinical development and to a minor extent preclinical development of various substances. Since these development activities are not yet generating any revenues from the sale of launched products, the scheduled expenses are correspondingly high. PAION aims to support the substances through the clinical development and regulatory approval phases and to ensure the availability of the requisite short-term and mid-term funding. This funding is primarily secured by means of equity and through development cooperation agreements, pursuant to which the cooperation partners effect milestone payments and assume direct and indirect responsibility for the development costs. Future possibilities to attract additional equity or receive milestone payments from cooperation partners will depend to a large extent on the positive clinical development progress of the individual substances. PAION's management therefore concentrates on managing and monitoring the individual development projects, its financial position and its future funding requirements.

The financial liabilities are comprised of a subordinate loan, provisions, trade payables and part of the other liabilities. PAION owns various financial assets, such as trade receivables, part of the other assets as well as bank account balances and current deposits. These financial assets and liabilities are direct products of PAION's business operations and/or are used to finance ongoing business activities.

PAION AG uses derivative financial instruments in the context of foreign exchange risk management. In doing so, only financial instruments with an explicit hedging context are used.

In order to hedge USD commitments of the subsidiary PAION UK Ltd in connection with the conduct of clinical studies with Remimazolam in the USA, PAION AG bought four USD call options with a total volume of KUSD 1,000 in favour of PAION UK Ltd. The premiums paid for the options were KEUR 37. From the exercise of the options an income of KEUR 76 was realised. The net income of KEUR 39 is recognised under other income. As of the balance sheet date no options exist.

The financial instruments expose PAION to the following risks:

PAION is exposed to **currency risks** arising from its trade payables and from the loans granted to its British subsidiary companies. Liquid assets are mainly invested in Euro.

The loans granted by PAION AG to its British subsidiaries produced exchange rate gains of KEUR 385 in 2010, which were recognised in equity. If the EUR/GBP exchange rate had been 10% higher on the balance sheet date, the currency component of equity would have increased by KEUR 1,989. If the EUR/GBP exchange rate had been 10% lower on the balance sheet date, the currency component of equity would have decreased by KEUR 1,989.

Trade receivables relate solely to development costs charged on to Lundbeck and are settled in Euro. PAION believes the **default risk** of the cooperation partner to be low. PAION's bank credit balances and current deposits are held with two major German banks, a savings bank and a major British bank. The choice of short-term capital investments is based on various security criteria (e.g. rating, capital guarantee, safeguarded by the deposit protection fund (Einlagensicherungsfonds)). In light of these selection criteria and the ongoing monitoring of its capital investments, PAION does not believe that there is any risk of default in this area. The amounts stated in the balance sheet always represent the maximum possible default risk.

PAION uses a customised business planning tool to monitor and manage its cash flows; this tool comprises both short and medium-term, and long-term business planning. **Liquidity risks** are identified at an early stage by simulating different scenarios and conducting sensitivity analyses. Current liquidity is captured and monitored on a daily basis.

The interest earned on bank credit balances and current deposits is dependent on the development of market interest rates. As such, these assets held by PAION are exposed to the risk of changing interest rates. A reduction of 50 base points in the interest rates would have resulted in a KEUR 94 lower Group result in fiscal year 2010 (previous year: KEUR 147). The interest rate charged on the subordinate loan is fixed and only exposed to the risk of interest rate changes, if the credit rating undergoes sustained improvement; in this case the interest rate could be reduced by 50 base points to 7.933%.

The other assets largely comprise claims for tax refunds from the Inland Revenue in England in connection with the partial reimbursement of research and development costs. The calculation of the refund claims is based on the calculation method agreed in previous years between the PAION UK companies and the British tax authorities. The British tax authorities had not, however, finalised their review of the refund claims filed for 2010 by the balance sheet date. Nevertheless, PAION does not expect to encounter any material risk in respect of the recoverability of the refund claims.

Financial instruments

The following table shows the book values and fair values of the financial instruments included in the consolidated financial statements:

in KEUR		Book value		Fair value	
		31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009
Financial assets:					
Cash and cash equivalents	(1)	14,882	22,871	14,882	22,871
Trade receivables	(1)	11	94	11	94
Other assets	(1)	7	76	7	76
Currency option	(2)	0	9	0	9
Financial liabilities:					
Fixed-interest subordinate loan	(3)	6,893	6,858	7,372	7,379
Provisions	(3)	2,023	2,078	2,023	2,078
Trade payables	(3)	1,835	1,724	1,835	1,724
Other liabilities	(3)	216	223	216	223

Measurement category according to IAS 39:
(1) Loans and receivables
(2) measured at fair value through profit and loss
(3) Liabilities recognised at amortised cost

In light of the short residual terms of the cash and cash equivalents, trade receivables, other assets, trade payables and other liabilities, the book values are equivalent to the fair values as of the balance sheet date. The fair value of the fixed-interest subordinate loan was calculated as the present value of the payments connected with this liability based on the interest structure curve applying on the balance sheet date. The fair value of the currency option in the previous year was calculated using the Black/Scholes option pricing model.

Members of the Management Board
The members of the Company's Management Board are:

– Dr Wolfgang Söhngen, CEO, Chairman
– Dr Mariola Söhngen, CMO
– Bernhard Hofer, CFO
– Dr Gavin Kilpatrick, CSO

Management Board remuneration totalled EUR 1,631,198 in fiscal year 2010. Currently payable benefits accounted for EUR 1,210,466 and share-based payments for EUR 420,732 of this remuneration. As of 31 December 2010, a total of 699,156 stock options (fair value at time of granting: EUR 1,796,659) and 75,000 stock appreciation rights (fair value as of 31 December 2010: EUR 18,750.00) had been issued to Management Board members. For more information on Management Board remuneration, please see our comments in the compensation report which is part of the management report.

With the exception of Dr Kilpatrick, all members of the Company's Management Board are also Managing Directors of PAION Deutschland GmbH. Management Board members Bernhard Hofer, Dr Gavin Kilpatrick and Dr Mariola Söhngen are also Managing Directors of PAION Holdings UK Ltd and its subsidiaries. All Management Board members work full time for the company and its subsidiaries.

As of 31 December 2010, Dr Mariola Söhngen owned 2.59% (648,641 voting rights) and Dr Wolfgang Söhngen 2.32% (582,340 voting rights) of the shares in PAION AG. These shareholdings include 0.02% (6,197 voting rights) of the shares in PAION AG of both shareholders respectively that are held in each case by Dres Söhngen Beteiligungs GmbH, in which Dr Mariola Söhngen and Dr Wolfgang Söhngen each hold 50%.

As of 31 December 2010 Dr Gavin Kilpatrick owned 0.01% (3,609 voting rights) of the shares in PAION AG.

Members of the Supervisory Board:
The members of the Supervisory Board are:

– Dr Jörg Spiekerkötter, Kleinmachnow, Germany, Chairman; lawyer

– Dr Walter Wenninger, Leverkusen, Germany, Deputy Chairman; businessman
  Other supervisory board memberships or similar positions:
  – Evotec AG, Hamburg
  – Novo A/S Hellerup, Denmark
  – NOXXON Pharma AG, Berlin, Chairman of the Supervisory Board
  – Recordati Industria Chimica E Farmaceutica S.p.A., Milan, Italy
  – Santaris Pharma A/S, Horsholm, Denmark

– Alan Goodman, Cambridge, England, Chairman of the Audit Committee; CEO of Avlar Bioventures Ltd, Cambridge, England

Remuneration to the members of the Supervisory Board totalled EUR 136,500 in fiscal year 2010. For more information on Supervisory Board remuneration, please see our comments in the compensation report of the group management report.

As of 31 December 2010, Alan Goodman owned directly 0.59% (147,244 voting rights) and indirectly through Advanced Technology Management Limited, Huntingdon/ Cambridgeshire, England 3.64% (912,309 voting rights) of the shares in PAION AG.

As of 31 December 2010, none of the other members of the Supervisory Board owned shares in PAION AG.

Auditors

The Annual General Meeting on 19 May 2010 appointed Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Cologne office, Germany, as auditor for the individual and consolidated financial statements for fiscal year 2010. The auditor has received or will invoice the following fees for services rendered to PAION AG and its subsidiary companies in fiscal year 2010:

	2010 KEUR	2009 KEUR
Audits	83	97
Other opinions	30	29
	113	**126**

The "other opinions" relate to fees for auditing reviews of the quarterly financial statements.

Corporate Governance

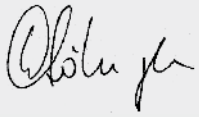
The Supervisory Board and Management Board of PAION AG declare that they are committed to responsible and transparent management and control of the Company focused on adding value in the long term.

The Company complies, for the most part, with the recommendations set forth in the most recent version of the German Corporate Governance Code dated 26 May 2010. On 10 December 2010 and on 21 February 2011, the Supervisory Board and the Management Board issued the declaration of compliance with the Corporate Governance Code pursuant to Section 161 AktG. These declarations of compliance are published on PAION AG's website (www.paion.com/corporategovernance).

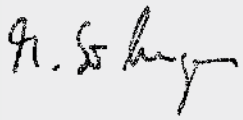
Events Occurring after the Balance Sheet Date

No significant events occurred in the time period between the balance sheet date, 31 December 2010, and the finalisation of this report.

Aachen, 8 March 2011
PAION AG



Dr Wolfgang Söhngen



Dr Mariola Söhngen

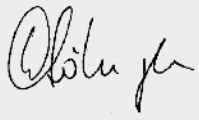
Bernhard Hofer

Dr Gavin Kilpatrick

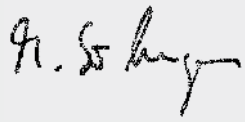
Responsibility Statement (Bilanzeid) in accordance with section 37y no.1 of the Wertpapierhandelsgesetz (WpHG – German Securities Trading Act) in conjunction with sections 297(2) sentence 4 and 315(1) sentence 6 of the Handelsgesetzbuch (HGB – German Commercial Code)

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

Aachen, 8 March 2011
PAION AG



Dr Wolfgang Söhngen



Dr Mariola Söhngen

Bernhard Hofer

Dr Gavin Kilpatrick

Audit Opinion

We issued the following opinion on the consolidated financial statements and the group management report:

"We have audited the consolidated financial statements prepared by PAION AG, Aachen, comprising the balance sheet, the statement of comprehensive income, the cash flow statement, the statement of changes in equity and the notes to the consolidated financial statements, together with the group management report for the fiscal year from 1 January 2010 to 31 December 2010. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs [International Financial Reporting Standards] as adopted by the EU, and the additional requirements of German commercial law pursuant to Sec. 315a (1) HGB ["Handelsgesetzbuch": German Commercial Code] is the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statements and the group management report based on our audit.

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

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to Sec. 315a (1) HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development."

Cologne, 22 March 2011

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

Gockel
Wirtschaftsprüfer
(German Public Auditor)

Galden
Wirtschaftsprüfer
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PAION AG, Aachen

Financial Statements

as of 31 December 2010

Management Report

for the Fiscal Year 2010

PAION

Management Report for Fiscal Year 2010

Economic Background

1. Overall Economic Development

The year 2010 was marked by a strong recovery of the global economy after the heavy slump the year before. In most countries the economic output again reached the level it was before the financial crisis. In total the world economy increased by 3.9% in 2010. The strong increase of the world economy was driven especially by the economic growth of the emerging markets. In China for example the economy grew by 10%. The US economy also returned to the growth path; growth was 2.7%. In Germany the growth rate of 3.6% was relatively high compared to other industrial nations, especially driven by the strong export sector as a result of the robust world economy.

