BAVARIAN NORDIC

# Annual Report

# 07

# Breakthrough with US vaccine contract

The year 2007 was a busy and eventful year, but also a very successful year. With the award of the RFP-3 contract from the US authorities we fulfilled the most important milestone in the history of Bavarian Nordic. The contract was awarded after prolonged negotiations in which we succeeded, as the first in the world, in obtaining advance and milestone payments. In addition to the base contract for 20 million doses of IMVAMUNE®, our third-generation smallpox vaccine, the contract includes an option contract for the delivery of an additional 60 million doses.

The US contract has acted as a catalyst in drawing attention from many other countries. We recently entered into a smaller contract with an Asian country, and we are bidding in the Canadian Ministry of Defence tender for the supply of an MVA-based smallpox vaccine. The authorities of a number of countries are thus gradually recognising that there is a need for an alternative to the old vaccines, and we expect to enter into several small contracts within the next few years. However, we do not expect to see really large contracts until IMVAMUNE® has been registered as a pharmaceutical.

After the RFP-3 contract was signed, we successfully fulfilled all the requirements relating to the development of physical safety, IT security, validation of production and test processes, etc. underlying the advance payment of USD 50 million and the two milestone payments of USD 25 million each. These payments helped make our current financial position the best ever in our history.

In our pipeline, we have presented important data on IMVAMUNE®. Three out of four Phase II studies have been completed and show very promising results. When the Phase II-data package is available – expected late in 2008 – and has been accepted by the US health authorities, we can begin delivering the vaccine to the US national stockpile and thus begin invoicing. We expect to commence pivotal Phase III studies in 2009, and we are consequently well underway towards a final registration of the vaccine.

In 2007, we refocused our HIV strategy. Against a backdrop of recommendations from international scientific committees, data from the nef programme has been incorporated into the *multiantigen* programme, which thus continues to be our future HIV project.

Important progress has also been achieved in our cancer research. In 2007, we commenced Phase I/II studies of our vaccine candidate for breast cancer, and we expect to begin clinical trials with our vaccine candidate for prostate cancer in the first half of 2008.

In this spring, we reached the end of the strategy process we began in the autumn of 2007. We expect that the conclusions and initiatives deriving from this process will be implemented during 2008.

On the management side, Peter Wulff has handed the baton to Anders Hedegaard as new CEO. This management change also marks a new epoch for Bavarian Nordic, with new and different demands on the organisation, e.g. in the form of intensified commercial focus.

Finally, we would like to thank all the employees of Bavarian Nordic for each having contributed during the year to our joint results, which we now can look back upon with great pride. Everyone waited patiently for the new US contract, our organisation was characterised by good dynamics and a fantastic degree of enthusiasm while we waited, which ensured continuing progress in all areas of our organisation. In addition, we would like to thank the many new as well as “old” shareholders who continue to support Bavarian Nordic in spite of the difficult equity market of the past year.

**Asger Aamund**
Chairman

**Anders Hedegaard**
President and CEO

# Key figures

## Group key figures 2003 - 2007

| Amounts in DKK millions. All figures are as of December 31 | 2007 | 2006 | 2005 | 2004 | 2003 |
|---|---|---|---|---|---|
| **Income statements** | | | | | |
| Revenue | 332.1 | 175.3 | 247.6 | 164.8 | 524.5 |
| Production costs | 64.5 | 136.3 | 132.2 | 70.3 | 206.5 |
| Research and development costs | 243.6 | 118.4 | 114.4 | 120.4 | 61.0 |
| Sales expenses and Administrative costs | 89.1 | 124.4 | 75.4 | 56.4 | 43.0 |
| Other operating expenses | - | - | 45.4 | - | - |
| Income before interest and tax (EBIT) | (65,0) | (203.8) | (119.8) | (82.3) | 214.0 |
| Financial items, net | 14.5 | (1.0) | 3.4 | 5.6 | 3.6 |
| Income before company tax | (50.5) | (204.8) | (116.4) | (76.7) | 217.6 |
| Net profit for the year | (63.5) | (160.9) | (94.7) | (53.0) | 150.6 |
| **Balance sheet data** | | | | | |
| Total non-current assets | 538.8 | 568,2 | 472,4 | 291,8 | 71.0 |
| Total current assets | 1.193.2 | 386.2 | 456.2 | 310.3 | 358.2 |
| Total assets | 1.732.1 | 954.4 | 928.6 | 602.1 | 429.2 |
| Shareholders equity | 1.217.7 | 691.4 | 630.1 | 315.4 | 347.0 |
| Long-term current liabilities | 134.7 | 150.6 | 212.2 | 149.1 | 2.9 |
| Short-term current liabilities | 379.7 | 112.4 | 86.3 | 137.6 | 79.3 |
| **Cash Flow Statements** | | | | | |
| Net cash including securities | 913.6 | 332.7 | 269.0 | 56.6 | 198.7 |
| Cash flow from operating activities | 163.2 | (194.5) | (54.9) | (71.0) | 209.3 |
| Cash flow from investment activities | (16.1) | (192.2) | (196.9) | (224.6) | (33.2) |
| Investment in tangible assets | 5.8 | 73.9 | 151.2 | 190.5 | 28.9 |
| Cash flow from financing activities | 440.4 | 219.0 | 464.2 | 152.8 | 3.1 |
| **Financial Ratios (in DKK)** | | | | | |
| Earnings per share | | | | | |
| - basic earnings, per share of DKK 10.00 | (8.5) | (25.8) | (17.6) | (11.5) | 33.4 |
| - diluted earnings, per share of DKK 10.00 | (8.5) | (25.8) | (17.6) | (11.5) | 32.9 |
| PE, price/earnings ratio | 155.8 | 108.4 | 108.7 | 68.0 | 76.9 |
| Share price at the year-end | 293 | 582 | 476 | 539 | 251 |
| Share price/Net assets value per share | 1.9 | 5.4 | 4.4 | 7.9 | 3.3 |
| Numbers of outstanding shares at the year-end | 7.816 | 6.376 | 5.797 | 4.640 | 4.515 |
| Shareholders´ equity share | 70% | 72% | 67% | 52% | 81% |
| Number of employees at the end of the year | 264 | 233 | 224 | 145 | 87 |

Earnings per share (EPS) is calculated in accordance with IAS 33 ”Earnings per share”.
The financial ratios have been calculated in accordance with ”Anbefalinger og Nøgletal 2005” (Recommendations and Financial ratios 2005).

# The road to success

## Vision – the right powers and a strong will are the reasons why five years of dedicated work has lead to success

In June 2007, Bavarian Nordic received the long-awaited RFP-3 contract from the United States. In spite of the long wait, the contract is now a clear symbol of the Company's greatest success to date, and it is also one of the greatest successes in Danish biotech in recent times.

Behind the success lies many years of focused R&D work with our patented vaccine technology, MVA-BN®, one of the cornerstones of the Company. As a result of the accelerated development of our third-generation smallpox vaccine since 2003, when we signed our first development contract with the US government (RFP-1), Bavarian Nordic expects to have this vaccine registered in a few years' time, thus making the success complete.

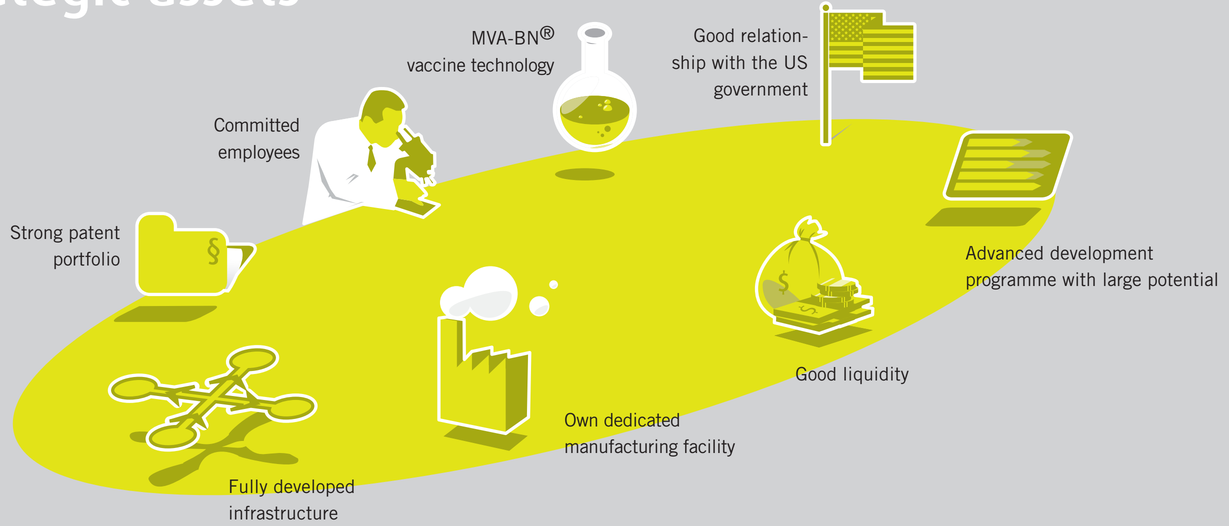
However, the success of Bavarian Nordic is not only the result of our unique technology. We are working hard to build up a competent organisation and an infrastructure that can support the business platform in the best possible way. As far back as 2003, the Company decided to establish a manufacturing facility of its own in order to best position itself for coming orders for smallpox vaccines, including the RFP-3 contract. Construction of the facility at Kvistgård, Denmark, was not only a major step and a major investment for the then-small biotech company, it was also a process that required complete commitment throughout the entire Company: In record time, we successfully established large-scale manufacturing which meets the strictest regulatory requirements. This was an achievement that bears witness to our great competencies and strong commitment to getting things done.

The development and commercialisation of our first product was an achievement which has not just left a great impression on our staff, it has also received much recognition both nationally and internationally, and in just a few years' time, Bavarian Nordic has successfully established itself as an important player in the international vaccine market.

### The basis for success

With a product that is approaching its final phase of development, a unique technology, an extensive patent portfolio, and in-house production, Bavarian Nordic has laid the foundation for a coming commercial breakthrough. These elements, together with a large number of other factors, make up our strategic

## Strategic assets



# A new man at the helm

## Anders Hedegaard will be the spearhead of Bavarian Nordic's transformation from a traditional into an industrial biotech company

Shortly before the RFP-3 contract was signed by the US authorities, Peter Wulff, then president and CEO of Bavarian Nordic, announced that he wanted to step down. Wulff had been at the helm of the Company since its inception in 1994 and deserves a great deal of credit for the many results achieved by Bavarian Nordic.

The appointment of Anders Hedegaard as new President and CEO on 1 August 2007 marked a new epoch for Bavarian Nordic, one that requires a different style of management. The Company is moving from a position as a traditional biotech company, 100% focused on technology and development, to a situation where it must focus equally on more traditional industry disciplines such as own production, sales and marketing.

Hedegaard came to Bavarian Nordic from pharmaceutical company ALK-Abelló, where he was in charge of the group's business operations. With a background as a chemical engineer specialising in molecular biology and with many years of experience in sales and marketing of pharmaceuticals, Hedegaard possesses exactly the competencies required to manage the transformation of a conventional biotech company and take Bavarian Nordic to a new level.

"In recent years, Bavarian Nordic has been succeeding in attaining the goal of all biotech companies: getting its first product on the market. The huge US contract we won has created a more solid foundation for further development of the most promising projects in our pipeline and, with our new strategy, we are now actively projecting a new image of Bavarian Nordic to the outside world. While we continue the development of our products, we look out into the world to identify not just new customers, but also potential new projects and partners."

The implementation of a more aggressive sales strategy designed to commercialise IMVAMUNE® is one of the new initiatives taken by Hedegaard.

Changes in strategy and focus also mean that the Company must adapt internally. Corporate structure and culture changes, and the Company must now handle research, development, manufacturing, sales and marketing in the manner of a "real" industrial company. This also means that a large number of management elements and strategic management must be built into the organisation.

"As an industrial company, there are many procedures, routines and demands with respect to safety and documentation that we now have to comply with. There is a growing requirement that processes and internal procedures be streamlined so that the organisation has leadership and is adjusted to meet the demands and challenges of tomorrow in the middle of what can be the minefield between research and business."

**Anders Hedegaard**
Born in 1960.

M.Sc. in chemical engineering from the Technical University of Denmark.

2002-2007: ALK-Abelló A/S, Executive Vice President, Business Operations & International Marketing

2000-2002: Foss A/S, Group Vice President

1991-2000: Novo Nordisk A/S. Various executive positions, most recently International Marketing Director.

# Strategy and focus areas

## A new strategic starting point is made to establish the position as an innovative and globally leading vaccine supplier

It is the goal of Bavarian Nordic to be a leading supplier of innovative vaccines for the treatment and prevention of life-threatening diseases. In addition, the Company seeks to create shareholder value by ensuring sustained profitable operations, by focusing its development activities and by optimising the resources used.

Given its progress and achievement of important interim goals in 2007, Bavarian Nordic is in a new strategic situation in 2008 involving a number of new key elements which will, in combination, help determine what happens in the Company in the years ahead. These elements include:

- A strong financial position has been achieved
- A partially new executive group will be set up.
- The Company has finished a strategy process.

Since the autumn of 2007, Bavarian Nordic has undergone a strategy process which was completed in spring 2008, after which the conclusions from the process and derived initiatives will be implemented continuously. In the meantime, the Company is focusing strongly on streamlining its organisation and on value-generating elements that can cement the position of Bavarian Nordic as an innovative, globally leading supplier of vaccines. In the short term, this means that the key focus will be on:

- Fulfilling the RFP-3 contract
- Focusing and prioritising the pipeline
- Building up market demand for IMVAMUNE®

### Fulfilling the RFP-3 contract

With a continuing strong focus on project management, a number of important milestones forward are expected in the development of IMVAMUNE® over the next 12-24 months:

- Completion of Phase II studies (2008)
- Commencement of Phase III studies (2009)
- Start-up of inventory production of vaccine (2008)
- Start-up of actual delivery of vaccine for the US strategic national stockpile (2009)

To begin delivering IMVAMUNE® to the United States, Bavarian Nordic must first fulfil the requirements connected with the potential use of the vaccine during a declared emergency. Provided that patient enrolment for the last Phase II study progresses as planned, the Company expects to be able to complete this study in late 2008 as previously announced, after which the Phase II HIV data package will be sent to the US health authorities for evaluation of whether it meets the conditions for an Emergency Use Authorisation (EUA). Consequently, the first deliveries of vaccines are expected in early 2009. With a view to optimising the use of resources at the manufacturing facility at Kvistgård, delivery of vaccines is expected to be distributed more or less evenly over the period 2009-2011.

### Focusing and prioritising the pipeline

The Company's pipeline currently includes a total of five development programmes in the following three areas: *biodefense*, *cancer* and *infectious diseases*.

All programmes are subjected to an overall pragmatic, data-driven prioritisation strategy so that future favourable or unfavourable data will be decisive factors for the individual programmes.