The recovery of the world economy had an effect on the development of the stock markets. Thus the DAX increased by 16% compared with the closing index the previous year. The development of other important indexes was similar. The Dow Jones Index increased by 11% and the S&P 500 increased by 13% compared with the closing indexes the previous year.

For 2011 and 2012 a further increase of the economy is expected, but at lower growth rates than in 2010. For the world economy a growth of 3.3% is expected. In Germany a growth of 2.2% is expected. Risks are especially the sovereign debt crisis in Europe and the USA as well as the still weak real estate and financial sectors in the USA. The forecast uncertainty remains at a high level.

2. Development of the Pharmaceutical and Biotechnology Industry

In the pharmaceutical and biotechnology industry the consolidation pressure is continuing unrelieved. This results especially from the high risks and costs associated with pharmaceutical development, the expiry of patent protection on a number of products in the years to come and in the budget cuts in the health sector by several industrial nations following the budget deficit overruns. 2010 again saw several company mergers, cooperation agreements, in-licensing and out-licensing. In addition to mergers among pharmaceutical companies, numerous biotechnology companies were again acquired by pharmaceutical companies. These acquisitions were frequently preceded by long-standing cooperations between the parties. The difficult financing conditions for small biotech companies and the still low valuations have increased the trend towards acquisitions and cooperation agreements. It is expected that the industry consolidation will continue over the next years.

The share prices of listed pharmaceutical and biotechnology companies developed differently on a regional basis. The NASDAQ Biotechnology Index increased by 15% compared with the closing index the previous year. The AMEX Biotechnology Index even increased by 38% in 2010. On the contrary the Deutsche Börse AG's DAXsubsector Biotechnology Index decreased by 4% compared with the closing index the previous year.

As a result of the crisis on the financial markets, investors became much more hesitant in 2009 and IPOs have virtually ground to a halt, both of which have considerably exacerbated especially biotechnology companies' chances of securing financing. The IPO activity has recovered slightly in 2010 but is still weak. In 2010 investors were willing in individual cases to invest in biotechnology companies, however, overall the chances of securing financing are still difficult for biotechnology companies.

Business Performance

I. Preliminary Remarks

PAION AG is a holding company that only provides management and services to its subsidiary companies. These services primarily focus on administrative tasks, including accounting, legal, human resources, public relations and controlling. In addition, PAION AG supports the financing of its subsidiaries' ongoing business activities, while the Group companies provide each other with development-related services. The activities of the PAION Group (hereinafter also referred to as "PAION") are thus mainly determined by the development operations of PAION Deutschland GmbH and PAION UK Ltd which are presented below.

PAION's portfolio comprises five candidates in clinical development. These are the substances Remimazolam (CNS 7056), M6G and Solulin in internal development and the substances Desmoteplase and GGF2 which are being developed by cooperation partners. Furthermore, Remimazolam is being developed by cooperation partner Ono for the Japanese market. Remimazolam and M6G are being developed by the subsidiary PAION UK Ltd and Solulin is being developed by the subsidiary PAION Deutschland GmbH. Desmoteplase is an asset of PAION Deutschland GmbH and GGF2 is an asset of PAION Holdings UK Ltd.

The development of the compounds CNS 5161 and Flovagatran was discontinued in the fiscal year. PAION had based the further development of CNS 5161 on third-party financing. Since such financing could not be secured by year end 2009, the existing development cooperation for CNS 5161 with Ergomed was terminated and activities discontinued at the beginning of 2010.

With the compound Flovagatran preclinical studies were conducted. After weighing the probability of commercial and clinical success, the development of Flovagatran was discontinued in December 2010, as a promising indication could not be identified.

PAION has rights to further substances which are partly out-licensed and may lead to additional success-related incomes and payments. At present the likelihood is still assessed to be low, since these substances are not a major part of PAION's or its partners' development strategy.

Fiscal year 2010 was marked by the concentration of PAION Group on the development of the substances of PAION UK Ltd, especially Remimazolam.

2. Overview of Development Activities of PAION Deutschland GmbH and PAION UK Ltd

a. Remimazolam

Remimazolam is an innovative short-acting general anaesthetic/sedative that is being developed by PAION initially for use in minor medical interventions (procedural sedation). Sedatives are used, for example, in endoscopic procedures such as colonoscopies. After intravenous administration to over 300 human volunteers/patients in the course of the clinical trials performed, Remimazolam rapidly induced the desired sedation. Importantly, for the benefit of the volunteer/patient, this sedative effect quickly disappears again. This means that the patient can be selectively sedated for the duration of the intervention and rapidly regains full consciousness after the procedure. This rapid offset of the effect of the substance is due to its metabolism by tissue esterase enzymes that are widely distributed throughout the body.

Remimazolam is currently being developed by PAION as a sedative agent for day case procedures. It has additional potential in the induction and maintenance of anaesthesia, which is the initial indication being developed by PAION's partner Ono for the Japanese market. Furthermore, Remimazolam could also be used as a sedative during artificial respiration in the Intensive Care Unit (ICU).

Clinical Development

The clinical studies performed with Remimazolam comprise two Phase I and two Phase II studies with single or multiple dose without an intervention or during endoscopy of the upper gastrointestinal tract or the colon. The patient recruitment of the Phase IIb study performed in 2010 ran from May to September; the results were reported in November 2010.

The generated data indicate a good tolerability of Remimazolam. The effect of Remimazolam can be reversed by the benzodiazepine antagonist Flumazenil. A rapid onset and offset of the sedative effect was observed during the procedures. It was also shown that it is possible to achieve the same (safety) or better (efficacy) results as compared to a single dose of the gold standard Midazolam with a single dose of Remimazolam. Furthermore, an adequate sedation level can be maintained for 30 minutes with a multiple dose regimen. This time period is usually required to perform a colonoscopy if an additional intervention is required (e.g. removal of one or more polyps). A routine, purely diagnostic colonoscopy takes approximately 10–15 minutes.

Based on the results of the Phase IIb study, the optimal dose regimen for Phase III studies can now be defined.

Cooperation Agreements

In 2007 Ono Pharmaceutical Co., Ltd. (Ono) was granted the rights to develop and market Remimazolam for the Japanese market in return for development milestone payments and royalties. Ono is developing Remimazolam in indications where continuous infusion is needed, whereas PAION initially concentrates on indications requiring single or repeated bolus dosing to sedate patients for short procedures. In this co-operation, data and information are continually shared by each other so that each party benefits from the development progress of the other party. In February 2010 Ono informed PAION about the initiation of the first Japanese Phase I study. The first subject was enrolled in April 2010. This triggered the first milestone payment of USD 1 million from Ono. Meanwhile the Phase I programme has progressed as planned. The progress that has been made will help to support and accelerate the development of Remimazolam for the indications anaesthesia and ICU sedation in the PAION territories.

PAION is exploring partnering opportunities outside Japan to advance the development of Remimazolam, preferably for multiple indications, as quickly as possible as well as to prepare the subsequent commercialisation.

b. Morphine-6-glucuronide

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

Clinical Development

PAION has performed various in-depth analyses of the available clinical data. The results support PAION's view that M6G has a wider therapeutic window than morphine at equi-analgesic dosages with a lower incidence of post-operative nausea and vomiting. Based on these findings a development plan has been agreed with the FDA for this New Chemical Entity, i.e. a novel, distinct substance. This improves the potential profitability for potential pharma partners as it provides the prospect for longer market exclusivity. The aim of the remaining Phase III programme is to prove that M6G causes significantly less post-operative nausea and vomiting compared to equi-analgesic doses of morphine.

Cooperation Agreements

The intellectual property rights for M6G are based on PAION's own development as well as rights developed by third parties. In connection with this third party intellectual property, PAION has success-related obligations in the form of milestones and royalties.

Despite the positive results of the in-depth re-analysis and the encouraging FDA consultation PAION has so far not been able to conclude a global partnership. Currently PAION is in discussions on continuing the development together with several partners in regional deal structures.

c. Desmoteplase

Desmoteplase is a recombinant protein (a so-called plasminogen activator) derived from the saliva of the vampire bat, Desmodus rotundus, which is intravenously administered to dissolve blood clots. It is currently being developed for the treatment of acute ischaemic stroke. The treatment is being carried out in a timeframe of three to nine hours post onset of stroke symptoms – a time window for which there currently is no approved drug treatment.

Clinical Development

So far Desmoteplase has been tested in two Phase II studies and one Phase III study for the treatment of acute ischaemic stroke. In 2008 PAION's licence partner H. Lundbeck A/S (Lundbeck) took on the further development of Desmoteplase. In December 2008 Lundbeck initiated a further Phase III development programme consisting of two comparable studies (DIAS-3 and DIAS-4). Furthermore, in March 2010 Lundbeck initiated a Phase II study in Japan (DIAS-J).

In current corporate communication Lundbeck reported that patient enrolment in the clinical Phase III programme with Desmoteplase was slower than anticipated (Lundbeck Annual Report 2010). Lundbeck expects to be able to file the market authorisation application by the end of 2012 (Lundbeck presentation at the SEB Nordic Seminar in January 2011).

Cooperation Agreements

PAION in-licensed Desmoteplase from Bayer AG (former Schering AG) in 2001 in return for milestones and royalties. Today Lundbeck holds the exclusive global rights for research, development, production and marketing of Desmoteplase. The licence agreement came into effect in January 2008 and was extended in October 2010, to include potential follow-up compounds. Under these agreements, Lundbeck agreed to undertake the following payments:

- Payment of a non-refundable amount of EUR 8 million upfront payment, on the date the agreement took effect (January 2008; disclosed as deferred income and being released proportionally over the probable development period),
- Payment of a non-refundable purchase price of EUR 1.5 million, on the date the extended agreement took effect (October 2010; disclosed as revenue in 2010),
- Milestone payments for Desmoteplase of up to EUR 68 million, of which up to EUR 40 million relate to milestones due before and including market approvals (regional splitting) and in total EUR 28 million are due upon commencement of marketing activities and the achievement of specific revenue targets,

– Milestone payments for the second generation molecules (follow-up compounds) of up to EUR 25 million for development and commercialisation,
– Assumption of all costs, especially for clinical development, production development, patent costs and marketing approval,
– Payment of licence fees (dependent on revenues) which amount to a low double-digit percentage following the deduction of the licence fees PAION has to pay to the original licensor, Bayer AG.

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

d. Solulin

Solulin is an improved variant of the human protein thrombomodulin, an important natural regulator of the coagulation system. One function of thrombomodulin is the stabilisation of the haemostatic fibrin clot. In contrast to natural thrombomodulin, which is an integral protein of vascular membranes, Solulin can travel through the blood stream to reach its potential site of action.

PAION decided in 2008 to investigate alternative indications for Solulin. In December 2010 positive preclinical data were reported for the indication haemophilia and PAION has decided to select haemophilia as new lead indication for Solulin. Before entering clinical development in the indication haemophilia, advanced pre-clinical experiments are planned.

e. Glial Growth Factor (GGF2)

GGF2 (Glial Growth Factor 2) is known to stimulate the growth and differentiation of a variety of cells including glial cells, the support cells of the nervous system. These glial cells form the myelin sheath that insulates nerve cells and is essential for their survival and proper functioning. In demyelinating diseases such as multiple sclerosis, the myelin sheath is damaged, leading to the degeneration of nerve cells.

In pre-clinical studies PAION's licence partner Acorda Therapeutics, Inc. (Acorda) demonstrated that GGF2 can stimulate the cell growth necessary to protect and regenerate a damaged myelin sheath. GGF2 is the lead neuregulin in Acorda's portfolio. Neuregulins have also shown the ability to restore cardiac function in preclinical models of heart failure caused by myocardial infarction, rapid pacing, viral and chemically induced cardiomyopathies. In April 2010 the FDA approved the IND (Investigational New Drug) application for GGF2 for the indication of heart failure. In July 2010 Acorda announced that the National Heart, Lung and Blood Institute (NHLBI) has awarded a USD 1 million Cardiac Translational Research Implementation Program (C-TRIP) grant to Acorda and its collaborator Vanderbilt University Heart and Vascular Institute to support the early phase clinical research on GGF2. In December 2010 Acorda announced the start of the first Phase I study.

Cooperation Agreements
The rights relating to the recombinant GGF2, rh GGF2, were licensed to Acorda in 2002 by PAION UK. The IND application submitted in March 2010 triggered the obligation to pay the first milestone of USD 0.5 million; the payment was received in April 2010. The IND approval communicated by Acorda in April 2010 triggered the obligation to pay the second milestone of USD 0.5 million; the payment was received in May 2010. In total, further milestone payments of USD 2.5 million prior to market approval and an additional milestone payment of USD 5 million are due upon market authorisation; after that PAION will receive revenue dependent royalties.

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

a. Results of Operations

Other operating income decreased by KEUR 453 compared to the previous year and amounted to KEUR 829 because less management and services were provided to the subsidiary companies. The decrease in other operating income was compensated by a reduction of KEUR 224 in personnel expenses and a reduction of KEUR 223 in other operating expenses. The decrease in personnel expenses is mainly due to the reduced Management Board and the decrease in other operating expenses is mainly due to lower legal and consulting fees as well as lower costs for audit and the annual report.

The operating result is on the prior year level and amounts to KEUR -2,679 (previous year: KEUR -2,666).

The financial result increased by KEUR 80 compared to the previous year mainly because of higher interest income from the British subsidiaries.

In total the loss for the year improved by KEUR 67 to KEUR -2,674.

	2010 KEUR	2009 KEUR	Change KEUR
Other operating income	829	1,282	-453
Personnel expenses	-1,550	-1,774	224
Depreciation and amortisation	-6	-5	-1
Other operating expenses	-1,945	-2,168	223
Taxes (excl. income taxes)	-7	-1	-6
Operating result	-2,679	-2,666	-13
Financial result	5	-75	80
Net loss for the year	**-2,674**	**-2,741**	**67**

Other **operating income** mainly comprises income from the provision of management and other services to the subsidiary companies (KEUR 721; previous year: KEUR 1,161), of which PAION Deutschland GmbH accounted for KEUR 388 (previous year: KEUR 544) and PAION UK Ltd for KEUR 333 (previous year: 617).

Personnel expenses decreased by KEUR 224 mainly because of the reduction of the Management Board and amounted to KEUR 1,550.

Year on year, **other operating expenses** decreased by KEUR 223 to KEUR 1,945 and mainly include legal and consulting fees (KEUR 385; previous year: KEUR 468), services rendered by PAION Deutschland GmbH (KEUR 410; previous year: KEUR 434), insurance, contributions and fees (KEUR 210; previous year: KEUR 201), travel expenses (KEUR 150; previous year: KEUR 174), expenses in connection with Supervisory Board remuneration (KEUR 137; previous year: KEUR 131) as well as audit costs and costs for the annual report (KEUR 68; previous year: KEUR 103).

Compared with the previous year, the **financial result** increased by KEUR 80 to KEUR 5. The interest income from banks decreased from KEUR 211 in the previous year to KEUR 51 which is mainly due to considerably lower money market interest rates as well as lower cash and cash equivalents. The decrease was absorbed by higher interest income from affiliated companies (KEUR 584; previous year: KEUR 350). Interest income from affiliated companies was generated from the loans granted to the PAION UK Group companies. The financial result also contains interest expenses of KEUR 630 (previous year: KEUR 630) for the subordinate loan raised in April 2006.

b. Net Assets and Financial Position

Fixed assets have decreased in fiscal year 2010 down to KEUR 43,836 mainly due to the withdrawal of free reserves from the subsidiary PAION Deutschland GmbH (KEUR 1,800). Current assets increased by KEUR 284 mainly due to an increase of receivables from affiliated companies and a concurrent decrease in cash and cash equivalents. On the credit side the equity decreased by KEUR 1,516 to KEUR 66,877. The equity ratio remained virtually unchanged at 89.6% as of the balance sheet date, compared with 89.8% last year. If the subordinate loan is considered to be economic equity, the equity ratio remains unchanged at a very high 98.9% (previous year: 99.0%).

	31 Dec. 2010 KEUR	31 Dec. 2009 KEUR	Change KEUR
Fixed assets	43,836	45,641	-1,805
Current assets and deferred items	30,826	30,542	284
Assets	**74,662**	**76,183**	**-1,521**
Equity	66,877	68,393	-1,516
Long-term debt	7,000	7,000	0
Short-term debt	785	790	-5
Shareholders' equity and liabilities	**74,662**	**76,183**	**-1,521**

Fixed assets comprise mainly the shares in PAION Deutschland GmbH (KEUR 31,500) and the shares in PAION Holdings UK Ltd (KEUR 12,318). The shares in PAION Deutschland GmbH decreased due to the KEUR 1,800 withdrawal from the capital reserve from KEUR 33,300 to KEUR 31,500.

The loans granted to the PAION UK companies included in the **current assets** increased from KEUR 13,600 to KEUR 19,780. Concurrently cash and cash equivalents declined by KEUR 6,001 to KEUR 10,522. The change in cash and cash equivalents over the fiscal year is attributable to the following items:

	2010 KEUR	2009 KEUR
Cash flow from operating activities	-2,780	-2,634
Cash flow from investing activities	1,800	5,986
Cash flow from financing activities	-5,021	-7,670
Changes in cash and cash equivalents	**-6,001**	**-4,318**

The cash flow from operating activities in an amount of KEUR -2,780 is mainly attributable to the loss for the year in the amount of KEUR -2,674.

The receipts from investing activities relate to the withdrawal from the capital reserve of PAION Deutschland GmbH (KEUR 1,800).

Financing expenses resulted from the provision of loans to subsidiary companies (KEUR 6,180). On the other hand the issue of 470,765 new shares led to cash inflows of KEUR 1,159.

Despite a net loss of KEUR -2,674 the **equity** decreased only by KEUR 1,468, since the issue of 470,765 new shares led to an increase of equity of KEUR 1,159.

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

The Group generated a consolidated net loss of KEUR -9,254 in fiscal year 2010 (previous year: KEUR -13,037). The key items in the consolidated balance sheet as of 31 December 2010 were cash and cash equivalents of KEUR 14,882 on the assets side (previous year: KEUR 22,871) and equity of KEUR 11,968 on the credit side (previous year: KEUR 19,304). With a balance sheet total of KEUR 26,836, the Group equity ratio totalled 44.6% as of 31 December 2010 (previous year: 54.3%).

Headcount

As of 31 December 2010, the total headcount of the PAION Group amounted to 27 employees, of whom six work for the PAION UK Group. By comparison, the headcount as of 31 December 2009 amounted to 30 employees. As of 31 December 2010, the headcount at PAION AG totalled six employees.

Changes to the Management and Supervisory Board

The Annual General Meeting on 19 May 2010 re-elected Dr Wenninger as member of the Supervisory Board. Afterwards the Supervisory Board elected Dr Spiekerkötter as Chairman of the Supervisory Board and Dr Wenninger as Deputy Chairman of the Supervisory Board.

Compensation Report

I. Management Board

The remuneration paid to Management Board members comprises a fixed annual compensation, a variable bonus, a long-term performance-based compensation component in the form of stock options and stock appreciation rights as well as other compensation in terms of taxable payments in kind, insurance premiums and pension contributions. All stock options and stock appreciation rights granted to Management Board members so far have a ten-year term. The variable bonus depends on the achievement of long-term and sustainable financial and strategic corporate targets and personal goals which are defined by the Supervisory Board in conjunction with the Management Board at the beginning of each fiscal year. The level of target achievement and the related amount of the variable compensation is assessed and determined by the Supervisory Board at the end of each year. Bonuses are limited to a maximum amount and are paid depending on personal goal achievement. Furthermore, negative developments do have an effect on the amount of the variable bonus in terms of a malus. Performance targets are not subsequently adjusted.

Apart from Dr Kilpatrick, the compensation as board member covers the director function in the subsidiaries.

The members of the Management Board have received stock options from the Stock Option Plan 2005 approved by the Annual General Meeting on 30 December 2004. The number of shares to be allocated to the Management Board was determined by the Supervisory Board immediately after the IPO. The two- to four-year vesting period before stock options can be exercised acts as a long-term incentive to increase the company's value. The exercise price of the stock options is EUR 8.00, equivalent to the issue price of the shares at the IPO. As of 31 December 2010, the exercise hurdle was EUR 11.33.

The Supervisory Board granted the Management Board members a total of 75,000 stock appreciation rights under the Employee Participation Plan 2006. The stock appreciation rights have a two-year vesting period after which time the holder is entitled to receive a sum of money based on the PAION AG share price. In addition to an annual minimum appreciation, the Employee Participation Plan 2006 also limits the value of the amount payable. The maximum payable amount is 100% of the exercise price, which is EUR 7.89 for the stock appreciation rights granted in fiscal year 2006. As of 31 December 2010, the exercise hurdle was EUR 9.50.

From the Stock Option Plan 2008 approved by the Annual General Meeting on 5 May 2008 a total of 172,170 stock options were granted to the members of the Management Board. The Supervisory Board determined the number of stock options to be allocated to the Management Board. The two-to-four-year vesting period before stock options can be exercised acts as a long-term incentive to increase the company's value. The exercise price is between EUR 1.11 and EUR 1.26 per stock option depending on the price of the share price at the time of allocation. As of 31 December 2010 the exercise hurdle for those options that have vested was EUR 1.40.

In January 2010 further 169,650 stock options from the Stock Option Plan 2008 with a vesting period of four years were issued to the members of the Management Board. The exercise price is EUR 1.84 per stock option and reflects the share price at the time of allocation.

In total 341,820 stock options from the Stock Option Plan 2008 were granted to members of the Management Board.

From the Stock Option Plan 2010 which was approved by the Annual General Meeting on 19 May 2010 no stock options have been issued so far.

The stock option agreements with the individual members of the Management Board limit the numbers of stock options which can be granted. With the exception of minimum increases in value, no restrictions have been imposed in respect of changes in the value of the stock options, which are directly linked to PAION's share price performance. Regarding the performance of the stock appreciation rights granted to the Management Board members, which is directly linked to the performance of the PAION share price, a cap is agreed.

In fiscal year 2010 no stock options or stock appreciation rights were exercised by the Management Board.