#### Biodefense

This is the Company's principal area of business. The strategy for this area focuses on handling the entire value chain, all the way from development to production and sale of vaccines. One goal is to complete the clinical development of IMVAMUNE® in the run-up to registration. The vaccine will then be commercialised via sales to the United States and other countries. In addition, the intention is to build up a biodefense portfolio of projects that can complement IMVAMUNE® and ensure the Company a sustained and growing business.

### Cancer

In the short term, the goal is to complete the Phase I/II studies of the vaccine candidate for breast cancer and to initiate Phase I/II studies of the vaccine candidate for prostate cancer.

As and when positive clinical data are obtained, partnering of the projects will be considered and the Company will also keep an eye on potential in-licensing opportunities.

### Infectious diseases

The Company has a number of projects in infectious diseases, all of which are at an early development stage: HIV, measles/RSV, dengue fever and Japanese encephalitis. The goal with the first two projects is to complete early-stage clinical trials. If supported by the data obtained, the option of placing these projects in external partnerships will be explored. Alternatively, the Company will seek other external funding. For the latter two projects, discussions with a potential external partner on clinical development and funding are pending.

The programme for measles/RSV will be tested up to and through clinical Phase I, where it is expected that proof of concept will be obtained.

As for HIV *multiantigen*, Phase I/II clinical studies will be completed, and partnering negotiations will be initiated as and when the project progresses.

## Building market demand for IMVAMUNE®

As part of the process of taking the Bavarian Nordic organisation to new and professional levels, a new commercial organisation was established in 2007.

The overall objective of the new commercial organisation is to ensure that all key processes and work flows in Bavarian Nordic have a firmly rooted strategic and market-driven base. This is not only relevant for the future IMVAMUNE® activities, but also for our future vaccine projects. In the continued development of the Company's pipeline, the commercial organisation will ensure that the Company's research and development is moving in an ever-increasingly commercial direction, and that the necessary market knowledge is integrated in the decision-making processes at an early stage in clinical development.

Bavarian Nordic winning the RFP-3 contract in 2007 and the growing amount of clinical evidence in favour of IMVAMUNE® has cemented IMVAMUNE® and MVA technology as unique and innovative. This represents an attractive opportunity which Bavarian Nordic must capitalise on going forward.

Adding to the opportunity is the fact that smallpox is one of the most fatal and complicated biological terror or warfare threats governments face. Preparing for such an event is further complicated by the fact that the currently available first- and second-generation vaccines are associated with a high rate of serious side effects and are considered too risky for use in as many as 25% of the general population.

For its new commercial organisation, Bavarian Nordic will put together a team of people possessing the skills and competences required to engage all stakeholders in a dialogue about the need for a new and better vaccine and about how IMVAMUNE® can play a critical and improving role in a national smallpox preparedness plan. Establishing this team is critical, since IMVAMUNE® is still under development.

Bavarian Nordic wants international representation, either through local agent agreements or its own representatives. The Company will prioritise and target markets in which the need for a new and better smallpox vaccine and/or an improved smallpox preparedness plan is fully recognised.

Until IMVAMUNE® has been licensed, the Company will work with its stakeholders to position it as a new and superior third-generation smallpox vaccine using a three-step strategy:

1. Protection of all first-line responders
2. Protection of the immunocompromised population
3. Protection of the general population

Although IMVAMUNE® cannot be fully commercialised until the vaccine has been licensed, the Company remains greatly encouraged by the prospects due to the clear need for a new and better smallpox vaccine, the US endorsement of the IMVAMUNE® programme through the RFP-3 contract award, and the continuing amount of positive clinical evidence for IMVAMUNE®. Thus Bavarian Nordic is confident that a number of governments will in future include IMVAMUNE® as a new and innovative resource in their smallpox preparedness plans.

# 2007 highlights

The most important event for Bavarian Nordic in 2007 was receiving the RFP-3 contract by the US government for the production and delivery of 20 million doses of IMVAMUNE®, Bavarian Nordic's third-generation smallpox vaccine. The contract was awarded in June, but an indication of the award was already given in April. This event has had a major impact on activities at Bavarian Nordic. As part of these activities, the Company began planning and executing various interim targets in the contract immediately after receiving the contract, which triggered a total of USD 100 million of advance and milestone payments during the year.

In addition, a new person took over as CEO in 2007: Anders Hedegaard, who joined Bavarian Nordic in August.

### RFP-3 contract awarded: Total value USD 1.6 billion

In June, the US Department of Health and Human Services (HHS) awarded a USD 500 million contract to Bavarian Nordic for the manufacture and delivery of 20 million doses of IMVAMUNE®. In addition, the contract includes an option for the supply of an additional 60 million doses. The option has a value of USD 1.1 billion. In connection with the award, the Company raised its full-year guidance by DKK 300 million.

### RFP-3 contract advance and milestone payments total USD 100 million

In 2007, after receiving the contract, Bavarian Nordic has fulfilled a number of significant milestones in the contract, allowing the invoicing of a total USD 100 million in advance and milestone payments.

### RFP-2 contract extended

This past autumn, the US government extended the RFP-2 contract awarded to Bavarian Nordic in 2004. The contract extension has a value of USD 15 million that will be used to fund a Phase II study with IMVAMUNE® in people diagnosed with atopic dermatitis.

### Large-scale Phase II study with IMVAMUNE® completed

In November, Bavarian Nordic reported the successful completion of a large-scale Phase II trial in 745 healthy subjects. The results of this study are seen as a pivotal step on the path to moving into Phase III registration trials in order to obtain a BLA (biologic licence application) for healthy subjects.

### Collaboration agreement with GlaxoSmithKline terminated

In February, Bavarian Nordic announced that it and GlaxoSmithKline agreed not to pursue a collaboration for the production and marketing of IMVAMUNE® as contemplated in a memorandum of understanding signed by the two companies in 2004, at a time where Bavarian Nordic's own production facility was not established. Bavarian Nordic currently has the capacity to produce the RFP-3 order and future orders. Termination of the agreement has not caused any negative financial consequences for Bavarian Nordic.

### First cancer vaccine candidate enters clinical trials

In first half of 2008, Bavarian Nordic's subsidiary, BN ImmunoTherapeutics initiated Phase I/II clinical trials with its breast cancer vaccine candidate, MVA-BN®-HER2.

### Capital increase

In March, the Company successfully completed a rights issue increasing its equity and cash preparedness by DKK 443 million.

### Settlement with Acambis

In July, Bavarian Nordic and Acambis reached a global settlement ending the legal disputes between the two companies on matters relating to smallpox vaccines based on the modified vaccinia Ankara (MVA) virus. The settlement involves the patent disputes at the US International Trade Commission (ITC) and the Commercial Court in Vienna, Austria, as well as the conversion, unfair trade acts and unfair competition action at the US Federal District Court of the District of Delaware.

The suits were originally filed to protect Bavarian Nordic's extensive IP rights.

Under the agreement, Bavarian Nordic will grant a licence to some of its MVA patents in return for Acambis making an undisclosed payment, which is recognised in 2007. Acambis will also make royalty and milestones payments should it develop or commercialise certain MVA products in the future.

### Commercial organisation strengthened

This past autumn, Bavarian Nordic set up a new commercial function to strengthen the Company's commercial activities and build market demand for IMVAMUNE® and future vaccines, including HIV and cancer vaccines. To lead this new commercial function, the Company appointed Nicolai Buhl Andersen as Executive Vice President for Commercial Affairs. He joined the Company in November.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# Outlook for 2008

The strategy process that was recently completed has resulted in a long-term strategy plan, which contains a number of new initiatives and prioritising of existing activities. With this plan, Bavarian Nordic is prepared for making the priorities, which create the most value for the Company's shareholders.

For 2008, Bavarian Nordic expects revenue in the region of DKK 180 million, and a pre-tax loss in the region of DKK 225 million.

Revenue will consist of the third milestone payment under the RFP-3 contract and invoicing in continuation of the RFP-2 contract. Contracts with other countries for smallpox vaccines are not included in the guidance for 2008, as this would still be too uncertain due to the long-term process involved in obtaining each contract.

Research and development costs in 2008 are expected to be approximately DKK 280 million, including the further development of IMVAMUNE® under the RFP-3 contract, of which DKK 70 million expectedly are capitalised in the balance sheet under intangible assets.

In 2008, the Company's cash resources will be extraordinarily affected by increased production costs in connection with the upscaling of production, build-up of vaccine stockpiles and increased costs for Phase II and Phase III studies of IMVAMUNE®. Thus the liquidity drain in 2008 will be around DKK 400 million. At the end of 2008 the Company's net free liquidity is expected to amount to around DKK 500 million.

The forecast assumes that, as part of the RFP-3 contract, Bavarian Nordic in late 2008 files the necessary data to the FDA for confirmation that the data fulfil the requirements to support the use of IMVAMUNE® in a declared emergency, which is the trigger to initiate the delivery of vaccines to the United States. The review process is still uncertain, as Bavarian Nordic is one of the first companies to operate under this set of rules. Since approval from the authorities is outside the control of the Company, the budget assumes that approval is *not* received in time for delivery of IMVAMUNE® under the RFP-3 contract to begin in 2008. Bavarian Nordic expects that the 20 million doses of IMVAMUNE® under the RFP-3 contract will be delivered in 2009 – 2011.

Furthermore, the net profit forecast assumes that Bavarian Nordic obtains the necessary approvals to continue its preclinical and clinical trials.

**IMVAMUNE® third-generation smallpox vaccine**

The company expects to discuss the Phase III study design and data requirements for a biologic licence application (BLA) with the FDA. Subsequently, clinical activities to support Phase III studies are expected to start in 2009.

Interim safety data from the Phase II study in more than 300 HIV-infected subjects are expected in the second half of 2008. Subsequently, the data package will be submitted to the US health authorities. The completed submission will trigger a milestone payment of USD 25 million.

A Phase II study to demonstrate the effect of IMVAMUNE® as a booster vaccination (re-vaccination of subjects previously vaccinated with IMVAMUNE®) is expected to be initiated in the first half of 2008. Furthermore, the Company expects to initiate a Phase II study in the second half of 2008 to investigate the safety and immunogenicity of IMVAMUNE® in an elderly population.

**Cancer Immunotherapy**

The Phase I/II studies of the breast cancer vaccine are expected to fully enrol patients as planned in 2008. Initial immune data will be analysed in the first half of 2008, and complete safety and immunological efficacy data will be available later in 2008. Tthe Company will then plan the next clinical development steps on the basis of these data.

Bavarian Nordic still expects to start Phase I studies with its vaccine candidate against prostate cancer in the first half of 2008.

**HIV**

A Phase I/II study in HIV-infected subjects is expected to be initiated with the MVA-BN® HIV *multiantigen* vaccine in the first half of 2008.

**Childhood vaccines**

The ongoing Phase I study with the measles/RSV vaccine candidate is expected to be completed in 2008. It is planned that this will be followed by a Phase I study in young infants in Africa in the second half of 2008.

**Production**

Bavarian Nordic intends to scale up production all through 2008 in order to prepare for the delivery of IMVAMUNE® to the United States. Under the terms of the contract, the Company expects to be ready to begin delivering the vaccines immediately after receiving authorisation to do so.


Unlicensed Smallpox Vaccine.
Use on official recommendation only.

# The big contract

## In 2007, the US Department of Health and Human Services (HHS) awarded a five-year exclusive contract (RFP-3) to Bavarian Nordic for the delivery of 20 million doses of IMVAMUNE®

The RFP-3 contract continues the long-standing collaboration between Bavarian Nordic and the US health authorities for the development and production of IMVAMUNE® as a modern and safer smallpox vaccine. The first RFP contract (RFP-1) was awarded to the Company in 2003, four years after it began its MVA-based smallpox vaccine programme. Under the subsequent contract (RFP-2), which was awarded in 2004, Bavarian Nordic delivered half a million doses of IMVAMUNE® smallpox vaccine to the US government.

The tender terms of the RFP-3 were announced in August 2005, and Bavarian Nordic submitted its tender to the HHS in October of the same year. UK-based Acambis also submitted a tender and, for a long time, there was an expectation that the order for the 20 million doses would be split in two. However, in November 2006, Acambis announced that they had been excluded from further participation in the RFP-III process by the US authorities. This paved the way for the entire order to go to Bavarian Nordic.

RFP: Request for proposals.

### RFP-3 contract: Contents and conditions

The total value of the contract including contractual options is USD 1.6 billion, of which the base contract constitutes USD 500 million.

**The RFP-3 contract is the first contract from the HHS under what is called the "BioShield" programme since the US Pandemic and All-Hazards Preparedness Act came into force in December 2006. Among other things, the passing of this act made possible some of the advance and milestone payments received by Bavarian Nordic in 2007.**

### The base contract

In addition to the supply of 20 million doses of IMVAMUNE®, the base contract will support additional research and development of the product to fulfil requirements for the potential use of the vaccine during a declared emergency. In addition, contract support will be used to fund the non-clinical and clinical studies necessary for Bavarian Nordic to register IMVAMUNE® with the US Food and Drug Administration as a safe and effective smallpox vaccine for healthy people.

A minor part of the total contract sum is due on registration of the vaccine.

### Contractual options

The contract contains an option, which the HHS can exercise in continuation of the base contract. The optional part of the contract, with a value of USD 1.1 billion, includes further clinical studies to extend the licence to include people infected with HIV, children and the elderly, as well as the supply of up to an additional 60 million doses of IMVAMUNE®.

In connection with the awarding of the contract, the HHS stated in a press release that the United States required a vaccines that could be administered safely to the entire population, including immunocompromised patients, and that the purchase of 20 million doses of Bavarian Nordic's vaccine was an important step towards protecting an even larger share of the population in the event of an outbreak of smallpox. To Bavarian Nordic, this is an important indication that, in the longer term, the United States wants to exercise the option in the contract, but the timing and certainty of this is not known.

### Advance and milestone payments

Since the RFP-3 contract was signed, Bavarian Nordic has successfully met all requirements with respect to physical safety, IT security, validation of production and test processes, etc. which were part of the criteria underlying the advance payment of USD 50 million and the two milestone payments of USD 25 million each.

The advance payment, which is subject to a repayment obligation in case Bavarian Nordic does not meet the requirements in the contract, is recognised under liabilities and will be recognised in the income statement as the delivery of vaccines takes place.

Bavarian Nordic expects to receive a further milestone payment of USD 25 million in 2008 for meeting the conditions for use of IMVAMUNE® during a declared emergency.

In addition, the contract contains a performance-based milestone payment of USD 25 million, which is conditioned by progress in the clinical studies.

In the years ahead, the Company will continue to focus on fulfilling the contract in its manufacture and delivery of the order, including a focus on continuing the good relations with the US government that it has built up during the entire development process for IMVAMUNE®. This will ensure that the Company will be well positioned to receive the optional part of the contract.