Based on the agreements with the members of the Management Board, the compensation structure for fiscal year 2010 is as follows:

		Dr Wolfgang Söhngen	Dr Mariola Söhngen	Bernhard Hofer	Dr Gavin Kilpatrick[1]
Total remuneration 2010:					
Fixed salary	EUR	236,667	216,667	200,000	22,953
Variable compensation	EUR	86,616	79,398	72,180	36,483
Other compensation	EUR	25,699	16,479	11,637	227
Fair value of stock options issued in 2010	EUR	140,244	93,496	93,496	93,496
Status of non-exercised stock options and stock appreciation rights as of 31 December 2010:					
Stock options 2005	NO.	138,964	109,186	109,186	
Stock options 2005 – fair value[2]	EUR	494,017	388,156	388,156	
Stock options 2008	NO.	113,940	75,960	75,960	75,960
Stock options 2008 – fair value[2]	EUR	172,956	115,304	115,304	122,765
Stock Appreciation Rights (SAR)	NO.	25,000	25,000	25,000	
SAR - fair value[3]	EUR	6,250	6,250	6,250	

1 Payment in GBP; amounts converted from GBP to EUR at monthly average exchange rates
2 Applicable fair value at the time of issuance, calculated using the Black/Scholes option pricing model
3 Applicable fair value on the balance sheet date, calculated using the Black/Scholes option pricing model

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

Management Board remuneration in fiscal year 2010 amounted to KEUR 1,426 (previous year: KEUR 1,240).

Dr Kilpatrick drew in 2010 in addition to the compensation as board member a base salary of GBP 132,207 (KEUR 154,363) a bonus of GBP 20,800 (KEUR 24,531) and other compensation amounting to GBP 22,751 (KEUR 26,566) from PAION UK Ltd. The figures indicated in EUR were converted at monthly average EUR/GBP exchange rates.

In the event of a change of control and the termination of employment within a certain period after the change of control, the Management Board members are each entitled to contractual severance payments. In the cases of Mr Hofer and Dr Kilpatrick the severance payment corresponds to 100% of their annual fixed basic compensation. In the cases of Drs Söhngen the severance payment corresponds to 100% of their annual fixed basic compensation and the annual bonus. However, claims to severance payment in connection with a change of control can only be exerted if the change of control also entails a significant change in business strategy, a significant change in responsibilities or a relocation of the place of work by at least 300 kilometres. In case of Dr Kilpatrick the relocation of the place of work by at least 300 kilometres does not apply as a precondition for a severance payment.

A notice period of one year has been agreed between Dr Kilpatrick and PAION UK Ltd.

With the exception of changes of control as described above, the employment contracts of Management Board members do not contain any specific severance payment provisions in the event of early termination of employment relationships. The employment contracts of Management Board members do not provide for interim payment upon expiry.

Pursuant to the terms of the Stock Option Plans 2008 and 2010 in the event of a change of control, the waiting period for all stock options issued to Management Board members ends two years (Stock Option Plan 2008) and four years (Stock Option Plan 2010) respectively after the day of issue in the case of those stock options whose two- or four-year waiting period has expired or, in case a longer waiting period has been defined, on the day the controlling acquisition comes into effect. In the case of issued stock options for which the two- or four-year waiting period has not yet expired, the entitlement to subscribe to shares on the basis of issued stock options is converted into an entitlement to a corresponding cash settlement based on the share price on the day the controlling acquisition comes into effect. The corresponding stock options lapse. The Company may choose to grant listed shares in the acquiring company instead of the cash settlement.

2. Supervisory Board

Supervisory Board remuneration comprises basic compensation and per-meeting fees. The members of the Supervisory Board do not currently receive performance-based remuneration. The Chairman of the Supervisory Board receives twice the basic compensation and per-meeting fee, his deputy receives one-and-a-half times these amounts. Members of the Supervisory Board who are resident in a country outside Europe receive for each Supervisory Board meeting they physically attend double the basic attendance fee. The attendance fee is paid for a maximum of six meetings per year.

The members of the Supervisory Board received the following remuneration for their activities in fiscal year 2010:

	Basic compensation EUR	Per-meeting fees EUR	Total EUR
Dr Jörg Spiekerkötter	36,192	15,750	51,942
Dr Walter Wenninger	33,808	15,750	49,558
Alan Goodman	20,000	15,000	35,000

The Supervisory Board remuneration in fiscal year 2010 amounted to KEUR 137 (previous year: KEUR 131).

Disclosures Pursuant to Section 289 (4) HGB and Explanatory Report

Composition of subscribed capital
As of 31 December 2010, PAION AG had a subscribed capital of EUR 25,073,684.00, divided into 25,073,684 no-par value shares, each representing a notional share in the capital stock of EUR 1.00. The shares are issued to the bearer and are fully paid in. Shareholders are not entitled to demand share certificates for their shares under Art. 6 (2) of the Articles of Incorporation. All shares carry the same rights and duties. Each share carries the right to one vote at the Annual General Meeting and also forms the basis of the holder's share in profit. More information on the individual rights and duties of shareholders can be found in the German Stock Corporation Act (Aktiengesetz, AktG), in particular Sections 12, 53a et seqq., 118 et seqq. and 186.

Restrictions relating to voting rights or the transfer of shares
Pursuant to German legislation and the Articles of Incorporation of PAION AG, no restrictions are imposed on the voting rights or transferability of the shares. The Management Board of PAION AG is also not aware of any voting rights or share transfer restrictions at shareholder level.

Shareholdings which exceed 10% of voting rights
The German Securities Trading Act (Wertpapierhandelsgesetz, WpHG) stipulates that any shareholder who achieves, exceeds or falls short of specific shares in the voting rights in the Company through the purchase or sale of shares or by other means, must notify the Company and the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin) accordingly. The lowest threshold for this reporting obligation is 3%. The Company has been notified by Innoven Partenaires S.A., Paris, France, that the latter owns

direct or indirect shares in the Company's capital that equal or exceed 10% of the voting rights. On 1 August 2008, Innoven Partenaires S.A., Paris, France, held 10.57% of the voting rights of PAION AG (equivalent to 2,602,953 voting rights).

Shares with special rights conferring control

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

Type of control of voting rights when employees are shareholders and do not directly exercise their control rights

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

Legal provisions and provisions of the Articles of Incorporation on the appointment and removal of members of the Management Board and amendments to the Articles of Incorporation

Members of the Management Board are appointed and removed in accordance with Sections 84 and 85 AktG and the supplementary provisions of the Supervisory Board's rules of procedure which stipulate an age limit of 65 years for Management Board members. Pursuant to Section 84 AktG, members of the Management Board can be elected for a maximum of five years by the Supervisory Board. Repeat appointments or extensions of the term of office for up to a maximum of five years at a time are permissible. Pursuant to Art. 8 (1) of the Articles of Incorporation, the Management Board must comprise at least two members. The Supervisory Board determines the number of members on the Management Board. Furthermore, pursuant to Section 84 (2) AktG and Art. 8 (2) of the Articles of Incorporation, the Supervisory Board may appoint a member of the Management Board as CEO.

Amendments to the Articles of Incorporation are effected in accordance with Sections 179 and 133 AktG in conjunction with Art. 27 of PAION AG's Articles of Incorporation. The shareholder resolution required for any amendment to the Articles of Incorporation can, under PAION AG's Articles of Incorporation, be adopted by a simple majority of the capital stock represented at the adoption of the resolution, provided this is permitted by law.

Authority of the Management Board to issue or buy back shares

The Management Board is authorised to increase the share capital on or prior to 25 May 2014, with the consent of the Supervisory Board, on one or more occasions, by up to EUR 12,300,000.00 in total by issuing up to 12,300,000 new no-par value bearer shares in return for cash contributions or contributions in kind (Authorised Capital 2009). In the case of capital increases against contributions in kind, the Management Board may also exclude subscription rights, subject to the Supervisory Board's consent. Shareholders must be granted subscription

rights if the capital is to be increased against payments in cash. The new shares may also be taken by one or more financial institutions on condition that they offer them to shareholders. The Management Board may, subject to the Supervisory Board's consent, exclude peak amounts from shareholders' subscription rights. The Management Board is also authorised to exclude shareholders' subscription rights, subject to the consent of the Supervisory Board, if the issue price of the new shares is not significantly less than the market price and the shares issued in return for cash contributions with subscription rights excluded pursuant to Section 186 (3) Sentence 4 AktG do not exceed 10% of the share capital as of 25 May 2009. The Management Board is moreover authorised to exclude shareholders' subscription rights, subject to the consent of the Supervisory Board, to the extent necessary to grant subscription rights to holders of convertible bonds, participation rights or options as defined in Section 221 AktG. To date, 470,765 issued shares of the Authorised Capital 2009 have been used.

Furthermore, subject to the consent of the Supervisory Board, the Management Board is authorised to issue on or before 18 May 2015, on one or more occasions, bearer and/or registered convertible and/or warrant bonds of up to an aggregate of EUR 98,000,000.00 with a maximum term of 20 years and to grant the holders or beneficiaries of the bonds conversion rights or options to new shares in PAION AG with a share in share capital of up EUR 9,800,000.00 in total (Conditional Capital 2010 II). Furthermore, the company is authorised to issue 858,121 shares (Conditional Capital 2004 II), 760,235 shares (Conditional Capital 2008 I) and 720,000 shares (Conditional Capital 2010 I) in connection with the Stock Option Plans 2005, 2008 and 2010.

Material arrangements dependent on a change in control in the wake of a takeover bid

The licence agreement reached with Lundbeck at the end of 2007 stipulates that Lundbeck, in certain circumstances, has the authorisation to limit PAION's information rights to a minimum in the event of a change of control at PAION, and, if required, to terminate all options exercised by PAION with regard to co-marketing. If Lundbeck exercises its termination right, PAION retains its claim to milestone payments and to a share in the joint marketing result.

Based on the agreement with H.E.A.T. Mezzanine S.A., Luxemburg regarding the subordinate loan of EUR 7,000,000, H.E.A.T. Mezzanine S.A. has the right, to terminate the loan ("extraordinary dismissal") following a change of control, if PAION after a change of control does not provide written evidence to the creditor, that as a consequence of the change of control the credit rating of PAION does not fall under a defined level.

Compensation agreements entered into by the company with members of the Management Board and employees in the event of a takeover bid

The terms of the Stock Option Plans 2008 and 2010 stipulate for both members of the Management Board and employees that in case of a change of control the vesting period for all options, whose two-year (Stock Option Plan 2008) or four-years (Stock Option Plan 2010) vesting period has expired the vesting period ends at the date of the change of control. For all options, whose two- or four-year vesting period has not expired yet at the date of the change of control, the entitlement to subscribe to shares is converted into an entitlement to a cash settlement based on

the share price on the day the change of control comes into effect; the corresponding stock options lapse. The company may choose to grant listed shares in the acquiring company instead of the cash settlement.

For information on further existing compensation agreements with Management Board members, please refer to our comments in the section "Compensation Report".

Statement on Corporate Governance pursuant to Section 289a HGB

The Statement on Corporate Governance pursuant to Section 289a HGB is published on PAION AG's website (www.paion.com/corporategovernance).

Risks and Opportunities Report

I. Risk Management

As a biopharmaceutical company, PAION is exposed to the segment and market risks that are typically associated with the development of pharmaceutical products. In accordance with the German Law on Control and Transparency in Business (Gesetz zur Kontrolle und Transparenz im Unternehmensbereich, KonTraG), PAION has implemented a Group-wide comprehensive and effective risk management system which is integrated into the operating processes and flexibly adaptable to the changing environment. The task of the risk management system is to promote the conscious and responsible handling of risks, and to enable the early identification, monitoring, analysis, evaluation and management of future developments with inherent risks and future opportunities. Involving all management levels and project management in the process of strategic and business development creates a shared awareness of the critical success factors and related risks.

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

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

The implemented internal control system includes rules for the management of business activities as well as arrangements for monitoring compliance with these rules. The primary tasks of the internal control system include determining which types of business transactions require

approval, limiting the issuance of signing and banking authority, standardising workflows using procedural instructions, monitoring compliance with process steps by using checklists and establishing measures for the protection of data and IT systems. Furthermore, PAION mandated an audit company to carry out the tasks of an internal audit department. Internal Audit works on the basis of a multi-year audit plan, which was worked out by Internal Audit in collaboration with the management based on a risk-oriented audit approach and materiality aspects. The internal auditors report at least once per year in the context of a report about the audit procedures carried out and report promptly on potential findings. Both the audit plan and the reports are forwarded to the Supervisory Board for information and discussion.

PAION has implemented a matrix organisation which combines both project organisation and department organisation. Detailed reporting and information structures have been set up within these organisational structures to ensure the early identification and communication of risks. The individual projects are managed and monitored by project teams. The project teams regularly provide the individual department heads and management with reports – also in writing – on the current progress of projects and potential risks.

2. Accounting-Related Risk Management and Internal Control System (Disclosures Pursuant to Section 289 (5) HGB and Explanatory Report)

The risk management system and the internal control system involve also the accounting-related processes and aim to ensure the compliance and the reliability of the financial statements and the management report and the released interim financial statements.

The accounting-related risk management and internal control system aim at the risk of significant misstatements in the financial reporting. Essential measures and controls in financial reporting are the clear assignment of responsibilities, four-eyes principle, the segregation of duties, the use of an appropriate financial accounting system with a corresponding authorisation concept as well as the use of checklists and work instructions. Furthermore, single and consolidated financial statements are prepared every month for internal purposes. The monthly, quarterly and annual financial statements are analysed by means of the Group-wide controlling with regard to plan/actual variances and implausibilities and inconsistencies in the accounting. The monthly financial statements are forwarded to the Supervisory Board. The quarterly and annual financial statements are published. The quarterly and annual financial statements are discussed with the Supervisory Board prior to publication.

The risk management system is reviewed once per year and discussed with the Supervisory Board. The risk analysis is updated during the year and presented to the Supervisory Board; special risks are communicated ad-hoc. The internal control system is reviewed continuously with regard to the effectiveness of the controls and is adjusted if required. The risk management system and the internal control system are audited by Internal Audit in line with a multi-year audit plan.

Significant issues in context of the preparation of financial statements are discussed promptly with the audit committee. Furthermore, the audit committee determines additional audit topics and key audit procedures for the auditor.

In addition, the auditor is obligated to report to the Supervisory Board on accounting relevant risks and control deficiencies as well as other deficiencies of the risk management system and the internal control system that he becomes aware of in the course of his audit.

3. Significant Risks to Future Development

a. Drug Development Risks

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

There is a risk that the conduct of studies is approved with a delay or is denied. On occurrence of this risk, the further development can be delayed considerably or development of a specific drug candidate may be discontinued altogether.

The completion of clinical studies depends, among other things, on the ability to enrol a sufficient number of patients to participate in them. Difficulties in enrolling patients, additional requirements for the conduct of studies or a more expensive study monitoring and more expensive analyses may increase costs and negatively affect the timing of these clinical studies.

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

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

Further there is a risk that PAION does not receive the required insurance coverage for potential damages from the conduct of clinical studies. This can result in a delay or termination of studies.

b. Risks in Relation to the Manufacture of Pharmaceutical Substances

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

Some of PAION's substances are produced in biological production processes. These processes are highly complex and require extensive validation. In the past, the substances have been produced in sufficient quantities for clinical development, but it is not entirely certain that the larger batches needed for commercial purposes can be produced. Problems with the production of substances could lead to higher costs, delays or even the discontinuation of the clinical development or market potential not being fully exploited.

c. Risks in Relation to the Marketing of Drugs

In the foreseeable future, PAION expects to continue to be dependent on cooperation agreements with experienced partners to complete the development of its current and future drug candidates and to market them successfully. Drug prices are more and more subject to governmental regulation. There is a risk that through governmental price regulation the development of certain drugs may become unprofitable. This could make it difficult or impossible for PAION to close cooperation agreements or to secure alternative financing for drug development. Should PAION fail to enter into cooperation agreements at favourable terms, fail to enter into cooperation agreements at all or fail to maintain existing cooperation agreements, the development and marketing of its existing and future drug candidates may be delayed or fail completely, which may increase development and marketing expenses and limit its financing ability.

d. Risks in Relation to Patents and Other Intellectual Property

PAION's business operations are largely dependent on its ability to secure extensive patent protection and other intellectual property protection for the individual substances and to defend these against third parties without violating their rights. There can be no assurance that current or future patent applications will be granted or that any patents issued or licensed to PAION will be valid and sufficiently extensive to provide PAION with adequate legal protection or any commercial advantage.

e. Competitive Risks

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

f. Risks in Relation to Additional Financing Requirements

PAION believes that the currently available cash and cash equivalents and future payments expected from the cooperations with Lundbeck, Ono and Acorda and possible future cooperation agreements will be sufficient to cover its short- and mid-term financing needs. However, it may need additional funding within this timeframe in order, for example, to license new drugs, acquire or invest in businesses, drug candidates or technologies, and to fund preclinical studies, clinical studies and production development. Funding requirements may also arise due to delays or cost increases in development and the related delays in milestone payments from cooperation partners. Milestone payments could even be cancelled altogether if agreed targets are not met. PAION's future ability to secure additional funding will depend on the success of its development activities, the situation on the capital markets and other factors. If PAION is unable to raise financing at favourable terms or unable to raise financing at all, it could be forced to reduce its operating expenses by delaying, reducing or discontinuing the development of one or more of its drug candidates. The global financial crisis has strongly exacerbated the possibilities for debt and equity funding especially for small biotechnology companies.

g. Risks in Relation to Personnel

PAION's management and its scientific and technical staff in key positions are crucial to the company's success. Many of these members of staff have substantial experience with the company and would be difficult to replace. In addition, competition for qualified personnel is intense in PAION's industry and PAION might be unable to attract and retain highly qualified employees.

h. Currency Risks

Some of PAION's contracts are based on foreign currencies, in particular on the US Dollar. PAION does maintain a small reserve of foreign currency funds consisting of amounts in US Dollars and Pound Sterling. Currency risks are systematically captured and monitored. With the consent of the Supervisory Board of PAION AG, the Management has drawn up clear rules governing the hedging tools that may be used to limit currency risks. Hedging contracts are transacted under certain circumstances for foreign currency items with relatively secure definition of the amount and timing of the cash flows.

i. Risk of Availability of Tax Losses Carried Forward

PAION AG and its subsidiaries have considerable tax losses carried forward available. PAION assumes that based on the current German and British tax legislation, these losses can be carried forward indefinitely and offset against future earnings according to the relevant tax regulations (e.g. minimum taxation). If the usage of tax losses is partly or completely disallowed, for example on the basis changes in the legislation, the change of capitalisation or ownership structure as well as other events, income tax payments would become due on the expected earnings if one or more compounds are developed successfully. These tax payments would correspondingly reduce the liquidity.

j. Risk of Insolvency

There is a risk that one or several subsidiaries could go into insolvency. The occurrence of this risk would lead to a substantial impairment on the shares in subsidiaries and the loans to subsidiaries. This would accordingly reduce the equity of PAION. Furthermore, if expected payments from subsidiaries, e.g. loan repayments, are not made, this could lead to illiquidity of PAION.

4. Market Opportunities

PAION AG and its subsidiaries are biopharmaceutical companies focusing on the clinical development of drug candidates for diseases or interventions for which there is a substantial unmet medical need. After proof of concept in humans the strategy is to out-license or co-develop the drug candidates with pharma partners. Thus revenues can be generated at an early stage, decreasing development costs and risks. The company further profits from the receipt of milestones for reaching clinical and commercial milestones and receiving royalties after market approval of the drugs. Further upside can be generated from co-commercialisation activities or marketing.

The clinical studies performed with Remimazolam comprise two Phase I and two Phase II studies with single or multiple dose without an intervention or during endoscopy of the upper gastrointestinal tract or the colon. After intravenous administration to over 300 human volunteers/patients in the course of the clinical trials performed, Remimazolam rapidly induced the desired sedation. Following the successful completion of two Phase I studies and two Phase II studies with Remimazolam, PAION is continuing the Remimazolam partnering discussions with vigour. Remimazolam also has potential in all indications where a short sedation makes the medical invasion more comfortable for the patient. From the expected out-licensing PAION anticipates significant cash inflows from milestones and royalties in case of a successful development and marketing.

With its most advanced drug candidate Desmoteplase, PAION demonstrated in two clinical Phase II studies that the timeframe for treating patients with ischaemic stroke may possibly be extended up to nine hours, and other parameters indicate the superior effectiveness of Desmoteplase compared with currently approved drugs. It was not possible to confirm these positive results in the first Phase III study (DIAS-2), but the knowledge gained from the analysis of the DIAS-2 results provides a strong rationale for the further development of Desmoteplase. The conclusion of the extended licence agreement with Lundbeck secures the continuation of the development programme with Desmoteplase and underlines the potential offered by Desmoteplase for the treatment of acute ischaemic stroke. Currently Lundbeck is conducting two further Phase III studies (DIAS-3 and DIAS-4). The clinical development for approval in Japan is currently being progressed by Lundbeck through a Phase II study. From the existing licence agreement PAION expects significant cash inflows from milestones and royalties.

In clinical Phase II and III studies, M6G, the most advanced development programme at PAION UK, demonstrated a strong analgesic effect in the treatment of moderate to severe, peri-operative pain. At the same time, the common side effects of morphine administration, such as nausea and vomiting, were significantly reduced. Partnering activities are ongoing.

So far Solulin has been tested clinically in a Phase I study. The study confirmed the substance's good safety profile. In December 2010 positive preclinical data were reported for the indication haemophilia. Before entering clinical development in haemophilia, advanced pre-clinical experiments are planned.

GGF2, which is licensed to Acorda, is being tested in clinical Phase I since the end of 2010. In case of a positive development PAION is entitled to receive milestone payments as well as revenue dependent licence fees.

If the compounds are successfully developed, PAION will have substantial earnings potential in the future.

Events After the Balance Sheet Date

No significant events occurred in the time period between the balance sheet date, 31 December 2010, and the finalisation of this report.

Forecast

PAION's major goals for 2011 are the out-licensing of Remimazolam, the production of Remimazolam study medication in preparation of a Phase III study programme, the out-licensing of M6G as well as further development of Solulin. Furthermore, PAION expects in 2011 extensive development activities by the cooperation partners Lundbeck (Desmoteplase), Ono (Remimazolam) and Acorda (GGF2), which can lead to single-digit million revenues in 2011 if the development is successful.