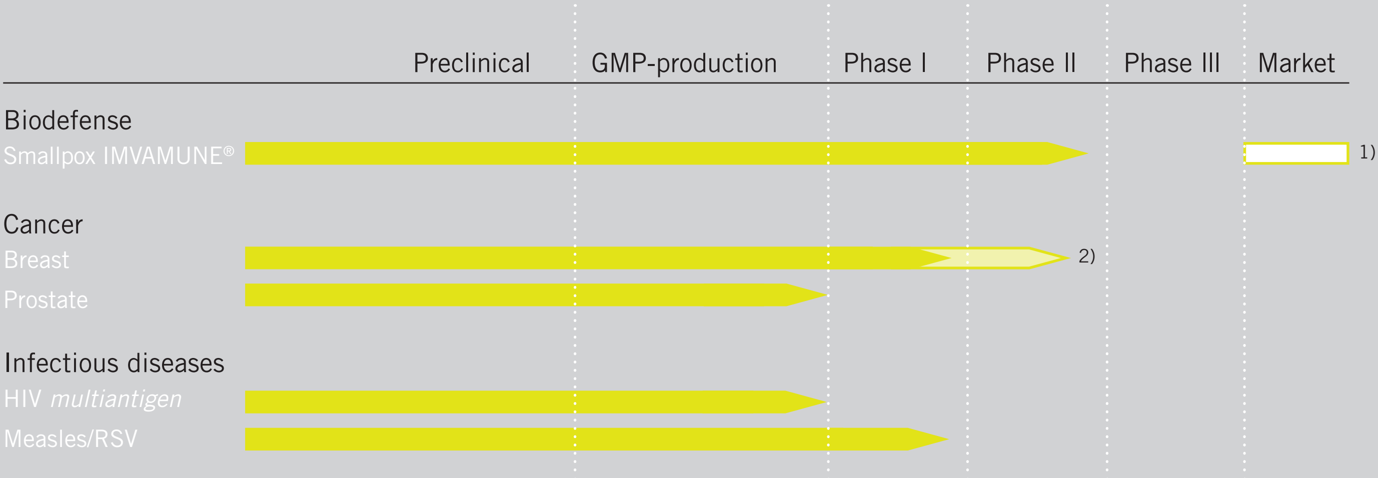
### Cash flow hedging

Following the award of the base contract, the Group has hedged USD 300 million by Forward Rate Agreements (FRA) at an exchange rate of DKK 5.53 per USD. By year-end 2007, USD 200 million is secured at this level. The FRA had a value of DKK 92 million as of 31 December 2007

## Overview of and contents of RFP contracts

| Contract | Contents | Awarded in | Value |
|---|---|---|---|
| **RFP-1** | Early clinical and technical development of IMVAMUNE® | 2003 | **USD 29m** |
| **RFP-2** | Industrialisation of production process – production and delivery of 500,000 doses. Clinical studies to support an EUA for the use of the vaccine in healthy persons. | 2004 | **> USD 115m** |
| **RFP-3 base** | 20 million doses of vaccine<br>Clinical studies designed to support registration of the vaccine for use in healthy persons and for an EUA for use of the vaccine in persons infected by HIV. | 2007 | **USD 500m.** |
| **RFP-3 option** | Procurement of an additional 60 million doses.<br>Clinical studies designed to support registration of the vaccine for use in persons infected by HIV, children and elderly people. | ? | **USD 1.1bn** |

# Pipeline




1) Sold to goverments as vaccine in development

2) The programme is in Phase I/II

# Technology

Bavarian Nordic's technology platform is based on the patented MVA-BN® virus. MVA-BN® is a further development of the MVA (modified vaccinia Ankara) vaccine used to pre-vaccinate more than 100,000 individuals against smallpox in Germany in the 1970s.

MVA-BN® technology has a number of advantages that makes it ideal in the development of therapeutic or prophylactic vaccines:

- MVA-BN® does not replicate in human cells, which considerably reduces the risk of side effects.
- Vaccination with MVA-BN® elicits a strong immune response, which is one of the most important factors in obtaining the desired therapeutic or prophylactic effect.
- MVA-BN® can be genetically designed (as a recombinant vaccine) to combat diseases other than smallpox without losing its unique characteristics.

These advantages have been documented in the Company's clinical studies involving more than 1,600 patients, as well as in numerous preclinical studies over the past ten years.

# Research and development

## Several interesting vaccine candidates in the pipeline

### IMVAMUNE® - SMALLPOX VACCINE PROGRAMME

Bavarian Nordic is developing IMVAMUNE® as a stand-alone third-generation smallpox vaccine. IMVAMUNE® has unique advantages compared to traditional smallpox vaccines. In ten completed or ongoing clinical studies, the vaccine has shown an improved safety profile in more than 1,600 subjects, including persons who are otherwise contraindicated to receive traditional smallpox vaccines. Furthermore, efficacy studies have shown that IMVAMUNE® elicits an immune response faster than traditional smallpox vaccines.

**Phase II in healthy subjects completed**

In 2007, Bavarian Nordic completed the Phase II development of IMVAMUNE® in healthy subjects, which served as the basis for discussions with the US Food and Drug Administration (FDA) on the design of the Phase III programme, which is planned to commence in 2009.

In November, Bavarian Nordic reported the successful completion of a Phase II trial in 745 healthy subjects who received either one or two doses of IMVAMUNE® or placebo. The large amount of safety data collected from this study confirmed the excellent safety and tolerability profile of IMVAMUNE®. Importantly, vaccinations with IMVAMUNE® did not result in any clinically significant abnormal cardiac findings and no serious cardiac events (e.g. cases of myo-/pericarditis) similar to those reported for traditional smallpox vaccines. Moreover, vaccinations with IMVAMUNE® resulted in detectable immune responses in almost all subjects (98.9%) previously not vaccinated against smallpox. Similarly, a single vaccination with IMVAMUNE® boosted the immune responses in the majority of people who had in the past already been vaccinated against smallpox.

**Studies in immunocompromised subjects strengthens Phase II data package**

In February, Bavarian Nordic reported the first safety and immunogenicity data of an MVA-based smallpox vaccine in HIV-infected subjects. The data represented a landmark in the development of IMVAMUNE®, as the trial in 151 people demonstrated that IMVAMUNE® was not only well tolerated, but was as immunogenic in HIV-infected subjects as in healthy people.

Bavarian Nordic has two ongoing Phase II studies in immunocompromised subjects. In the US, a multicentre study is currently ongoing in HIV-infected subjects. The main part of the study is expected to be completed in 2008, and the safety data will be included in the data package for submission to the FDA to support the potential use of IMVAMUNE® in a declared emergency.

The other ongoing Phase II study in immunocompromised subjects is part of the RFP-2 contract extension.

**RFP-2 contract extended**

In 2007, the US Government extended the RFP-2 contract that was awarded to Bavarian Nordic in 2004.

Within the scope of the extension, Bavarian Nordic is performing a larger Phase II study in Mexico and the USA investigating the safety and immunogenicity of IMVAMUNE® in people diagnosed with atopic dermatitis (AD). This is an important population, because people with a history of or active AD are excluded from vaccination with traditional smallpox vaccines due to the problematic safety profile of these vaccines. The study is expected to be completed in the second half of 2009.

# CANCER IMMUNOTHERAPY

One of the Company's product candidates targets HER-2 and thus has the potential to complement one of the current "gold standards", Herceptin®, in the treatment of breast cancer. The drawback of using passive immunotherapy alone is that it uses only one arm of the immune system (the humoral arm) based on antibodies. Research has shown that controlling cancer is accomplished more effectively if all arms of the immune system are engaged. This activation of cellular, humoral and innate immunity can potentially be achieved by active vaccination.

Bavarian Nordic's strategy for developing vaccines against cancer is based on activating all arms of the immune system. The Company has two vaccine candidates under development: one against breast cancer and the other against prostate cancer.

**Breast cancer**

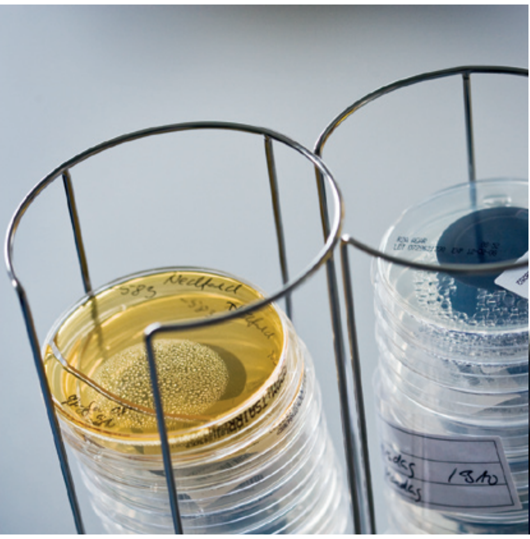
The Company's breast cancer vaccine candidate is based on a HER-2/Neu antigen. The product combines MVA-BN® technology with an improved form of the HER-2 sequence in-licensed from the Danish biotech company Pharmexa A/S.

As planned, Bavarian Nordic initiated Phase I/II clinical studies in first half of 2007. Currently, patients with HER-2 positive, metastatic breast cancer are being enrolled in two clinical Phase I/II studies to be performed in three countries. The first study is ongoing in California, USA. The second study is enrolling patients in multiple centres in Serbia and Poland. In the US study, metastatic cancer patients are vaccinated after they have received chemotherapy; in the European study, chemotherapy and vaccination are combined. Patients may or may not receive Herceptin® concurrently. The studies are enrolling patients as planned, and no drug-related severe adverse events have been reported thus far. Initial data regarding patient immune response are expected in the first half of 2008.

**Prostate cancer**

The Company's vaccine candidate for the treatment of prostate cancer is designed to express sequences that control immunity to prostate-specific antigen (PSA) and prostatic acid phosphatase (PAP).

An investigational new drug application (IND) was filed with the FDA in December 2007 to start a clinical study in hormone-refractory prostate cancer patients in 2008. This study will be performed in the USA, is designed as an open label dose escalation study, and is currently planned to enrol 18 patients.




# OTHER DEVELOPMENT PROGRAMMES

In 2007, Bavarian Nordic announced Phase II data from the MVA HIV *nef* programme showing proof of concept for the MVA technology's ability to control HIV replication in certain patients, thus confirming previous positive data. The data also indicated that a successful product should consist of more antigens than just nef to generate a broader immune response. As a result of recommendations by several scientific advisory boards after evaluating the data, Bavarian Nordic has refocused its strategy for the development of HIV vaccines. Data from MVA HIV *nef* will be used in support of the MVA-BN® HIV *multiantigen* programme, which has the potential to meet the success criteria for an effective HIV vaccine.

### MVA-BN® HIV *multiantigen*

MVA-BN® HIV *multiantigen* is both a prophylactic and a therapeutic vaccine candidate expressing eight whole or truncated antigens from HIV (including nef) with the aim of eliciting a very broad immune response against HIV.

Following successful pre-IND discussions with the FDA, an investigational new drug application (IND) to support clinical development will be filed in the first half of 2008. A Phase I/II trial investigating the safety and immunogenicity of the vaccine in HIV-infected patients is expected to be initiated in first half of 2008.

### Measles/RSV

Measles vaccines currently on the market are not optimal for use in children less than one year of age, a period during which most infections result in a high morbidity and mortality. Significant reductions in childhood mortality could be achieved if safer and efficacious vaccines could be developed for use in this susceptible age group.

Bavarian Nordic's goal is to develop an improved measles vaccine suitable for children under one year old, a vaccine based on MVA-BN® expressing three measles virus antigens.

Preclinical studies have revealed that MVA-BN® is not only safe, but also immunogenic in newborn animals. The measles vaccine candidate will be the first MVA-BN®-based childhood vaccine to evaluate the potential of this technology to induce good immune responses in children under one year old.

In 2007, Bavarian Nordic initiated a Phase I study in South Africa. The study will evaluate the safety and immunogenicity of the vaccine in 30 healthy adult subjects before evaluating the vaccine in children in the second half of 2008.

Due to the accelerated development of the measles vaccine to clinical studies in children, the Phase I study for the RSV vaccine has now been postponed, with an anticipated start of a Phase I study in 2009, after the measles vaccine has been shown to be safe and immunogenic in this target population.

### Immunotherapy (IMVABOOST)

The hypothesis of the concept behind IMVABOOST has been to improve the immune system by enhancing T-cells in subjects with HIV, cancer, bone marrow transplants, etc.

Bavarian Nordic has shown data from early studies suggesting increased T-cell counts after vaccination with IMVAMUNE®. However, later and recent studies did not show elevated T-cell counts following vaccination with MVA nef or IMVAMUNE®, i.e. the earlier Phase I data could not be repeated in a larger study population. Thus there is no solid data that could support further studies examining the potential stimulation of general immune enhancement, i.e. IMVABOOST.

# Production

Bavarian Nordic started up commercial production of IMVAMUNE® in 2007 at its facility in Kvistgård, Denmark. Commercial-scale filling of vaccines began at IDT, Bavarian Nordic's contract manufacturing organisation (CMO) in Germany. As part of this, the processes at both Kvistgaard and the facilities of IDT were validated, and they meet both European and US regulatory requirements. The extensive analysis programme required for the vaccine to be approved for use in humans has been completed. The first batches of IMVAMUNE® were released in the fourth quarter of 2007 for use in clinical trials.

The extensive safety measures at the Kvistgaard facility required to obtain approval by the US authorities were completed in the fourth quarter of 2007 and have been approved by the US authorities.

The facility at Kvistgaard with its quality control laboratory and its quality assurance department were inspected by the Danish Medicines Agency in the autumn of 2007. The inspection proved that everything was wholly satisfactory.

As part of its continuing efforts to improve its vaccine production technology, Bavarian Nordic has entered into collaboration with French-based Vivalis to explore the potential of cultivating the MVA-BN® virus in permanent stem cell lines. Furthermore, Bavarian Nordic has begun the development of new technologies for the purification of the MVA-BN® virus.

Bavarian Nordic's production facility in Berlin, Germany, has made a number of batches for use in clinical trials.

# Environment

Since the establishment of its production facility at Kvistgaard, Bavarian Nordic has been required by Danish law to prepare annual green accounts. The green accounts from previous years can be downloaded from the corporate website. In April 2008, the Company will issue its third set of green accounts, which contain a detailed description of the environmental factors relating to the production of vaccines.

In its design and planning of the Kvistgaard facility, Bavarian Nordic focused on implementing cleaner technology through development and adjustment of the technology used. Its efforts included a focus on reducing the environmental impact from production by reducing energy consumption as well as the use of subsidiary materials. The Company continues to focus on reducing its environmental impact from operations and has, among other things, described its environmental management activities based on ISO 14001. In addition, the Company continues to promote environmentally conscious behaviour and pollution prevention throughout the organisation.