Based on the results of the Phase IIb study PAION intends to out-license in 2011 the development and marketing rights for Remimazolam (outside Japan) and expects to receive a substantial upfront payment, development milestone payments, a partial or complete assumption of future development costs until market approval and royalties from market approval onwards. Cooperation partner Ono started in 2010 the first clinical Phase I study in Japan. PAION benefits from the progress of development in the form of additional development data and benefits financially in the form of milestone payments and royalties from launch onwards. Triggered by the progress of the programme, a modest milestone payment may become due in 2011.

Cooperation partner Lundbeck is currently conducting two Phase III studies with Desmoteplase in stroke and expects to be able to file applications in 2012. Lundbeck bears all development costs and pays to PAION milestones of up to EUR 68 million, thereof up to EUR 40 million are due before and including market approvals, and from market entry a double-digit percentage revenue share. If the further development is successful, based on Lundbeck's development plan, further milestone payments can be expected in 2012.

Acorda started a clinical Phase I study with GGF2 at the end of 2010. Milestone payments of up to USD 7.5 million before and including approval and thereafter revenue dependent licence fees are payable to PAION.

Revenues in 2011 will include, just as last year, the monthly release of deferred income in the amount of EUR 1.5 million. This results from the non-refundable milestone payment of EUR 8 million received in 2008 from Lundbeck. From the existing licence agreements noted above, further milestone payments may become due if the development activities of our partners are successful. Furthermore, PAION expects revenues in 2011 from the intended out-licensing, in a substantial amount for Remimazolam and in a smaller amount from M6G.

Research and development expenses are expected to be lower than the previous year but could increase if out-licensing is successful, either in connection with the out-licensing or by investing in other programmes. The out-licensing activities may lead to increased selling expenses, especially in connection with consulting services and success fees.

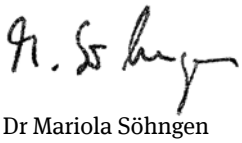
The budgeted expenses will lead to a significant net loss in 2011 which may be reduced by milestone payments from our partners in case of successful development. A successful out-licensing of Remimazolam and M6G could lead to a further sustainable improvement of the results.

In 2011 and thereafter PAION expects significant cash inflows from the existing cooperations with Lundbeck (a total of up to EUR 68 million for the development of Desmoteplase), Ono (development of Remimazolam in Japan), Acorda (a total of up to USD 7.5 million for the development of GGF2) as well as from the intended licence agreements. Part of these expected milestone payments may be realised in 2011 and 2012. Some of the milestone payments which are expected in the future are linked to milestone obligations for PAION which would accordingly reduce the result.

As of 31 December 2010 PAION's cash and cash equivalents amounted to EUR 15 million and the remaining equity facility amounted to EUR 14 million. The cash and cash equivalents and the expected cash inflows from a partial use of the equity facility secure a cash reach until the middle of 2012. This does not account for further cash inflows from existing and future partners. Further upfront payments, milestone payments and cost reimbursements or a use of the equity facility could expand the cash reach, but may also be used fully or in part for funding of additional development activities within the existing portfolio or new strategic investments, e.g. the acquisition of new substances.

Aachen, 8 March 2011
PAION AG

Dr Wolfgang Söhngen



Dr Mariola Söhngen

Bernhard Hofer

Dr Gavin Kilpatrick

Balance Sheet as of 31 December 2010

ASSETS	31 Dec. 2010 EUR	31 Dec. 2009 EUR
Fixed assets		
Non-current assets		
Franchises, trademarks, patents, licences and similar rights	17,549.75	23,237.75
Financial assets		
Shares in affiliated companies	43,818,015.15	45,618,015.15
	43,835,564.90	45,641,252.90
Current assets		
Receivables and other assets		
Receivables from affiliated companies	19,855,937.58	13,695,029.33
Other assets	43,108.98	128,897.08
	19,899,046.56	13,823,926.41
Cash on hand and bank balances	10,522,333.18	16,523,360.42
	30,421,379.74	30,347,286.83
Prepaid expenses		
thereof debt discount: EUR 91,666.66 (previous year: EUR 131,666.66)	404,450.54	194,902.90
	74,661,395.18	**76,183,442.63**

EQUITY AND LIABILITIES	31 Dec. 2010 EUR	31 Dec. 2009 EUR
Equity		
Subscribed capital	25,073,684.00	24,602,919.00
thereof: 25,073,684 no-par value shares		
(previous year: 24,602,919 no-par value shares)		
Conditional capital: EUR 12,138,356.00 (previous year: EUR 7,973,121.00)		
Capital reserve	97,498,549.25	96,810,704.25
Accumulated loss	-55,695,174.70	-53,021,100.53
	66,877,058.55	68,392,522.72
Accruals		
Other accruals	510,823.08	446,593.96
Liabilities		
Liabilities to banks	7,000,000.00	7,000,000.00
thereof due in up to one year: EUR 0.00 (previous year: EUR 0.00)		
Trade payables	58,270.74	102,674.48
thereof due in up to one year: EUR 58,270.74		
(previous year: EUR 102,674.48)		
Liabilities to affiliated companies	27,601.87	68,551.80
thereof due in up to one year: EUR 27,601.87		
(previous year: EUR 68,551.80)		
Other liabilities	187,640.94	173,099.67
thereof due in up to one year: EUR 187,640.94		
(previous year: EUR 173,099.67)		
thereof for taxes: EUR 51,140.94		
(previous year: EUR 43,751.61)		
	7,273,513.55	7,344,325.95
	74,661,395.18	**76,183,442.63**

Income Statement for Fiscal Year 2010

	2010 EUR	2009 EUR
Other operating income	829,152.00	1,282,192.40
Personnel expenses		
Wages and salaries	-1,467,513.82	-1,689,733.79
Social security	-82,775.20	-84,503.96
	-1,550,289.02	-1,774,237.75
Depreciation of intangible assets	-5,688.00	-5,096.00
Other operating expenses	-1,945,367.15	-2,167,410.53
Other interest and similar income	635,355.76	560,388.56
thereof from affiliated companies: EUR 584,100.90 (previous year: EUR 349,716.58)		
Interest and similar expenses	-630,324.01	-635,039.04
Result from ordinary activities	-2,667,160.42	-2,739,202.36
Other taxes	-6,913.75	-1,314.00
Net loss for the year	-2,674,074.17	-2,740,516.36
Loss carryforward	-53,021,100.53	-50,280,584.17
Accumulated loss	**-55,695,174.70**	**-53,021,100.53**

Notes

PAION AG

Notes to the Financial Statements for Fiscal Year 2010

Preliminary Remarks

The financial statements for the fiscal year from 1 January 2010 to 31 December 2010 were prepared in accordance with the applicable provisions of the German Commercial Code (Handelsgesetzbuch, HGB) and the German Stock Corporation Act (Aktiengesetz, AktG), as amended. The balance sheet and income statement have been classified according to the provisions of Sections 266 and 275 HGB. The notes to the financial statements were prepared in accordance with the requirements of Sections 284 to 288 HGB.

PAION AG shares are admitted to trading on the Frankfurt Stock Exchange and listed in the Prime Standard of the regulated market. In accordance with Section 267 (3) Sentence 2 HGB, PAION AG qualifies as a large corporation as it has issued securities which use an organised market as defined in Section 2 (5) Securities Trading Act (Wertpapierhandelsgesetz, WpHG).

Accounting and Valuation Methods

1. Fixed assets are measured at acquisition cost and are subject to scheduled linear amortisation. Low-value assets costing less than EUR 150 are written off in full in the year of acquisition. Assets acquired during the course of the fiscal year at a cost of between EUR 151 and EUR 1,000 are combined into a pool and amortised over five years. The lower applicable value is subject to unscheduled depreciation if required. If the reason for the unscheduled depreciation ceases to exist, the assets are written up in accordance with Section 280 HGB.
2. Financial assets are recognised at the lower of cost or market.
3. Receivables and other assets are always stated at nominal value. Receivables denominated in a foreign currency were generally converted with the average spot exchange rate. In case of a remaining term of more than one year the realisation principle (Section 252 (1) No. 4 Sentence 2 HGB) and the acquisition cost principle (Section 253 (1) Sentence 1 HGB) were considered.
4. Differences between the amount repayable on a liability and a lower issue amount (discount) are recognised as an asset and amortised over the term of the liability.
5. Prudent business judgement is applied to the estimation of accruals; these are recognised at an amount deemed necessary and adequate. Accruals with a remaining term of more than one year are discounted with the weighted market interest rate of the last seven years.
6. Liabilities (including those denominated in foreign currencies) are carried at the amount repayable. Liabilities denominated in a foreign currency were generally converted with the average spot exchange rate. In case of a remaining term of more than one year the realisation principle (Section 252 (1) No. 4 Sentence 2 HGB) and the acquisition cost principle (Section 253 (1) Sentence 1 HGB) were considered.
7. The income statement is prepared using the cost-summary method in accordance with Section 275 (2) HGB.

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

I. Financial Assets

The shareholdings in affiliated companies as of 31 December 2010 refer to PAION Deutschland GmbH (KEUR 31,500) and PAION Holdings UK Ltd (KEUR 12,318). In a shareholders' meeting on 15 October 2010 PAION AG, the sole shareholder of PAION Deutschland GmbH, passed a resolution to pay out EUR 1,800,000.00 free reserves to PAION AG. The carrying value of PAION Deutschland GmbH decreased accordingly from EUR 33,300,000.00 to EUR 31,500,000.00.

The composition and performance of the fixed assets is shown on the schedule of fixed assets (exhibit A).

2. Receivables from Affiliated Companies

The receivables from affiliated companies are comprised as follows:

EUR	Total	of which loans	of which services and interest
PAION UK Ltd	17,049,744.54	17,000,000.00	49,744.54
PAION Holdings UK Ltd	2,788,355.06	2,780,000.00	8,355.06
PAION Deutschland GmbH	17,837.98	0.00	17,837.98
	19,855,937.58	**19,780,000.00**	**75,937.58**

3. Other Assets

As of 31 December 2010, other assets are comprised substantially of VAT receivables (KEUR 39; previous year: KEUR 125) and interest owing on capital investments (KEUR 4; previous year: KEUR 4).

4. Equity

In May 2010 PAION entered into an equity facility agreement for EUR 15 million with Commerce Court Small Cap Value Fund Ltd. (CCSCVF) managed by Acqua Capital Management Inc., Toronto, Canada. This share facility has a term until May 2013 and gives PAION the right to issue new shares out of the existing authorised capital in multiple tranches to CCSCVF against a cash contribution.

CCSCVF has committed to buy these shares at a price calculated based on a daily volume weighted average share price over a five day period (pricing period) less a discount of 5%. CCSCVF guarantees a minimum investment amount per tranche within a range from EUR 150,000 to EUR 1,300,000 dependent on the share price (within a range from EUR 1.00 to and exceeding EUR 8.00). Both parties can agree on higher amounts per tranche. Furthermore, PAION has the right to determine for every tranche a floor price below which PAION is not obliged to issue shares. After the end of the pricing period PAION will announce on its website the number of subscribed shares as well as the achieved placement price.

In 2010 470,765 new shares were issued to CCSCVF leading to a cash inflow of EUR 1,158,610. The share capital increased accordingly by EUR 470,765 and the capital reserve increased by EUR 687,845.

As of 31 December 2010 the share capital amounts to EUR 25,073,684.00 and is divided into 25,073,684 no-par value shares (unit shares).

By virtue of a resolution adopted by the Annual General Meeting on 25 May 2009, the Management Board was authorised to increase the share capital on or prior to 25 May 2014, with the consent of the Supervisory Board, on one or more occasions, by up to an aggregate of EUR 12,300,000.00 by issuing up to 12,300,000 new no-par value bearer shares in return for cash contributions or contributions in kind (Authorised Capital 2009). Furthermore, the Management Board was authorised to use up to EUR 2,460,291 out of the Authorised Capital 2009 to issue new shares for cash by excluding pre-emptive rights. The Authorised Capital 2009 and the authorisation to issue shares by excluding pre-emptive rights were called upon in the amount of EUR 470,765 in connection with the

usage of the equity facility. As of 31 December 2010 the remaining Authorised Capital 2009 is EUR 11,829,235 and the authorisation to issue shares by excluding pre-emptive rights is EUR 1,989,526.

By virtue of another resolution adopted by the Annual General Meeting on 19 May 2010, the Management Board was authorised to increase the capital stock on or before 18 May 2015, on one or more occasions by up to an aggregate amount of EUR 98,000,000.00 by issuing registered and/or bearer convertible or warrant-linked bonds with a maximum term of 20 years and to grant the holders or beneficiaries of the bonds conversion or option rights to new shares in PAION AG with a proportionate share in the capital stock of up to EUR 9,800,000.00 in total (Conditional Capital 2010 II). Conditional Capital 2010 II has not yet been used. Furthermore, the Annual General Meeting revoked Conditional Capital I which has not yet been used.

The Annual General Meeting of 5 May 2008 adopted a resolution to reduce Conditional Capital 2004 II to EUR 858,121.00. The conditional capital increase may be executed only to the extent that the holders of options granted by PAION AG in connection with the Stock Option Plan 2005 exercise their options. Under the Stock Option Plan 2005, 845,343 stock options have been issued to current and former Management Board members and employees of the PAION Group as of 31 December 2010. The stock options have not yet been exercised.

A resolution was adopted by the Annual General Meeting on 5 May 2008 to conditionally increase the capital stock of PAION AG by an aggregate of up to EUR 815,000.00 by issuing an aggregate of up to 815,000 new no-par value bearer shares (Conditional Capital 2008 I). A resolution was adopted by the Annual General Meeting on 19 May 2010 to adjust the Conditional Capital 2008 I to EUR 760,235.00. The conditional capital increase may be executed only to the extent that the holders of options granted by PAION AG in connection with the Stock Option Plan 2008 exercise their options. Under the Stock Option Plan 2008, 740,755 stock options have been issued to current and former Management Board members and employees of the PAION Group as of 31 December 2010. The stock options have not yet been exercised.

A resolution was adopted by the Annual General Meeting on 19 May 2010 to conditionally increase the capital stock of PAION AG by an aggregate of up to EUR 720,000.00 by issuing an aggregate of up to 720,000 new no-par value bearer shares (Conditional Capital 2010 I). The conditional capital increase may be executed only to the extent that the holders of options granted by PAION AG in connection with the Stock Option Plan 2010 exercise their options. Under the Stock Option Plan 2010 no stock options have been issued to Management Board members and employees of the PAION Group as of 31 December 2010.

5. Accruals

The accruals break down as follows:

	31 Dec. 2010 EUR	31 Dec. 2009 EUR
Management bonuses	274,397.30	182,483.49
Financial statements and audit	74,349.00	63,300.00
Legal fees	45,150.00	61,600.00
Outstanding invoices	50,368.00	60,890.00
Other	66,558.78	78,320.47
	510,823.08	**446,593.96**

6. Liabilities to Banks

In mid-April 2006, HSBC Trinkaus & Burkhardt KGaA, Düsseldorf, granted PAION a subordinate loan of EUR 7,000,000, which is part of a structured mezzanine financing scheme entitled H.E.A.T Mezzanine I-2006. HSBC Trinkaus & Burkhardt KGaA has meanwhile transferred the subordinate loan to H.E.A.T Mezzanine S.A., Luxembourg. The bullet loan is due in April 2013 and has a term of seven years and was disbursed with a debt discount of EUR 280,000. Interest is payable quarterly and amounted to KEUR 590 in 2010.

7. Liabilities to Affiliated Companies

The liabilities to affiliated companies refer in the amount of KEUR 27 to PAION Deutschland GmbH as a result of VAT affiliation as well as in the amount of KEUR 1 to PAION UK Ltd from intercompany charges.

8. Other Operating Expenses

Other operating expenses mainly include legal and consulting fees (KEUR 385; previous year: KEUR 468), services rendered by PAION Deutschland GmbH (KEUR 410; previous year: KEUR 434), insurance, contributions and fees (KEUR 210; previous year: KEUR 201), travel expenses (KEUR 150; previous year: KEUR 174), expenses in connection with Supervisory Board remuneration (KEUR 137; previous year: KEUR 131) as well as audit costs and costs for the annual report (KEUR 68; previous year: KEUR 103).

9. Income Attributable to Other Periods

In the fiscal year 2010, income that is attributable to other periods amounted to KEUR 33 and refers to income from the reversal of accruals.

10. Taxes

As of 31 December 2010, the company's tax losses carried forward amount to about EUR 25 million (previous year: EUR 22 million). Based on the current German tax legislation, these losses can be carried forward indefinitely and offset against future earnings according to the relevant tax regulations (e.g. minimum taxation).

The combined German income tax rate is 31.4% resulting from a corporate income tax rate of 15.0%, the solidarity surcharge of 5.5% that is levied on corporate income tax, and the trade earnings tax rate of 15.58%.

If the current compound income tax rate was applied to the tax losses carried forward as of 31 December 2010, the resulting deferred tax assets would amount to KEUR 7,712 (previous year: KEUR 6,914).

The temporary differences between the tax base and the HGB carrying amount would produce a net balance as of 31 December 2010 of deferred tax assets in an amount of KEUR 38 (previous year: KEUR 38).

Other Compulsory Disclosures

1. Average Number of Employees

In fiscal year 2010 the company had an average of six employees (previous year: six employees).

2. Other Financial Obligations

Other financial obligations amounted to KEUR 58 on the balance sheet date and referred to leasing obligations.

3. Stock Option Plan 2005

On 30 December 2004, the Annual General Meeting approved a stock option plan granting options to Management Board members and employees to acquire shares in PAION AG. Each option entitles the owner to purchase one share out of the Conditional Capital 2004 II, which was set up for this purpose. The stock options have a ten-year term and can only be exercised after a vesting period (between two and four years), which has been fulfilled for all options. Options can only be exercised when the stock price on the exercise date has increased by a cumulative 5% each year since their issue. No more options can be issued out of the Stock Option Plan 2005. As of 31 December 2010, 845,343 stock options had been issued in total: 496,300 to current and former Management Board members as well as 349,043 to PAION Group employees. The stock options have not yet been exercised. As of 31 December 2010, the exercise hurdle lay between EUR 9.47 and EUR 12.15, depending on the time of issue of the respective stock options.

4. Employee Participation Plan 2006

With the consent of the Supervisory Board, the Management Board of PAION AG has launched an employee participation plan granting stock appreciation rights. A stock appreciation right entitles the holder to receive a sum of money based on the PAION AG share price. The maximum amount payable on a stock appreciation right is limited to 100% of the exercise price. The stock appreciation rights have a term of ten years and can only be exercised after a two-year waiting period, which has been fulfilled for all options. In addition, they may only be exercised when the stock price on the exercise date has increased by a cumulative 5% each year since issuance. No more stock appreciation rights can be issued out of the employee participation plan 2006. As of 31 December 2010, a total of 134,000 stock appreciation rights had been issued, 100,000 to current and former Management Board members as well as 34,000 to PAION Group employees. The stock appreciation rights have not yet been exercised. As of 31 December 2010, the exercise hurdle was EUR 9.50.

PAION AG's payment obligation that is directly attributable to this employee participation plan is recognised as an accrual and measured at fair value on the balance sheet date. The expenses are recorded over the service period of two years. The fair value is determined using the Black/Scholes option pricing model. The expenses attributable to Management Board members and PAION AG employees are disclosed as personnel expenses. The portion of expenses attributable to employees of PAION Deutschland GmbH is recorded under other operating expenses. Under a contractual agreement, these expenses are borne by PAION Deutschland GmbH; the corresponding refund claims against PAION Deutschland GmbH are therefore shown under other operating income. The accrual for the payment obligation resulting from the employee participation plan amounted to EUR 33,500.00 as of 31 December 2010; the corresponding refund claims against PAION Deutschland GmbH came to EUR 6,000.00.

5. Stock Option Plan 2008

On 5 May 2008, the Annual General Meeting approved a stock option plan granting options to Management Board members and employees to acquire shares in PAION AG. In total, 815,000 options may be granted under the Stock Option Plan 2008, of which 366,750 to Management Board members and 448,250 to employees. Each option entitles the owner to purchase one share out of the Conditional Capital 2008, which was set up for this purpose. The options have a term of ten years and can be exercised only after a vesting period. The vesting period for beneficiaries receiving options for the first time starts with the date of issue and ends for 50% of the options two years after the date of issue; for 25% of the options the vesting period ends three or four years, respectively, after the issue date. For all other beneficiaries the vesting period ends two years after the issue date. The Supervisory and Management Board may decide to extend the waiting periods. Moreover, the options may only be exercised if the share price on the exercise date has increased by a cumulative 5% p.a. since issuance. In the fiscal year 2010 371,150 options with a waiting period of four years were granted to Management Board members (169,650) and to

employees (201,500) of the PAION Group, thereof 364,650 options at an exercise price of EUR 1.84 and 6,500 options at an exercise of EUR 2.69. As of 31 December 2010, a total of 740,755 options from the Stock Option Plan 2008 were granted, thereof 366,735 to current and former Management Board members as well as 374,020 to employees of the PAION Group. The stock options have not yet been exercised. As of 31 December 2010, the exercise hurdle for those options that have vested was between EUR 1.23 and EUR 1.40 depending on the date of issue.

6. Stock Option Plan 2010

On 19 May 2010, the Annual General Meeting approved a stock option plan granting options to Management Board members and employees to acquire shares in PAION AG. In total, 720,000 options may be granted under the Stock Option Plan 2010, of which 324,000 to Management Board members and 396,000 to employees. Each option entitles the owner to purchase one share out of the Conditional Capital 2010 I, which was set up for this purpose. The options have a term of ten years and a vesting period of two years. The options can be exercised only after a waiting period of four years. The Supervisory and Management Board may decide to extend the vesting periods and waiting periods. Moreover, the options may only be exercised if the share price on the exercise date has increased by a cumulative 5% p.a. since issuance. So far no options from the Stock Option Plan 2010 were issued.

7. Management Board and Supervisory Board

The members of the Company's Management Board are:
– Dr Wolfgang Söhngen, CEO, Chairman
– Dr Mariola Söhngen, CMO
– Bernhard Hofer, CFO
– Dr Gavin Kilpatrick, CSO

Management Board remuneration totalled EUR 1,425,738 in fiscal year 2010. As of 31 December 2010, a total of 699,156 stock options (fair value at time of granting: EUR 1,796,659) and 75,000 stock appreciation rights (fair value as of 31 December 2010: EUR 18,750.00) had been issued to Management Board members. For more information on Management Board remuneration, please see our comments in the compensation report of the management report.