In 2007, the facility at Kvistgaard was inspected by the Environmental Centre Roskilde and the Municipality of Elsinore. The inspections did not give rise to any emphasis of restrictions, and Bavarian Nordic was even classified as a Category 1 company by the Environmental Centre Roskilde with the following motivation:

*"The Company has formulated environmental targets and involved its employees in its environmental work. In addition, procedures are in place for corrective action with respect to complying with the terms and conditions of the environmental approval. Thus the Company has medium-level systematics. The Company's degree of legal compliance is high: it has received no warnings over the past two years.*
*Accordingly, the Company is classified as Category 1."*

### Category 1 company:

**Category 1 comprises companies which are at the forefront of environmental activities, among other things by involving their employees in the environmental activities, procedures for corrective action and a high level of compliance with the rules and regulations.**

# Organisational development

## Flexible working conditions, freedom with responsibility and comprehensive challenges create a great work environment

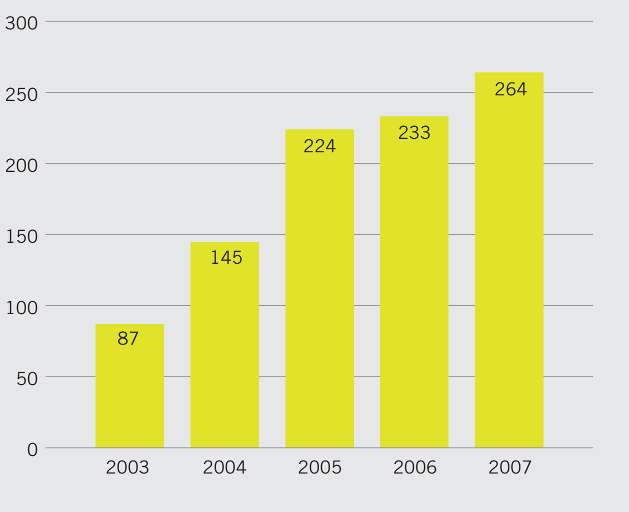
The year 2007 was designated a year of employee well-being at Bavarian Nordic, i.e. a year with a focus on employee satisfaction and engagement. The Company ranks high in internal measurements of staff well-being, and the number of days lost to illness is low. Furthermore, the Company has a very high retention rate (90%), which is not least due to the high level of flexibility, freedom under accountability, and versatile and challenging workdays. The working environment is good at all locations, as are intercollegial relations.

The number of employees rose from 233 to 264 at year-end. New employees were mainly recruited for research and development and for technical operations (production). In 2008, additional employees are expected to be recruited for technical operations as a result of the start-up of production for the US order.

### Management changes

New faces were seen in management in 2007. In August, Anders Hedegaard joined Bavarian Nordic as new president and CEO, replacing Peter Wulff, who wished to step down. Nicolai Buhl Andersen was appointed Executive Vice President Commercial Affairs, joining the Company on 16 November to become a member of the Group Management. Finally, CFO Hans Christian Teisen resigned to seek new challenges outside Bavarian Nordic, leaving the Company at the end of February 2008.

**Trends in employee numbers**

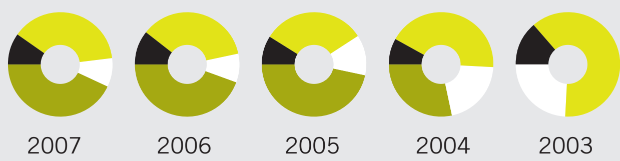



**Employee breakdown by geography**

| | 2007 | 2006 | 2005 | 2004 | 2003 |
|---|---|---|---|---|---|
| Denmark | 120 | 105 | 121 | 66 | 34 |
| Germany | 121 | 107 | 99 | 79 | 53 |
| USA | 22 | 20 | 3 | 0 | 0 |
| Singapore | 1 | 1 | 1 | 0 | 0 |
| Total | 264 | 233 | 224 | 145 | 87 |

**Employee breakdown by function**

| | 2007 | 2006 | 2005 | 2004 | 2003 |
|---|---|---|---|---|---|
| Corporate Management and staff functions | 20 | 25 | 20 | 12 | 12 |
| Research/development | 107 | 84 | 72 | 62 | 54 |
| Administrative and commercial affairs | 24 | 21 | 28 | 30 | 21 |
| Technical operations | 113 | 103 | 104 | 41 | 0 |
| Total | 264 | 233 | 224 | 145 | 87 |




Graphic representation of above figures: The circle represents the total figure and the colours represent the proportions by staff category.

- Corporate Management and staff functions
- Research and development
- Administrative and commercial affairs
- Technical operations

# Corporate Governance

Bavarian Nordic continuously evaluates developments in corporate governance and best practice in relation to the Company's business areas.

The "Rules for Issuers" recommend that companies listed on the OMX Nordic Exchange Copenhagen comment in their annual reports on their position relative to the Corporate Governance Recommendations, also by applying the "comply or explain" principle.

The management of Bavarian Nordic believes that the Company is operated in compliance with guidelines and recommendations that support the Company's business model and can create value for Bavarian Nordic's stakeholders. Management monitors regularly and at least once a year adherence to the corporate governance principles in order to ensure the best possible utilisation of and compliance with the recommendations and legislation.

The information to be provided in accordance with the recommendations has to the greatest possible extent been incorporated as an integral part of the other sections of this annual report, except as stated below. Below are also explanations of areas in which the Company has decided to deviate from the recommendations.

For more information, please see supplementary disclosures on our corporate website.

**The Company does not follow the following corporate governance recommendations**

*It is recommended that the company agree on a retirement age for members of the supervisory board*

The Company has not fixed an age limit for Board members. The Board is composed of competent and experienced persons, each of whom contribute to the Company's growth and management. The Board members are elected by the Company's shareholders. The other members of the Company's management have no objections to the way the Board members handle their work, and the shareholders demonstrate their confidence in the Board by electing or re-electing them. Consequently, the Company has found no reason to set an age limit. This issue is evaluated regularly as part of the overall assessment of the work of the Board and the management.

*It is recommended that the supervisory board consider and decide whether to establish committees, including nomination, remuneration and audit committees.*

The Board of Directors has not currently established any separate sub-committees. The Company's rules of procedure allow sub-committees to be set up, a measure which has previously been employed.

The Company has not established an audit committee. The Board of Directors regularly consider whether the Company's accounting and audit matters are of a nature that would necessitate such a committee.

*It is recommended that the supervisory board adopt a remuneration policy and that the company disclose the contents of such policy in its annual report and on the company's website.*

The Company does not have a formalised remuneration policy as this is not considered to serve its purpose. The shareholders approve the remuneration of the Board of Directors at the annual general meeting, and the Board of Directors determines the remuneration of the Corporate Management and, in consultation with the Corporate Management, the remuneration of the executive vice presidents. When setting the remuneration, the Company considers the interests of the Company and its shareholders. Furthermore, the Company ensures that the remuneration is at a reasonable level considering the tasks and the responsibility that are managed. The Company has approved guidelines for incentive plans for the Board of Directors and Corporate Management, which contain detailed instructions on the use of this form of remuneration.

The Company does not only use warrants in the remuneration of the Corporate Management but also for the Board of Directors. The Company jugdes that warrants ensures convergence between the structure of the Board's remuneration and the shareholders interests.

# Risk management

It is Company strategy with respect to risk management to work continually to identify material risks that could affect the Company's work, future performance or goals or the interests of the shareholders, so that the Company is run in accordance with best practice in the Company's area of business.

The Company has set up internal systems for this purpose and also uses external advisers to assist in the constant assessment and updating work. The Board of Directors regularly monitor reporting on these initiatives, and their work is then included in the Board's assessments and decisions about the Company's activities and future.

In connection with signing of the agreement with the US health authorities for delivery of smallpox vaccine to the United States and, thus, start-up of commercial production at the Kvistgaard facility, there was special focus in 2007 on physical security and emergency preparedness procedures at the production facility. In addition, the Company made a special effort in 2007 to strengthen its collaboration with third-party suppliers etc. for production in order to reduce operational risks. These activities will continue in 2008. The Company also began a complete review and evaluation of its insurance portfolio in 2007.

When he took office in August 2007, the Company's new CEO initiated a long-term strategy process, which was completed in the spring of 2008. This process is intended to help chart the Company's development course and will also help identify and counter the Company's long-term risks.

### Risk factors

Expectations and assumptions in the annual report concerning Bavarian Nordic's business, the market for smallpox vaccines, and Bavarian Nordic's revenue, accounting results and expected market share are subject to substantial uncertainty. There is no guarantee that Bavarian Nordic will wholly or partly achieve its expectations for revenue or its accounting result. The major uncertainties include, but are not limited to:

- Developments in demand and prices for smallpox vaccine
- Bavarian Nordic's production capacity and subcontractors
- Government approval of the required licences and permits necessary for vaccine production at the Kvistgård facility
- Changes in the competition environment
- Maintenance of existing and pending patent protection
- Results of clinical trials
- Requirements as to vaccine specifications and end products
- Liability/indemnification claims from governments

Bavarian Nordic's operational risks include, but are not limited to, the ability to enter into collaborations with partners for development, manufacturing, marketing and financial resources. There are additional risks related to sales contracts and the related production.

Currency risk includes the risk arising because sales and production contracts are in US dollars and other currencies and the cost base is primarily in Danish kroner. Contracts in currencies other than the US dollar do not represent significant currency risks. Bavarian Nordic is primarily exposed to interest rate risk through interest-bearing assets and obligations. The liquidity surplus is primarily invested in short-term solid credit-rated bonds in Danish kroner or euros or by fixed deposits in Danish kroner, euros or US dollars.

The intellectual property position on matters relating to biopharmaceuticals and bio-technological innovation is uncertain and involves complex legal and factual issues. There can be no assurance that Bavarian Nordic can successfully defend the validity of its patents or oppose infringement claims.

Delays or intervention by the authorities in future or ongoing clinical trials can also have a substantial impact on Bavarian Nordic's operations and financial position

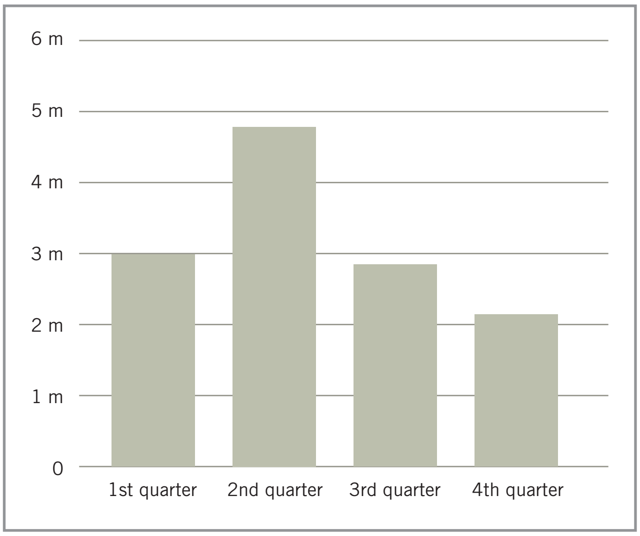
# Shareholder information

## Communication with investors is enhanced by a couple of new initiatives

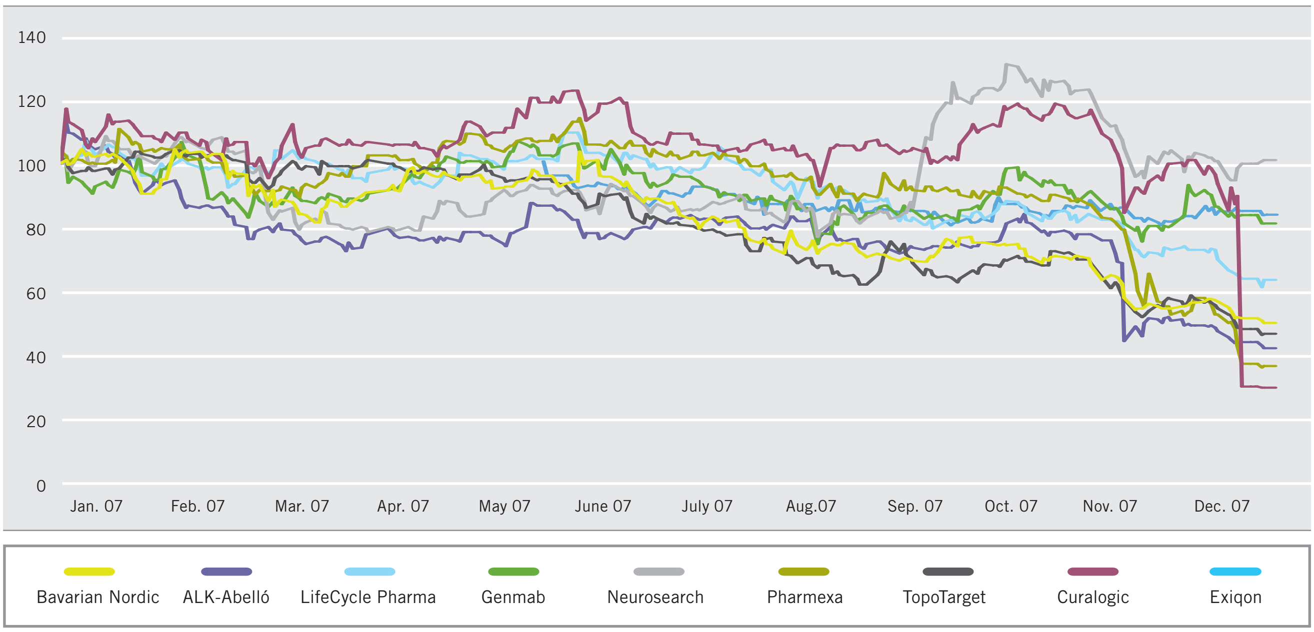
The year 2007 was a challenging year on the equity market for Bavarian Nordic's shares and for Danish biotech shares in general. The price of the Company's share fell by almost 50% over the year from DKK 582 per share at the beginning of the year to DKK 293 per share at the end of the year.

Despite the unqualified success that the Company obtained in 2007 via the recognition from the RFP-3 contract, this is not reflected in the Company's share price. Immediately after the award of the contract, the Company's share price peaked at 605, but subsequently there was, as expected, profit-taking amongst shareholders who bought at significantly lower prices. The unrest in the international financial market caused by the credit crisis and a fear of recession in the United States has caused a hesitative market, which in particular has created a negative climate for risk investments, including biotech shares. The significant decrease in trading volume in the Bavarian Nordic share causes even minor sell-offs to influence negatively on the share price.

**Trading volume in the Bavarian Nordic share in 2007**




**Performance of Danish Biotech shares in 2007:**



It is clear from the graph (page 22), with the exception of one company, the Danish biotech shares have suffered a major fall in prices. There has been a tendency towards the different companies dragging each other down, thus making it difficult for anyone to gain distinction in the market.

### Technology value

The 50 % depreciation in Bavarian Nordic's shares in 2007 lowered the Company's market capitalisation by 38 % from DKK 3,711 million at year-end 2006 to DKK 2,290 million at year-end 2007. The market capitalisation decrease is lower than the decrease in the price of the shares because of a capital increase made in early 2007.

**Bavarian Nordic's technology value**

| Amounts in mDKK. As of 31 December | 2005 | 2006 | 2007 |
|---|---|---|---|
| Market capitalisation | 2,759 | 3,711 | 2,290 |
| Cash, equivalents and securities | 383 | 333 | 913 |
| **Technology value** | **2,376** | **3,378** | **1,377** |
| Change compared to previous year | | + 42 % | - 59 % |

Another way of assessing the value of the Company's development programmes in 2007 is to look at the development in the Company's technology value or the equity market's opinion of the Company's pipeline and potential. The technology value is calculated by deducting the Company's cash and cash equivalents and securities from the market capitalisation. The technology value dropped by 59 % in 2007. Thus the fall in the share price has happened despite the fact that the Company's financial base is stronger than ever due to advance- and milestone payments received under the RFP-3 contract.

### Bavarian Nordic's core data as of 31 December 2007

| | |
|---|---|
| Stock exchange | OMX Nordic Exchange Copenhagen |
| Share capital | DKK 78,155,680 |
| Number of shares | 7,815,568 |
| Class of shares | One class |
| Nominal value | DKK 10 |
| Bearer security | Yes |
| Ownership and voting right restrictions | No |
| ID code | DK0015998017 |

Bavarian Nordic is included in the MidCap+ segment on the OMX Nordic Exchange Copenhagen.

### Capital increase

In March 2007 the Company successfully completed a rights issue increasing the equity and cash preparedness by net DKK 443 million. The rights issue added 1,275,236 new shares to the share capital. The new shares were offered with pre-emption rights to Company shareholders at the ratio of 5:1 with a subscription price of DKK 365 per share.

Share capital was increased again in May 2007, this time by 164,152 shares with a nominal value of DKK 10 per share as a consequence of exercise of the 2004 warrant programme by directors, management and employees in the Company and its subsidiaries. Of the new shares, 155,603 were subscribed at DKK 283 per share and 8,549 were subscribed at DKK 437 per share. Net proceeds of DKK 47.7 million were generated. The new shares were subscribed without pre-emptive rights for existing shareholders.

### Ownership

As of 31 December 2007, Bavarian Nordic had 11,798 registered shareholders owning 5,889,906 shares, which corresponds to 75 percent of the share capital. In 2007 the number of registered shareholders increased by 3,718.

Bavarian Nordic invites its shareholders to have their shares registered with the Company.

The following shareholders had publicly informed Bavarian Nordic that they owned five percent or more of the Company's shares:
A.J. Aamund A/S, Copenhagen (DK), 17.1%
PKA, Gentofte (DK), 5.8%
Bavarian Nordic does not hold any of its own shares.

### Internal rules and definition of insiders

In compliance with Danish securities legislation, Bavarian Nordic has adopted four sets of internal rules governing inside information, the obligation to disclose, and trading in Bavarian Nordic shares. The internal rules are drafted in accordance with the regulations for internal irules set out by the OMX Nordic Exchange Copenhagen. The Company's rules were extensively updated in 2005 and are evaluated regularly.

**Financial Calendar 2008**

| | |
|---|---|
| 31 March | 2007 Annual accounts |
| 29 April | Annual General Meeting |
| 29 April | First quarterly report (Q1) for the three-month period ended 31 March 2008 |
| 19 August | Half-year report (Q2) for the six-month period ended 30 June 2008 |
| 4 November | Third quarterly report (Q3) for the nine-month period ended 30 September 2008 |

Bavarian Nordic maintains a record of Bavarian Nordic insiders and has established procedures for registering and monitoring insider trading in the Company's shares.

Bavarian Nordic defines its insiders as members of the Board of Directors and Corporate Management, directors and other employees in Denmark, as well as persons who, by virtue of their affiliation with the Company, are considered to have access to inside information about Bavarian Nordic.

### Dividend policy

Bavarian Nordic does not expect to declare dividends until the Company has achieved an adequate capital base. However, the Company continues to strive towards securing an adequate capital base for future dividend payments. The Board of Directors will propose at the Annual General Meeting on 29 April 2008 that no dividends be paid.

### Annual General Meeting

The 2008 Annual General Meeting will be held at 4 pm on Tuesday, 29 April 2008, at the Radisson SAS Scandinavia Hotel, Amager Boulevard 70, 2300 Copenhagen S, Denmark.

### Proposals for Annual General Meeting 2008

Proposals to be made by the Board of Directors include:

- Re-election of current Board members
- Re-election of one auditor
- Authorisation to the Board to issue warrants
- Authorisation to the Board of Directors to acquire its own shares in the Company on behalf of the Company.
- Approval of general guidelines for an incentive policy
- Proposals from shareholders

## Investor relations

Through its investor relations policy, the Company wishes to comply with the general requirements and recommendations of the OMX Nordic Exchange Copenhagen. The Company seeks to do so by, among other things, ensuring timely and correct communication about relevant economic, financial, operational and scientific affairs of the Company.

Bavarian Nordic wishes to continue to develop its dialogue with the Company's shareholders, analysts, prospective investors and other stakeholders by providing open, honest and accessible information.

### Roadshows and investor meetings abroad

The management and the investor relations team work hard to present Bavarian Nordic to international institutional investors, analysts and the media. These activities will be given higher priority with the aim of attracting more international investors, including investors from the United States, so as to ensure that the shareholder base better reflects the geographic diversification of the Company's activities and future sales. Over the past year, Bavarian Nordic's roadshows travelled to venues such as Paris, Frankfurt, Scandinavia, Zurich, Geneva, London, New York, Boston and Asia. The Company also participates in a number of conferences.

Bavarian Nordic is also presented to private investors in Denmark. This is done in collaboration with other Danish biotech and pharmaceutical companies and investment banks. Bavarian Nordic often participates in shareholder events and meetings for private investors. In order to promote good relations with the local community, local shareholders and stakeholders are occasionally invited for an evening presentation at Bavarian Nordic.

To ensure that an efficient and suitable dialogue is maintained with the shareholders, Bavarian Nordic invites its shareholders to have their shares registered with the Company.

### E-mail service

Bavarian Nordic invites investors and other stakeholders to register for the Company's e-mail service at its corporate website: www.bavarian-nordic.com, under "Investor Relations". As a subscriber to this service, you will automatically receive Bavarian Nordic's announcements immediately after publication.

## Incentive programmes

Bavarian Nordic has introduced long-term incentive plans for Corporate Management and all employees in Bavarian Nordic A/S and Bavarian Nordic GmbH. The incentive programme consists of the award of phantom shares and warrants. Furthermore, warrant schemes have been introduced for employees in the U.S. An overview of these is found in note 21.


## Contact Investor Relations

The Company's investors and other stakeholders are always welcome to contact Investor Relations at Bavarian Nordic's headquarters or by e-mail.

**Rolf Sass Sørensen** Vice President Investor Relations
Phone: +45 33 26 83 83
E-mail: investor@bavarian-nordic.com

# Financial review 2007

Unless otherwise stated, the financial review is based on the consolidated financial information for the year ended 31 December 2007 as included in this Annual Report with comparative figures for 2006 in brackets. The accounting policies are unchanged from the Annual Report for 2006.

A pre-tax loss of DKK 50.5 million (DKK 204.8 million) was recorded for the year, which was in line with our guidance in the nine-month interim report published on 6 November 2007.

The increase in revenue in 2007 was achieved as the Group completed two milestones of USD 25 million each as part of the RFP-3 contract awarded in June 2007. This improved both consolidated revenue and profit for the year.

The Group's free net liquidity was strengthened in 2007 and stood at DKK 833.6 million at the end of the year (DKK 217.7 million). The improvement was attributable to a rights issue made in March 2007, the exercise of warrants by employees and management, and advance and milestone payments received under the RFP-3 contract. The rights issue in March 2007 resulted in an increase of equity and liquidity by the net proceeds of DKK 443.5 million. In May, net proceeds of DKK 47.7 million were received from the exercise by management and employees of warrants granted in 2004. Moreover, advance and milestone payments from the US health authorities under the RFP-3 contract totalled USD 100 million.

Equity was DKK 1,217.7 million at 31 December 2007 (DKK 691.4 million).

## Income statement

### Revenue

Bavarian Nordic generated revenue of DKK 332.1 million in 2007 (DKK 175.3 million).  The revenue was primarily composed of revenue from the ongoing contracts with the US health authorities (development contracts RFP-1 and RFP-2) and two milestone payments under the RFP-3 contract.

### Production costs

Production costs, which amounted to DKK 64.5 million (DKK 136.3 million), include costs incurred to generate the recognised revenue and costs of external suppliers, payroll costs, depreciation and amortisation.

### Research and development costs

Research and development costs totalled DKK 243.6 million (DKK 118.4 million) excluding capitalised expenses. The development costs primarily consisted of in-house payroll costs and costs related to projects. The increase in costs compared with 2006 was primarily the result of costs incurred for the development of processes at the Kvistgaard production facility.

### Sales costs and administrative expenses

Sales costs and administrative expenses in 2007 totalled DKK 89.1 million (DKK 124.4 million). The year-on-year fall in costs was primarily due to the completion of lawsuits.

### Financial items

During 2007, Bavarian Nordic posted net financial income of DKK 14.5 million (net expense of DKK 1.0 million). The increase was a result of the strong improvement of the Group's liquidity position compared with 2006.

### Income before tax

Bavarian Nordic recorded a loss before tax of DKK 50.5 million (a loss of DKK 204.8 million).

### Tax

Due to the reduction of the company tax rate in Denmark, the book value of the company's deferred tax asset was reduced by DKK 15.4 million, which has resulted in a tax charge on the company's net result for 2007.

### Net profit

A net loss of DKK 63.5 million after tax was posted in 2007 (a loss of DKK 160.9 million). It is proposed that the loss be transferred to free reserves.

### Balance sheet

The balance sheet total was DKK 1,732.1 million at 31 December 2007 (DKK 954.4 million). The increase was primarily the result of an increase in cash and cash equivalent, which increased significantly as a result of the rights issue, exercise of warrants and advance and milestone payments under the RFP-3 contract.

### Assets

Non-current assets stood at DKK 538.8 million (DKK 568.2 million). The fall was primarily due to depreciation as a result of the completion of the production facilities at Kvistgaard. Development costs for IMVAMUNE® have been capitalised by DKK 16.9 million in 2007 under intangible assets as asset under construction.

Based on the contracts already concluded and expectations for

future operations, the tax assets at the end of 2007 are recognised in the balance sheet at the amount of DKK 135.1 million (DKK 146.9 million).

Inventories amounted to DKK 11.6 million (DKK 12.9 million). Inventories consisted of raw materials for production at the Kvistgaard facility.

Receivables stood at DKK 268.0 million (DKK 40.6 million), Most of these receivables are from the US health authorities and an unrealised gain on financial instruments used to hedge future cash flows.

In 2007, Bavarian Nordic's cash and cash equivalents were invested in short-term government and mortgage bonds denominated in Danish kroner and euros, and ordinary or fixed-term bank deposits in Danish kroner and US dollars. As of 31 December 2007, free cash and cash equivalents stood at DKK 833.6 million (DKK 217.7 million).

The fixed-term deposits are denominated in Danish kroner and are at interest rates reflecting bond yields. The investments in bonds were also denominated in Danish kroner at year-end 2007.

Out of the total cash and cash equivalents and securities, DKK 80 million (DKK 115 million) has been provided in security of loans with banks.

### Equity

After the transfer of the loss for the year, equity stood at DKK 1,217.7 million (DKK 691.4 million). The DKK 526.3 million increase was attributable to the net proceeds of DKK 443.5 million from the rights issue and proceeds of DKK 47.7 million from the exercise of warrants. In addition positive value adjustments of financial instruments to hedge future cash flows were recognised in equity in an amount of DKK 94.1 million.

### Creditors

The Group's borrowings fell by DKK 53.0 million in connection with ordinary repayment of debt. Trade creditors amounted to DKK 21.6 million (DKK 19.7 million). Other creditors totalled DKK 65.6 million (DKK 38.1 million).

In connection with the award of the RFP-3 contract in 2007, an advance payment was received from the US health authorities in 2007. The advance payment is subject to a repayment requirement if Bavarian Nordic does not meet its requirements under the contract and is recognised as a current liability and will be recognised in the income statement as delivery of the doses to fulfil the contract takes place.

# Management

Bavarian Nordic is managed under a two-tier structure composed of the Board of Directors and the Corporate Management.

The Board of Directors consists of four external members elected by the shareholders at the Annual General Meeting for terms of one year. The Board elects a chairman from among its members. The Board is responsible for the overall management of the Company, which includes appointing the Corporate Management, ensuring responsible organisation of the Company's business, establishing the corporate strategy and evaluating the Company's financial situation.

The Board plans to hold five or six meetings each year. In 2007, the Board held seven meetings. Corporate Management and certain senior employees of Bavarian Nordic usually attend the Board meetings. The Board continually receives reports from Corporate Management on the status of the Company's operations and business. The Chairman of the Board and the Company's legal advisor evaluate the performance of the Board and Corporate Management on an annual basis. The result is presented to and discussed by the Board.

Corporate Management is Anders Hedegaard, the Company's President and CEO. Moreover, there are four executive vice presidents who assist Corporate Management in the day-today operations of the Company. Corporate Management is responsible for the day-to-day management of the Company, observing the guidelines and recommendations issued by the Board of Directors. Corporate Management holds monthly meetings with the executive vice presidents to coordinate the day-to-day management activities. Monthly meetings are also held with the management teams of the subsidiaries. One or more members of the Corporate Management, executive vice presidents or senior employees of the Company are represented on the boards of directors of the Company's subsidiaries.

## Board of Directors

**Asger Aamund**
Born in 1940.
President and CEO of A. J. Aamund A/S.
Chairman of the Board since establishment in 1994.

Chairman of the board for NeuroSearch A/S and BankInvest Biomedical Venture Advisory Board. Member of the board for A. J. Aamund A/S, Modern Times Group MTG AB in Stockholm and the World Wildlife Foundation (WWF).

Holding of shares in Bavarian Nordic: 1,334,099
Number of warrants: 10,279

**Eigil Bjerl Nielsen**
Born in 1937.
Joined the Board in 1994.

Chairman of the board of Vipergen ApS.

*Eigil Bjerl Nielsen is a co-founder and has been chairman of the board for several biotechnology companies in the USA, Australia and the UK.*

Holding of shares in Bavarian Nordic: 34,718
Number of warrants: 10,279

**Erling Johansen**
Born in 1944.
Joined the Board in 2000.

Member of the board of Cyncron A/S.

*Eigil Bjerl Nielsen is a co-founder and has been chairman of the board for several biotechnology companies in the USA, Australia and the UK.*

Holding of shares in Bavarian Nordic: 2,396
Number of warrants: 10,279

**Flemming Pedersen**
Born in 1965.
President and CEO of Neurosearch A/S.
Joined the Board in 2006.

Chairman of the board for Atonomics A/S and Sophion Bioscience A/S.
Member of the boards of MBIT Consulting A/S and Astion Pharma A/S. President and CEO of Naapster Aps.