With the exception of Dr Kilpatrick, all members of the company's Management Board are also Managing Directors of PAION Deutschland GmbH. Management Board members Bernhard Hofer, Dr Gavin Kilpatrick and Dr Mariola Söhngen are also Managing Directors of PAION Holdings UK Ltd and its subsidiaries. All Management Board members work full time for the company and its subsidiaries.

As of 31 December 2010, Dr Mariola Söhngen owned 2.59% (648,641 voting rights) and Dr Wolfgang Söhngen 2.32% (582,340 voting rights) of the shares in PAION AG. These shareholdings include 0.02% (6,197 voting rights) of the shares in PAION AG of both shareholders respectively that are held in each case by Dres. Söhngen Beteiligungs GmbH, in which Dr Mariola Söhngen and Dr Wolfgang Söhngen each hold 50%.

As of 31 December 2010 Dr Gavin Kilpatrick owned 0.01% (3,609 voting rights) of the shares in PAION AG.

The members of the Supervisory Board are:
– Dr Jörg Spiekerkötter, Kleinmachnow, Germany, Chairman; lawyer

– Dr Walter Wenninger, Leverkusen, Germany, Deputy Chairman; businessman
  Other supervisory board memberships or similar positions:
  – Evotec AG, Hamburg
  – Novo A/S Hellerup, Denmark
  – NOXXON Pharma AG, Berlin, Chairman of the Supervisory Board
  – Recordati Industria Chimica E Farmaceutica S.p.A., Milan, Italy
  – Santaris Pharma A/S, Horsholm, Denmark

– Alan Goodman, Cambridge, England, Chairman of the Audit Committee; CEO of Avlar Bioventures Ltd, Cambridge, England

Remuneration to the members of the Supervisory Board totalled EUR 136,500 in fiscal year 2010. For more information on Supervisory Board remuneration, please see our comments in the compensation report of the management report.

As of 31 December 2010, Alan Goodman owned directly 0.59% (147,244 voting rights) and indirectly through Advanced Technology Management Limited, Huntingdon/ Cambridgeshire, England 3.64% (912,309 voting rights) of the shares in PAION AG.

8. Shareholdings

The company owns the following direct and indirect shareholdings:

	Shares in %	Currency	Equity as of 31 Dec. 2010	Income 2010
PAION Deutschland GmbH, Aachen	100	EUR	-107,606.53	610,164.83
PAION Holdings UK Ltd, Cambridge/UK	100	GBP	5,526,767.06	346,673.01
PAION UK Ltd, Cambridge/UK	100	GBP	-14,870,730.29	-5,382,144.70
CeNeS Drug Delivery Ltd, Irvine/UK	100	GBP	-1,828,704.02	-68,483.63
CeNeS Pharmaceuticals Inc., Norwood/USA	100	USD	0.00	0.00
TheraSci Limited, Cambridge/UK	100	GBP	0.00	0.00

9. Reportable Equity Investments in PAION AG Pursuant to Section 21 WpHG

In fiscal year 2010, PAION AG did not receive notifications of reportable investments pursuant to Section 21 (1) and (1a) WpHG.

The following notifications received in previous years in respect of reportable equity investments pursuant to Section 21 (1) and (1a) WpHG, which were published in accordance with the stipulations of Section 25 (1) WpHG, are relevant for assessing which shareholders held more than 3% of the shares as of 31 December 2010:

- Pursuant to Section 21 (1) WpHG, Varuma AG, Basle, Switzerland, notified us that its share in the voting rights of PAION AG amounted to 9.84% on 9 February 2005.
- Pursuant to Section 21 (1) WpHG, Merrill Lynch & Co., Inc., New York, USA, notified us for and with the authority of Merrill Lynch Investment Managers LP, Plainsboro, New Jersey, USA, that the share of Merrill Lynch Investment Managers LP in the voting rights of PAION AG had exceeded the 5% threshold on 29 August 2005 and amounted to 5.12% as of this date. The voting rights are attributable to Merrill Lynch Investment Managers LP pursuant to Section 22 (1) Sentence 1 No. 6 WpHG.

- Pursuant to Section 21 (1) WpHG, Merrill Lynch & Co., Inc., New York, USA, notified us that the share of Merrill Lynch & Co., Inc. in the voting rights of PAION AG had exceeded the 5% threshold on 29 August 2005 and amounted to 5.12% as of this date. The voting rights are attributable to Merrill Lynch & Co., Inc. pursuant to Section 22 (1) Sentence 1 No. 6 WpHG.
- Pursuant to Section 21 (1) WpHG, Innoven Partenaires S.A., Paris, France, notified us on 8 August 2008 that its share in the voting rights of PAION AG had exceeded the 10% threshold on 1 August 2008 and amounted to 10.57% (equivalent to 2,602,953 shares) at that time.
- Pursuant to Section 21 (1) WpHG, we were notified on 30 October 2008
  - by Avlar BioVentures Limited, Madingley/Cambridge, England, that its share in the voting rights of our Company had exceeded the 3% threshold on 30 June 2008 and amounted to 3.57% (878,311 voting rights) at that time. Of these, 3.49% (857,873 voting rights) are attributable to the company pursuant to Section 22 (1) Sentence 1 No. 2 in conjunction with Sentence 2 WpHG, and 0.08% (20,438 voting rights) are attributable pursuant to Section 22 (1) Sentence 1 No. 2 WpHG.
  - by Avlar BioVentures Fund II Limited Partnership, Madingley/Cambridge, England, that its share in the voting rights of our Company had exceeded the 3% threshold on 30 June 2008 and amounted to 3.49% (857,873 voting rights) at that time. Of these, 3.49% (857,873 voting rights) are attributable to the fund pursuant to Section 22 (1) Sentence 1 No. 2 WpHG.
  - by Advanced Technology Management Limited, Huntingdon/Cambridgeshire, England, that its share in the voting rights of our Company had exceeded the 3% threshold on 30 June 2008 and amounted to 3.71% (912,309 voting rights) on that date. Of these, 3.49% (857,873 voting rights) are attributable to the company pursuant to Section 22 (1) Sentence 1 No. 2 in conjunction with Sentence 2 WpHG, and 0.22% (54,436 voting rights) are attributable pursuant to Section 22 (1) Sentence 1 No. 2 WpHG.
  - by Avlar BioVentures Scottish GP Limited, Edinburgh, Scotland, that its share in the voting rights of our Company had exceeded the 3% threshold on 30 June 2008 and amounted to 3.49% (857,873 voting rights) on that date. Of these, 3.49% (857,873 voting rights) are attributable to the company pursuant to Section 22 (1) Sentence 1 No. 2 in conjunction with Sentence 2 WpHG.
  - by Avlar BioVentures Scottish Limited Partnership, Edinburgh, Scotland, that its share in the voting rights of our Company had exceeded the 3% threshold on 30 June 2008 and amounted to 3.49% (857,873 voting rights) on that date. Of these, 3.49% (857,873 voting rights) are attributable to
    the company pursuant to Section 22 (1) Sentence 1 No. 2 in conjunction with Sentence 2 WpHG.

According to the notifications we have received pursuant to Section 21 WpHG, the following companies or individuals held shares of more than 3% in the voting rights of PAION AG as of 31 December 2010:

- Innoven Partenaires S.A.
- Varuma AG
- Merrill Lynch & Co, Inc.
- Avlar BioVentures Limited/Advanced Technology Management Limited

10. Auditors

The Annual General Meeting on 19 May 2010 appointed Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Cologne office, Germany, as auditor for the individual and consolidated financial statements for the fiscal year 2010. The auditor has invoiced or will invoice the following fees for services rendered to PAION AG and its subsidiary companies in the fiscal year 2010:

	2010 EUR	2009 EUR
Audits	83,348	96,628
Other opinions	29,550	29,521
	112,898	**126,149**

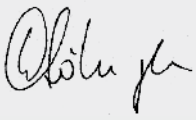
The "other opinions" relate to fees for auditing reviews of the quarterly financial statements.

11. Corporate Governance

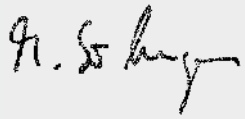
The Supervisory Board and Management Board of PAION AG declare that they are committed to responsible and transparent management and control of the Company focused on adding value in the long term.

The Company complies, for the most part, with the recommendations set forth in the most recent version of the German Corporate Governance Code dated 26 May 2010. On 10 December 2010 and on 21 February 2011, the Supervisory Board and the Management Board issued the declaration of compliance with the Corporate Governance Code pursuant to Section 161 AktG. These declarations of compliance are published on PAION AG's website (www.paion.com/corporategovernance).

Aachen, 8 March 2011
PAION AG



Dr Wolfgang Söhngen



Dr Mariola Söhngen

Bernhard Hofer

Dr Gavin Kilpatrick

Appendix A: Fixed Assets Movement for Fiscal Year 2010

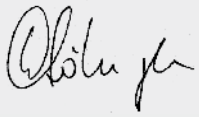
	Historic Costs			
	1 Jan. 2010	Additions	Disposals	31 Dec. 2010
	EUR	EUR	EUR	EUR
Intangible assets				
Franchises, trademarks, patents, licences and similar rights	28,333.75	0.00	0.00	28,333.75
	28,333.75	0.00	0.00	28,333.75
Financial assets				
Shares in affiliated companies	75,866,512.25	0.00	1,800,000.00	74,066,512.25
	75,866,512.25	0.00	1,800,000.00	74,066,512.25
	75,894,846.00	**0.00**	**1,800,000.00**	**74,094,846.00**

	Depreciation				Net Book Values	
	1 Jan. 2010	Additions	Disposals	31 Dec. 2010	31 Dec. 2010	31 Dec. 2009
	EUR	EUR	EUR	EUR	EUR	EUR
	5,096.00	5,688.00	0.00	10,784.00	17,549.75	23,237.75
	5,096.00	5,688.00	0.00	10,784.00	17,549.75	23,237.75
	30,248,497.10	0.00	0.00	30,248,497.10	43,818,015.15	45,618,015.15
	30,248,497.10	0.00	0.00	30,248,497.10	43,818,015.15	45,618,015.15
	30,253,593.10	**5,688.00**	**0.00**	**30,259,281.10**	**43,835,564.90**	**45,641,252.90**

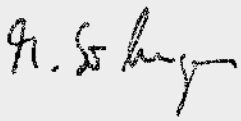
Responsibility Statement (Bilanzeid) in accordance with section 37v(1) and (2) of the Wertpapierhandelsgesetz (WpHG – German Securities Trading Act) in conjunction with sections 264(2) sentence 3 and 289(1) sentence 5 of the Handelsgesetzbuch (HGB – German Commercial Code)

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

Aachen, 8 March 2011
PAION AG



Dr Wolfgang Söhngen



Dr Mariola Söhngen

Bernhard Hofer

Dr Gavin Kilpatrick

Audit opinion

We issued the following opinion on the financial statements and management report:

"We have audited the annual financial statements, comprising the balance sheet, the income statement and the notes to the financial statements, together with the bookkeeping system, and the management report of PAION AG, Aachen, for the fiscal year from 1 January 2010 to 31 December 2010. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law are the responsibility of the Company's management. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

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

Our audit has not led to any reservations.

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

Cologne, 22 March 2011
Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

Gockel
Wirtschaftsprüfer
[German Public Auditor]

Galden
Wirtschaftsprüfer
[German Public Auditor]

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