Holding of shares in Bavarian Nordic: 0
Number of warrants: 10,279

# Group Management

**Anders Hedegaard**
**President and CEO**
MSc in Chemical Engineering. Born in 1960.
Joined Group Management in 2007

Chairman of the board for Bavarian Nordic Inc., Bavarian Nordic Holding Inc. and BN ImmunoTherapeutics Inc.

*Anders Hedegaard previously held various executive positions in ALK-Abelló A/S, Novo Nordisk A/S.*

**Paul Chaplin**
**Executive Vice President, Research and Development, CSO**
MSc in Biology, ph.d. in Immunology. Born in 1967.
Joined Group Management in 2001.

Member of the board for Bavarian Nordic Inc. and BN ImmunoTherapeutics Inc. Managing Director of Bavarian Nordic GmbH.

*Paul Chaplin previously worked for several years at the Institute for Animal Health in the UK in the areas of cytokine and dendritic cell biology and in the research and development of veterinary vaccines at CSIRO in Australia.*

**Nicolai Buhl Andersen**
**Executive Vice President, Commercial Affairs**
MSc in Economics and Business Administration.
Born in 1969.
Joined Group Management in 2007.

*Nicolai Buhl Andersen has many years of international experience in leading positions in the field of sales and marketing from Coloplast and Novo Nordisk.*

**René Djurup**
**Executive Vice President, Technical Operations, CTO**
Born in 1951.
Joined Group Management in 2003.

*René Djurup was CEO of Leukotech A/S, a Danish biotech company and previously worked for many years at Novo Nordisk A/S holding management positions.*

**Morten Max Rasmussen**
**Executive Vice President, Transactions, Legal and IPR**
Cand. jur. Born in 1963.
Joined Group Management in 2005.

Member of the Board of Bavarian Nordic Inc.

*Morten Max Rasmussen worked for several years at Danisco A/S as an attorney. During the latter part of his career at Danisco, he was based in London acting as general counsel for Danisco UK.*

# Statement from the Board of Directors and Corporate Management

The Board of Directors and the President of the Company have considered and approved the Annual Report of Bavarian Nordic A/S for the year 2007. The Annual Report has been prepared in accordance with International Financial Reporting Standards (IFRS) and additional Danish reporting requirements for companies quoted on the stock exchange. In our opinion, the accounting policies applied are appropriate and the Annual Report gives a true and fair view of the Company's and the Group's assets, liabilities, financial position, results of operations and cash flow.

In our opinion, the management report contains a description of the major risks and uncertainties that the Group and Company faces.

We recommend that the Annual General Meeting approve the Annual Report.

Kvistgård, 31 March 2008

**Corporate Management**

Anders Hedegaard
President & CEO

**Bestyrelse**

| | | | |
|---|---|---|---|
| Asger Aamund<br>Chairman | Eigil Bjerl Nielsen | Erling Johansen | Flemming Pedersen |

# Independent auditor's report

## To the shareholders of Bavarian Nordic A/S

We have audited pages 2 to 63 of the annual report of Bavarian Nordic A/S for the financial year 1 January to 31 December 2007, which comprises the statement by Management on the annual report, Management's review, income statement, balance sheet, statement of changes in equity, cash flow statement and notes, including the accounting policies, for the Group as well as the parent company.

The annual report has been prepared in accordance with International Financial Reporting Standards as adopted by the EU and additional Danish disclosure requirements for listed companies.

### Management's responsibility for the annual report

Management is responsible for the preparation and fair presentation of an annual report in accordance with International Financial Reporting Standards as adopted by the EU and additional Danish disclosure requirements for listed companies.

This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of an annual report that is free from material misstatement, whether due to fraud or error, and it includes selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

### Auditor's responsibility and basis of opinion

Our responsibility is to express an opinion on this annual report based on our audit. We conducted our audit in accordance with Danish and International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the annual report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the annual report. The procedures selected depend on the auditor's judgement, including an assessment of the risks of material misstatement of the annual report, irrespective of whether such misstatement is due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of an annual report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Management, as well as evaluating the overall presentation of the annual report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Our audit has not resulted in any qualification.

### Opinion

In our opinion, the annual report gives a true and fair view of the Group's and the parent company's financial position at 31 December 2007, and of their financial performance and their cash flows for the financial year 1 January to 31 December 2007 in accordance with International Financial Reporting Standards as adopted by the EU and additional Danish disclosure requirements for listed companies.

Copenhagen, 31 March 2008

**Deloitte**
Statsautoriseret Revisionsaktieselskab

| | |
|---|---|
| Jens Rudkjær<br>State Authorised<br>Public Accountant | Carsten Vaarby<br>State Authorised<br>Public Accountant |

# Income statements for the period 1 January - 31 December

| Note | Amounts in DKK thousands | Parent company 2007 | Parent company 2006 | Group 2007 | Group 2006 |
|---|---|---|---|---|---|
| 2 | Revenue | 332,103 | 175,292 | 332,103 | 175,292 |
| 3,4 | Production costs | 62,628 | 127,611 | 64,457 | 136,285 |
| | **Gross profit** | **269,475** | **47,681** | **267,646** | **39,007** |
| 3.4 | Research and development costs | 231,005 | 117,539 | 243,558 | 118.405 |
| 3,4,5 | Sales expenses and administrative costs | 76,052 | 112,916 | 89,114 | 124,368 |
| | **Total operating costs** | **307,057** | **230,455** | **332,672** | **242,773** |
| | **Income before interest and tax** | **(37,582)** | **(182,774)** | **(65,026)** | **(203,766)** |
| 6 | Financial income | 25,888 | 14,770 | 25,707 | 14,978 |
| 7 | Financial expenses | 11,171 | 15,592 | 11,174 | 16,005 |
| | **Income before company tax** | **(22,865)** | **(183,596)** | **(50,493)** | **(204,793)** |
| 8 | Tax on income for the year | 9,805 | 46,730 | 13,011 | 43,856 |
| | **Net profit for the year** | **(32.670)** | **136.866** | **(63,504)** | **(160,937)** |
| | **Distribution of result** | | | | |
| | Parent company´s part of the result | | | (59,972) | (158,040) |
| | Minority interest | | | (3,532) | (2,897) |
| | | | | **(63,504)** | **(160,937)** |
| | **Distribution of earnings:** | | | | |
| | **Proposal for distribution of earnings** | | | | |
| | Retained earnings | **(32,670)** | **(136,866)** | | |
| | **Earnings per share (EPS) - DKK** | | | | |
| 9 | -basic earnings per share of DKK 10.00 | | | **(8)** | **(26)** |
| 9 | -diluted earnings, per share of DKK 10.00 | | | **(8)** | **(26)** |

# Cash flow statements for the period 1 January - 31 December

| Amounts in DKK thousands | Parent company 2007 | Parent company 2006 | Group 2007 | Group 2006 |
|---|---|---|---|---|
| **Earnings before interest and tax** | **(37,582)** | **(182,774)** | **(65,026)** | **(203,766)** |
| Depreciations, amortisation and write-down | 34,219 | 10,900 | 40,139 | 17,950 |
| Share-based payment | 4,643 | 1,170 | 4,983 | 1,170 |
| Changes in inventories | 1,568 | (3,198) | 1,261 | (3,253) |
| Changes in receivables | (145,992) | (12,668) | (132,477) | 1,852 |
| Changes in provisions | - | - | (3,632) | (2,565) |
| Changes in current liabilities | 286,907 | 29,180 | 305,463 | 4,466 |
| **Cash flow from operating activities** | **143,763** | **(157,390)** | **150,711** | **(184,146)** |
| Financial income | 25,888 | 14,770 | 25,707 | 14,978 |
| Financial expenses | (11,171) | (15,592) | (11,174) | (16,005) |
| Paid taxes during the year | - | - | (2,079) | (9,320) |
| **Cash flow for activities** | **158,480** | **(158,212)** | **163,165** | **(194,493)** |
| Investments in intangible assets | (16,941) | (245) | (16,941) | (245) |
| Investments in tangible assets | (3,766) | (68,325) | (5,768) | (73,914) |
| Investments in financial assets | 13 | (40,144) | 69 | (236) |
| Investments in securities | 6,518 | (117,800) | 6,518 | (117,800) |
| **Cash flow for investment activities** | **(14,176)** | **(226,514)** | **(16,122)** | **(192,195)** |
| Payment on mortgage debt | (1,327) | (1,270) | (1,327) | (1,270) |
| Payment on financial leasing liabilities | (14,554) | (9,897) | (14,554) | (9,897) |
| Winding up bank loan | (35,000) | - | (35,000) | - |
| Proceeds from issue of new shares | 465,461 | 237,441 | 465,461 | 237,441 |
| Expenses regarding issue of new shares | (21,978) | (7,233) | (21,978) | (7,233) |
| Proceeds from exercise of warrant programme | 47,772 | - | 47,772 | - |
| **Cash flow from financing activities** | **440,374** | **219,041** | **440,374** | **219,041** |
| **Net changes in cash and cash equivalents of period** | **584,678** | **(165,685)** | **587,417** | **(167,647)** |
| **Cash as of 1 January** | **98,441** | **264,126** | **101,366** | **269,013** |
| **Cash, end of period** | **683,119** | **98,441** | **688,783** | **101,366** |
| Securities - highly liquid bonds | 224,804 | 231,322 | 224,804 | 231,322 |
| Trusted/pledged funds | (80,000) | (115,000) | (80,000) | (115,000) |
| Credit lines | 20,000 | 20,000 | 20,000 | 20,000 |
| **Cash preparedness** | **847,923** | **234,763** | **853,587** | **237,688** |

# Balance sheet - Assets

| Note | As of 31 December. Amounts in DKK thousands | Parent company 2007 | Parent company 2006 | Group 2007 | Group 2006 |
|---|---|---|---|---|---|
| | **Non-current assets** | | | | |
| 10 | Purchased rights | 3,138 | 3.586 | 3.138 | 3,586 |
| 10 | Software | 4,276 | 9,193 | 4,284 | 9,383 |
| 10 | Intangible assets under construction | 16,941 | - | 16,941 | - |
| | **Intangible assets** | **24,355** | **12,779** | **24,363** | **12,969** |
| 11 | Land and buildings | 159,198 | 164,332 | 159,198 | 164,332 |
| 11 | Leasehold improvements | - | - | 2,461 | 2,511 |
| 11 | Plant and machinery | 200,582 | 221,524 | 200,582 | 221,524 |
| 11 | Machinery, equipment and furniture | 3,591 | 5,294 | 14,301 | 19,690 |
| 11 | Assets under construction | 2,691 | - | 2,691 | - |
| | **Tangible assets** | **366,062** | **391,150** | **379,233** | **408,057** |
| 12 | Investments in subsidiaries | 80,423 | 80,423 | - | - |
| | Other financial non-current assets | 7 | 20 | 167 | 236 |
| | **Financial assets** | **80,430** | **80,443** | **167** | **236** |
| 8 | **Deferred tax assets** | **134,027** | **143,832** | **135,058** | **146,972** |
| | **Total non-current assets** | **604,874** | **628,204** | **538,821** | **568,234** |
| | **Current assets** | | | | |
| 13 | Raw materials and supply materials | 9,594 | 11,162 | 11,621 | 12,882 |
| | **Inventories** | **9,594** | **11,162** | **11,621** | **12,882** |
| 14 | Trade receivables | 144,810 | 24,257 | 144,872 | 24,257 |
| | Receivables from subsidiaries | 27,819 | 12,979 | - | - |
| 16 | Other receivables | 109,841 | 6,115 | 110,551 | 7,499 |
| | Pre-payments and accrued income | 9,711 | 7,910 | 12,598 | 8,860 |
| | **Receivables** | **292,181** | **51,261** | **268,021** | **40,616** |
| 16 | Securities | 224,804 | 231,322 | 224,804 | 231,322 |
| 16 | Cash and cash equivalents | 683,119 | 98,441 | 688,783 | 101,366 |
| | **Total current assets** | **1,209,698** | **392,186** | **1,193,229** | **386,186** |
| | **Total assets** | **1,814,572** | **1,020,390** | **1,732,050** | **954,420** |

# Balance sheet - Equity and liabilities

| Note | As of 31 December. Amounts in DKK thousands | Parent company 2007 | Parent company 2006 | Group 2007 | Group 2006 |
|---|---|---|---|---|---|
| | Share capital | 78,156 | 63,762 | 78,156 | 63,762 |
| | Retained earnings | 1,096,358 | 647,552 | 1,046,061 | 624,217 |
| | Other reserves | 94,089 | - | 92,754 | (1,220) |
| | **Equity, parent company** | **1,268,603** | **711,314** | **1,216,971** | **686,759** |
| | Equity, minority interest | - | - | 692 | 4,640 |
| | **Equity total** | **1,268,603** | **711,314** | **1,217,663** | **691,399** |
| | **Liabilities** | | | | |
| 17 | Provisions | - | - | - | 1,620 |
| 18 | Credit institutions | 134,673 | 148,976 | 134,673 | 148,976 |
| | **Non-current liabilities** | **134,673** | **148,976** | **134,673** | **150,596** |
| 17 | Provisions | - | - | 670 | 2,682 |
| 18 | Credit institutions | 15,161 | 51,739 | 15,161 | 51,739 |
| 19 | Prepayment from customer | 276,640 | - | 276,640 | - |
| | Accounts payable | 17,420 | 18,040 | 21,588 | 19,689 |
| | Payables to subsidiaries | 44,183 | 58,243 | - | - |
| | Company tax | - | - | 55 | 230 |
| | Other debts | 57,892 | 32,078 | 65,600 | 38,085 |
| | **Current liabilities** | **411,296** | **160,100** | **379,714** | **112,425** |
| | **Total liabilities** | **545,969** | **309,076** | **514,387** | **263,021** |
| | **Total liabilities and shareholders´ equity** | **1,814,572** | **1,020,390** | **1,732,050** | **954,420** |

16 Financial risks and financial instruments
20 Related party transactions
21 Warrant programme and phantom share programme
22 Contingent liabilities, contractual obligations

# Statement of changes in equity - Parent company

| Amounts in DKK thousands | Share capital | Retained earnings | Reserves for fair value of financial instruments | Equity total |
|---|---|---|---|---|
| **Shareholders´ equity as of 1 January 2007** | **63,762** | **647,552** | | **711,314** |
| Fair value of financial investments | | - | 139,111 | 139.111 |
| Transfer of fair value to secured items | | - | (21,290) | (21.290) |
| Tax effect on hedging | | - | (23,732) | (23.732) |
| **Transactions recorded on equity** | **-** | **-** | **94,089** | **94,089** |
| Net profit for the year | | (32,670) | | (32,670) |
| **Net income for the year** | **-** | **(32,670)** | **94,089** | **61,419** |
| Proceeds from issue of new shares | 12,752 | 452,709 | - | 465,461 |
| Expenses from issues of new shares | - | (21,978) | - | (21,978) |
| Proceeds from issue of warrant programme | 1,642 | 46,130 | - | 47,772 |
| Share-based payment | - | 3,775 | - | 3,775 |
| Tax effect on equity transaction | - | 840 | - | 840 |
| **Other transactions** | **14,394** | **481,476** | **-** | **495,870** |
| **Shareholders´ equity as of 31 December 2007** | **78,156** | **1,096,358** | **94,089** | **1,268,603** |
| **Shareholders´ equity as of 1 January 2006** | **57,971** | **566,448** | **-** | **624,419** |
| Exchange rate adjustments | | 515 | - | 515 |
| **Transactions recorded on equity** | | **515** | **-** | **515** |
| Net profit for the year | | (136,866) | - | (136,866) |
| **Net income for the year** | | **(136,351)** | **-** | **(136,351)** |
| Proceeds from issue of new shares | 5,791 | 231,650 | - | 237,441 |
| Expenses from issues of new shares | | (7,233) | - | (7,233) |
| Adjustment on warrant programme | | 1,100 | - | 1,100 |
| Change in deferred tax regarding warrant programme | | (8,062) | - | (8,062) |
| **Other transactions** | **5,791** | **217,455** | **-** | **223,246** |
| **Shareholders´ equity as of 31 December 2006** | **63,762** | **647,552** | **-** | **711,314** |

Transactions on the share capital have been the following

| Amounts in DKK thousands | 2007 | 2006 | 2005 | 2004 | 2003 |
|---|---|---|---|---|---|
| Share capital as of 1 January | 63,762 | 57,971 | 46,395 | 45,145 | 45,145 |
| Issue of new shares | 14,394 | 5,791 | 11,576 | 1,250 | - |
| **Share capital as of 31 December** | **78,156** | **63,762** | **57,971** | **46,395** | **45,145** |

The share capital comprises a total of 7,815,568 shares of DKK 10 as of 31 December 2007 (2006: 6,376,180 shares).
The shares are not divided into share classes, and each share carries one vote.

# Statement of changes in equity - Group

| Amounts in DKK thousands | Share capital | Retained earnings | Reserves for adjustment | Reserves for fair value for financial instru-ments | Equity Parent company | Equity Minority | Equity Group |
|---|---|---|---|---|---|---|---|
| **Shareholders´ equity as of 1 January 2007** | **63,762** | **624,217** | **(1,220)** | **-** | **686,759** | **4,640** | **691,399** |
| Fair value of financial investments | | | - | 139,111 | 139,111 | - | 139,111 |
| Transfer of fair value to secured items | | | - | (21,290) | (21,290) | - | (21,290) |
| Tax effect on hedging | | | - | (23,732) | (23,732) | - | (23,732) |
| Exchange rate adjustments | | | (115) | - | (115) | (416) | (531) |
| **Transactions recorded on equity** | **-** | | **(115)** | **94,089** | **93,974** | **(416)** | **93,558** |
| Net profit for the year | | (59,972) | | | (59,972) | (3,532) | (63,504) |
| **Net income for the year** | **-** | **(59,972)** | **(115)** | **94,089** | **34,002** | **(3,948)** | **30,054** |
| Proceeds from issue of new shares | 12,752 | 452,709 | - | - | 465,461 | - | 465,461 |
| Expenses from issue of new shares | - | (21,978) | - | - | (21,978) | - | (21,978) |
| Proceeds from exercise of warrant programme | 1,642 | 46,130 | - | - | 47,772 | - | 47,772 |
| Share-based payment | - | 4,115 | - | - | 4,115 | - | 4,115 |
| Tax effect on equity transaction | - | 840 | - | - | 840 | - | 840 |
| **Other transactions** | **14,394** | **481,816** | **-** | **-** | **496,210** | **-** | **496,210** |
| **Shareholders´ equity as of 31 December 2007** | **78,156** | **1,046,061** | **(1,335)** | **94,089** | **1,216,971** | **692** | **1,217,663** |
| **Shareholders´ equity as of 1 January 2006** | **57,971** | **570,464** | **(206)** | **-** | **628,229** | **1,875** | **630,104** |
| Exchange rate adjustments | | - | (1,014) | | (1,014) | | (1,014) |
| **Transactions recorded on equity** | | **-** | **(1,014)** | **-** | **(1,014)** | **-** | **(1,014)** |
| Net profit for the year | | (158,040) | - | - | (158,040) | (2,897) | (160,937) |
| **Net income for the year** | | **(158,040)** | **(1,014)** | **-** | **(159,054)** | **(2,897)** | **(161,951)** |
| Proceeds from issue of new shares | 5,791 | 231,650 | - | - | 237,441 | - | 237,441 |
| Expenses from issue of new shares | | (7,233) | - | - | (7,233) | - | (7,233) |
| Transfer to minority interest | | (5,662) | - | - | (5,662) | 5,662 | - |
| Adjustment on warrant programme | | 1,100 | - | - | 1,100 | - | 1,100 |
| Warrant programme | | (8,062) | - | - | (8,062) | - | (8,062) |
| **Other transactions** | **5,791** | **211,793** | **-** | **-** | **217,584** | **5,662** | **223,246** |
| **Shareholders´ equity as of 31 December 2006** | **63,762** | **624,217** | **(1,220)** | **-** | **686,759** | **4,640** | **691,399** |

# 1. Accounting policies

## General information

**Basis of preparation**
The Annual Report of Bavarian Nordic A/S for the year ended 31 December 2006, comprising the financial statements of the parent company and the consolidated financial statements, has been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU and additional Danish disclosure requirements for the annual reports of listed companies. Additional Danish disclosure requirements for the presentation of annual reports are imposed by the Statutory Order on Adoption of IFRS issued under the Danish Financial Statements Act and by the OMX Nordic Exchange Copenhagen.

The accounting policies are unchanged from last year.

The Annual Report is presented in Danish kroner (DKK), which is considered the primary currency of the Group's activities and the functional currency of the parent company.

The annual report is presented on a historical cost basis, apart from certain financial assets and derivative financial instruments which are measured at fair value. A further description of the accounting policies applied is given below.

The accounting policies described below have been consistently applied for the financial year and for the comparative figures. Certain layouts and notes to the financial statements have been changed compared with previous years.

**Effect of new financial reporting standards**
The IASB has issued certain standards, revisions and interpretations of existing standards which are mandatory for accounting periods commencing on or after 1 January 2007.

In the addendum to IAS 1, disclosure requirements are introduced relating to asset management. In IFRS 7, new disclosure requirements are introduced with respect to financial instruments. The implementation of IAS 1 and IFRS 7 has not affected the financial statements, but has resulted in additional supplementary disclosures in the relevant notes to the financial statements.

*Standards and interpretations not yet in force*
As of the date of the publication of this Annual Report, new or amended standards and interpretations have been issued which have not yet entered into force, and which are therefore not included in this Annual Report.

Management believes that the application of these new and revised standards and interpretations will not have any material impact on the Annual Report for the coming financial years.

**Significant accounting estimates and judgments**
The recognition and measurement of assets and liabilities often depends on future events that are somewhat uncertain. In that connection, it is necessary to assume a course of events that reflects Management's assessment of the most probable course of events.

In connection with the preparation of the financial statements, management has made a number of estimates regarding non-current assets, receivables, deferred tax assets and financial instruments.

*Useful lives of property, plant and equipment*
As stated below, the estimated useful lives of Bavarian Nordic's property, plant and equipment are reviewed at the end of each financial year.

*Receivables*
Bavarian Nordic's receivables primarily consist of receivables from the US authorities, and management believes the receivables are not subject to any appreciable credit risk.

*Deferred tax asset*
Full deferred tax has been estimated and provided on Bavarian Nordic's profit. The deferred tax is recognised as an asset in the balance sheet. On the basis of the coming years' activities and budgets, management believes the tax assets can be used against future profits.

*Financial instruments*
Bavarian Nordic uses financial instruments to hedge future cash flows. The fair value of derivative financial instruments is based on the official exchange rates, market interest rates and other market data such as volatility adjusted for the special characteristics of each instrument.

The estimates and assumptions applied are based on historical experience and other factors which management considers relevant under the circumstances, but which are inherently incomplete and inaccurate at the time of presentation of the financial statements, and unexpected events or circumstances may arise. The Company is subject to risks and uncertainties which may have the effect that the actual outcomes may deviate from the estimates made. Such risks are described in "Risk management", which is a separate section in the Annual Report.

**Recognition and measurement**
Income is recognised in the income statement when generated. Assets and liabilities are recognised in the balance sheet when it is probable that any future economic benefit will flow to or

from the Company and the value can be reliably measured. On initial recognition, assets and liabilities are measured at cost. Subsequently, assets and liabilities are measured as described below for each item.

**Basis of consolidation**

The consolidated financial statements include Bavarian Nordic A/S and the subsidiaries in which the Group holds more than 50% of the voting rights or otherwise has a controlling interest.

*Principles of consolidation*

The consolidated financial statements are prepared on the basis of the financial statements of the parent company and the individual subsidiaries, and these are prepared in accordance with the Group's accounting policies and for the same accounting period.

Intra-group income and expenses together with all intra-group profits, receivables and payables are eliminated on consolidation. In the preparation of the consolidated financial statements, the book value of shares in subsidiaries held by the parent company is set off against the equity of the subsidiaries.

On acquisition of companies, the purchase method of accounting is applied under which the identifiable assets and liabilities of the acquired companies are recognised at market value at the date of acquisition, and any excess of the cost of the acquired companies over the market value is recognised as goodwill.

Minority interests include a proportionate share of the profit and are stated as part of the consolidated profit and as a separate line item in equity.

**Foreign currency translation**

On initial recognition, transactions denominated in currencies other than the Group's functional currency are translated at the exchange rate ruling at the transaction date. Receivables, payables and other monetary items denominated in foreign currencies that have not been settled at the balance sheet date are translated at the exchange rates at the balance sheet date. Exchange differences between the exchange rate at the date of the transaction and the exchange rate at the date of payment or the balance sheet date, respectively, are recognised in the income statement under financial items. Property, plant and equipment and intangible assets, inventories and other non-monetary assets acquired in foreign currency and measured based on historical cost are translated at the exchange rates at the transaction date.

Transactions hedged by forward exchange instruments are recognised at the hedged exchange rate. See "Derivative financial instruments" below.
On recognition in the consolidated financial statements of subsidiaries whose financial statements are presented in a functional currency other than Danish kroner (DKK), the income statements are translated at average exchange rates for the respective months. Balance sheet items are translated at the exchange rates at the balance sheet date.

Exchange differences arising on the translation of foreign subsidiaries' opening balance sheet items to the exchange rates at the balance sheet date and on the translation of the income statements from average exchange rates to exchange rates at the balance sheet date are taken directly to equity. Similarly, exchange differences arising as a result of changes made directly in the equity of the foreign subsidiary are also taken directly to equity.

Foreign exchange adjustment of receivables or debt to subsidiaries which are considered part of the parent company's overall investment in the subsidiary in question are also taken directly to equity in the consolidated financial statements, whereas they are recognised in the income statement of the parent company.

**Derivative financial instruments**

On initial recognition, derivative financial instruments are measured at the fair value on the settlement date. Directly attributable costs related to the purchase or issuance of the individual financial instruments (transaction costs) are added to the fair value on initial recognition unless the financial asset or the financial liability is measured at fair value with recognition of fair value adjustments in the income statement. Subsequently, they are measured at fair value at the balance sheet date. Changes in the fair value of derivative financial instruments designated as and qualifying for recognition as fair value hedges of a recognised asset or a recognised liability are recognised in the income statement together with any changes in the value of the hedged asset or hedged liability. Changes in the fair value of derivative financial instruments designated as and qualifying for recognition as effective hedges of future transactions are recognised directly in equity. The ineffective portion is recognised immediately in the income statement. When the hedged transactions are realised, cumulative changes are recognised as part of the cost of the transactions in question. For derivative financial instruments that do not qualify for hedge accounting, changes in fair value are recognised as financial items in the income statement as they occur.

**Share-based payment**

Share-based incentive plans in which employees can only opt to buy shares in the parent company (equity schemes) are measured at the equity instruments' fair value at the grant date and recognised in the income statement in staff costs under the respective functions over the vesting period. The balancing item is recognised directly in equity. The fair value on the date of grant is determined using the Black-Scholes model.

Cash-based incentive programmes in which employees can have the difference between the agreed price and the actual share price settled in cash are measured at fair value at the date of grant and recognised in the income statement under staff costs over the period when the final right of cash-settlement is obtained. Vested rights are subsequently remeasured on each balance sheet date and upon final settlement, and any changes in the fair value of the programmes are recognised in the income statement under financial items. The balancing item is recognised under liabilities.

The fair value of the cash-based incentive programmes is determined using the Black-Scholes model.

## Income statement

**Revenue recognition**
Revenue comprises the value of sales of products and income derived from development contracts and amounts received for achieving milestones in development projects. These are recognised in the year in which any major risks and rewards connected with the title to the goods or right to the services are transferred and the Company no longer retains managerial responsibility for, or control of, the goods sold.

Revenue from milestone payments are recognised if all attached obligations are fulfilled and it is certain that there will be no demand for these to be refunded. Revenue from development contracts are recognised in line with the execution and delivery of the work…
Research and development grants without a profit element are set off against the costs of research and development at the time when a final and binding right to the grant has been obtained.

**Production costs**
Production costs consist of costs incurred to earn the revenue for the year. Production costs comprise consumables, factory-related general and administration costs, transport insurance and freight costs, salaries, depreciation and external costs required to fulfil the contractual deliveries.

**Research and development costs**
Research and development costs include salaries and costs directly attributable to the Company's research and development projects, less government grants. The Company considers a project to be a development project upon receipt of regulatory approval to initiate clinical trials. Furthermore, salaries and costs supporting direct research and development, including costs of patents, rent, leasing and depreciation attributable to laboratories, and external scientific consultancy services, are recognised under research and development costs.

Research and development costs incurred to achieve revenue are recognised under production costs.

Research costs are normally written off in the year they are incurred.

Where there is sufficient certainty that the future earnings to the Company will cover not only production and direct sales costs and administrative expenses, but also the development costs, the development costs that cover the ongoing costs of a clinical programme after the date of regulatory approval of the said clinical trial are recognised as assets. Due to the general risk relating to the development of pharmaceutical products, capitalisation in the balance sheet requires that the product can be completed and marketed. If sufficient certainty thereof does not exist, the development costs are expensed.

Development costs attributable to the licencing of IMVAMUNE® under the RFP-3 contract with the US health authorities are capitalised as intangible assets as per the above.

**Sales costs and administrative expenses**
Sales costs and administrative expenses include costs of Company management, staff functions, administrative and commercial personnel, office costs, rent, lease payments and depreciation not relating specifically to production or research and development activities.

**Financial items**
Interest income and expenses are recognised in the income statement at the amounts relating to the financial year. Financials also include financing costs related to finance leases, value adjustments of financial instruments, securities, items denominated in foreign currency and charges.

**Derivative financial instruments**
Derivative financial instruments are recognised in the balance sheet under advance payments and other financial assets based on the term to maturity. The items are continually adjusted to fair value (repurchase value).

Adjustment of derivative financial instruments used to hedge expected future cash flows is taken to retained earnings under equity. The reserve is recognised in the income statement on realisation of the hedged transactions.

If a derivative financial instrument used to hedge expected future cash flows expires, is sold or no longer qualifies for hedge accounting, any accumulated fair value reserve remains in equity, until the hedged transaction has been concluded.

Adjustments of the fair value of other financial instruments are recognised in financial income and expensed in the income statement as they occur.

**Tax**
Income tax for the year comprises current tax and deferred tax for the year. The part relating to the profit for the year is recognised in the income statement, and the part attributable to items in equity is recognised directly in equity. Current tax payable but not yet paid is recognised in the balance sheet under current liabilities.

Deferred tax is measured using the liability method on all temporary differences between accounting values and tax values. Deferred tax liabilities arising from temporary tax differences are recognised in the balance sheet as a provision. Deferred tax assets arising from temporary deductible differences and tax losses carried forward are recognised when it is probable that they can be realised by offsetting them against tax on future income. Unrealised temporary deductible differences are disclosed in a note to the financial statements with the relevant amounts.

Full deferred tax is provided on the accumulated fair value reserve under equity.

The tax effect of costs that have been recognised directly in equity is recognised in equity under the relevant items.

Deferred tax is calculated at the tax rate applicable on the balance sheet date.

Tax asset is recognised in the balance sheet to the extent that it is probable that future positive taxable income will be generated, against which the temporary differences and tax losses can be offset. Deferred tax assets are measured at expected net realisable values.

**Minority interests**
Minority interests include the part of net profit that is attributable to minority shareholders.

**Earnings per share**
Earnings per share is calculated as the profit or loss for the year compared to the weighted average of the issued shares in the financial year. The basis for the calculation of diluted earnings per share is the weighted average number of shares in the finan-cial year adjusted for the effects of warrants. No adjustment is made in the profit or loss for the year.

## Balance sheet

**Intangible assets**
Intangible assets are measured at historic cost less accumulated amortisation. Development projects that meet the requirements for recognition as assets are measured at direct cost plus production overheads relating to the development projects. Amortisation of development projects commences when the asset is taken into use and is provided on a straight-line basis over the useful economic lives of the assets. An asset is defined as being taken into use at the commencement of sales activities.

For development projects, an individual assessment of the useful economic life of the project is made by the Management. Purchased rights or rights acquired in connection with acquisitions which fulfil the requirements for recognition are measured at cost. Individual assessments are made of the useful economic lives of rights. Borrowing costs are not recognised as part of cost.

Amortisation is made on a straight-line basis over the expected useful lives of the assets, which are:

| | |
|---|---|
| Rights | max. 10 years |
| Development projects | max. 10 years |
| Software | 3 years |

**Tangible assets**
Tangible assets include land and buildings, production equipment, leasehold improvements, office and IT equipment and laboratory equipment and are measured at cost less accumulated depreciation and impairment losses. Cost includes the costs directly attributable to the purchase of the asset, until the asset is ready for use. For assets manufactured by the Company, cost includes direct and indirect costs of materials, components, third-party suppliers and labour.

Costs of borrowing relating to the acquisition of land and buildings, production equipment, leasehold improvements, IT equipment and laboratory equipment are capitalised in accordance with the Group's accounting polities.

Interest expenses on loans to finance the manufacture of tangible assets is included in cost if they relate to the production period. Other borrowing costs are taken to the income statement.

Depreciation is charged over the expected economic lives of the assets, and the depreciation methods, expected lives and residual values are reassessed individually for the assets at the end of each financial year. Assets are depreciated over their estimated useful lives as follows:

| | |
|---|---|
| Buildings | 20 years |
| Installations | 5 -15 years |
| Leasehold improvements | 5 years |
| Office and IT equipment | 3 - 5 years |
| Laboratory equipment | 10 years |
| Production equipment | 3 -15 years |

Depreciation and gains and losses from regular replacement of tangible assets are recognised in the income statement.

**Leasing**
Assets held under finance leases are measured in the balance sheet at the lower of the present value and future lease payments on the date of acquisition. The capitalised value of the residual lease obligation is carried as a liability in the balance sheet, and the interest element of the lease payment is recognised in the income statement under financial items. The interest rate implicit in the lease is used in the calculations. The liability is reduced by the repayment element of the lease payment. The assets are depreciated over the expected useful lives of the assets in the same way as other similar assets. Lease payments for assets held under operating leases are charged to the income statement. The total lease commitment is disclosed in a note to the financial statements.

**Financial assets**
Investments in subsidiaries are recognised and measured at cost in the financial statements of the parent company. Where the recoverable amount of the investments is lower than cost, the investments are written down to this lower value. In addition, cost is written down if dividend distributed exceeds the accumulated earnings in the company since the parent company's acquisition of the investments.

**Impairment of non-current assets**
The carrying amounts of both intangible assets, property, plant and equipment and investments carried at cost or amortised cost are tested annually to determine whether there are indications of any impairment in excess of that expressed in normal amortisation and depreciation. If that is the case, the asset is written down to the recoverable amount, which is the higher value of the net sales price and the capitalised value. Impairment losses on intangible assets and property, plant and equipment are recognised under the same line item as amortisation and depreciation of the assets.

**Inventories**
Inventories are measured at cost as direct acquisition costs incurred, or, for goods manufactured by the Company, at the lower of the direct costs incurred plus production overheads and net realisable value. Net realisable value is the estimated sales price in the ordinary course of business less relevant sales costs. The cost price is determined based on a weighted average.

**Receivables**
Receivables are measured at amortised cost, which is usually equal to the nominal value, less provision for bad debts based on an individual assessment of the risk.

Receivables from subsidiaries are written down when the receivable is deemed to be irrecoverable. In the event that the parent company has a legal or constructive obligation to cover the negative balance of the subsidiary, a provision will be made for the amount.

**Securities**
Securities consist of listed bonds, which are measured at market value as of the balance sheet date. The market value as of the balance sheet date is measured having regard to known future gains and losses on drawing or at final maturity. Bonds with a maturity of less than three months on the date of acquisition are recognised in the line item "Cash and cash equivalents". Both realised and unrealised value adjustments are recognised in the income statement under financial items.

**Provisions**
Provisions are recognised when the Company has an obligation as a result of events in the current or in previous financial years with a probability that the obligation will result in an outflow of the Company's financial resources.

**Prepayments from customers**
Advance payments are recognised under liabilities and will be recognised in the income statement as the delivery of paid products takes place.

**Pension obligations and similar obligations**
For defined contribution plans, the Group pays regular fixed contributions to independent pension funds and insurance companies. The Group has no obligations to pay additional contributions.

Periodical payments to defined contribution plans are disclosed in the income statement.

**Credit institutions**
Loans are initially recognised at market value, net of transaction costs incurred. Loans are subsequently measured at amortised cost as of the balance sheet date; any difference between the proceeds (net of transaction costs and amortised cost) is recognised in the income statement over the term of the loan using the effective interest method. Loans are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

**Debts**
Debts are measured at amortised cost.

**Cash flow statement**
The cash flow statement is prepared in accordance with the indirect method on the basis of the Group's operating profit/loss. The statement shows the Group's cash flows broken down into operating, investing and financing activities, cash and cash equivalents at year end and the impact of the calculated cash flows on the Group's cash and cash equivalents.

Cash flows in foreign currencies are translated into Danish kroner at the exchange rate on the transaction date. In the cash flows from operating activities, operating profit/(loss) is adjusted for non-cash operating items and changes in working capital. Cash flows from investing activities include cash flows from the purchase and sale of intangible assets, property plant and equipment, investments and securities. Cash flows from financing activities include cash flows from the raising and repayment of loans and capital increases as well as financial items.

**Segment reporting**
As the Bavarian Nordic Group only operates in one business segment, and because revenue comes solely from the US market, no separate segment information is provided in the notes to the Annual Report.

**Financial definitions**
Equity/assets ratio, %:

$$\frac{\textit{Total equity x 100}}{\textit{Total assets}}$$

Market capitalisation of equity, DKK:
*Market price at end of year x total share capital*

Equity value, DKK:

$$\frac{\textit{Equity}}{\textit{Number of shares}}$$

Market price/equity value:

$$\frac{\textit{Market price per share}}{\textit{Equity asset value per share}}$$

Earnings per share (EPS):

$$\frac{\textit{Bavarian Nordic's share of the net profit/(loss}}{\textit{Number of shares (average for four quarters)}}$$

The ratios are calculated and applied in accordance with "Recommendations and Financial Ratios 2005" issued by the Danish Society of Financial Analysts. The ratios are stated on page 2.

## 2. Revenue

| Amounts in DKK thousands | Parent company 2007 | Parent company 2006 | Group 2007 | Group 2006 |
|---|---|---|---|---|
| Contract work | 55,463 | 175,292 | 55,463 | 175,292 |
| Milestone payment from RFP-3 contract | 276,640 | - | 276,640 | - |
| **Total** | **332,103** | **175,292** | **332,103** | **175,292** |

## 3. Staff costs

| Amounts in DKK thousands | Parent company 2007 | Parent company 2006 | Group 2007 | Group 2006 |
|---|---|---|---|---|
| Wages and salaries | 73,988 | 59,214 | 133,643 | 107,416 |
| Pension and social security expenses | 5,121 | 4,488 | 13,485 | 11,798 |
| Other staff expenses | 7,508 | 6,961 | 12,227 | 12,642 |
| Share-based payment | 4,643 | 1,170 | 4,983 | 1,170 |
| **Staff costs before capitalisation** | **91,260** | **71,833** | **164,338** | **133,026** |
| Capitalised salaries | - | (33,182) | - | (33,182) |
| **Total staff costs** | **91,260** | **38,651** | **164,338** | **99,844** |
| | | | | |
| Staff expenses are distributed as follows: | | | | |
| Production costs | 9,339 | 18,498 | 9,341 | 23,995 |
| Research and development costs | 41,339 | 19,387 | 108,597 | 69,203 |
| Sales and administrative costs | 40,582 | 33,948 | 46,400 | 39,828 |
| **Staff costs before capitalisation** | **91,260** | **71,833** | **164,338** | **133,026** |
| Capitalised salaries | - | (33,182) | - | (33,182) |
| **Total staff costs** | **91,260** | **38,651** | **164,338** | **99,844** |
| | | | | |
| Of which: | | | | |
| Remuneration to the Board of Directors 1) | 1,128 | 526 | 1,128 | 526 |
| Remuneration to the President of the company 1) | 3,079 | 1,994 | 3,079 | 1,994 |
| Remuneration to the Managerial staff 1) | 10,074 | 7,288 | 12,653 | 9,161 |
| **Total management remuneration** | **14,281** | **9,808** | **16,860** | **11,681** |

1) Incl. share-based payment

Incentive programmes are disclosed in note 21.
The share based payment to the Board of Directors, the President of the company and the Managerial Staff are respectively DKK thousands 378, 570 and 2,477.
Members of the Management have contracts of employment containing standard conditions for members of the Management of Danish listed companies, including with regard to the periods of notice that both parties are required to give and competition clauses. If the executive officer´s contract of employment is terminated by Bavarian Nordic, without there having been misconduct on the part of the executive officer, the executive officer has the right to compensation, which, depending of the circumstances, may amount to maximum of two years' salary and pension contributions.

| | Parent company 2007 | Parent company 2006 | Group 2007 | Group 2006 |
|---|---|---|---|---|
| Average numbers of employees convert to full-time | 119 | 104 | 256 | 225 |
| Numbers of employees as of December 31 convert to full-time | 120 | 105 | 264 | 233 |

## 4. Depreciation and amortisation

| Amounts in DKK thousands | Parent company 2007 | Parent company 2006 | Group 2007 | Group 2006 |
|---|---|---|---|---|
| Depreciation and amortisation included in: | | | | |
| Production costs | 7,023 | 1,303 | 7,030 | 1,493 |
| Research and development costs | 21,725 | 3,120 | 27,587 | 9,922 |
| Sales expenses and administrative costs | 5,471 | 6,477 | 5,522 | 6,535 |
| **Total depreciation** | **34,219** | **10,900** | **40,139** | **17,950** |
| Hereof profit/loss from disposed fixed assets | 36 | (28) | 36 | (28) |

## 5. Fees to board auditor

| Amounts in DKK thousands | Parent company 2007 | Parent company 2006 | Group 2007 | Group 2006 |
|---|---|---|---|---|
| Audit of the annual report | 350 | 450 | 520 | 450 |
| Other assistance | 652 | 369 | 902 | 369 |
| **Fees total** | **1,002** | **819** | **1,422** | **819** |

## 6. Financial income

| Amounts in DKK thousands | Parent company 2007 | Parent company 2006 | Group 2007 | Group 2006 |
|---|---|---|---|---|
| Financial income from bonds | 14,101 | 11,824 | 14,101 | 11,824 |
| Financial income from bank and deposit contracts | 11,549 | 1,800 | 11,606 | 2,350 |
| Financial income from subsidiaries | 238 | 347 | - | - |
| Net income from exchange rate adjustments | - | 799 | - | 804 |
| **Total** | **25,888** | **14,770** | **25,707** | **14,978** |

## 7. Financial expenses

| Amounts in DKK thousands | Parent company 2007 | Parent company 2006 | Group 2007 | Group 2006 |
|---|---|---|---|---|
| Financial expenses | 6,828 | 9,115 | 7,100 | 9,813 |
| Financial leasing expense | 2,133 | 2,267 | 2,133 | 2,267 |
| Net income from exchange rate adjustments | 1,950 | 3,863 | 1,941 | 3,925 |
| Financial expenses to subsidiaries | 260 | 347 | - | - |
| **Total** | **11,171** | **15,592** | **11,174** | **16,005** |

## 8. Tax for the year

| Amounts in DKK thousands | Parent company 2007 | Parent company 2006 | Group 2007 | Group 2006 |
|---|---|---|---|---|
| Current income tax | - | - | 3.205 | 2.874 |
| Change in deferred tax | 9,805 | (38,807) | 11,914 | (39,429) |
| Corrections to previous years | - | (7,923) | (2,108) | (7,301) |
| **Tax for the year** | **9,805** | **(46,730)** | **13,011** | **(43,856)** |
| Tax on equity transactions | 22,892 | 8,062 | 22,892 | 8,062 |
| **Tax on income for the year** | **32,697** | **(38,668)** | **35,903** | **(35,794)** |
| Tax on income for the year is explained as follows: | | | | |
| Calculated tax (25%) tax on income before tax | (5,717) | (51,407) | (11,741) | (56,531) |
| Tax effect on: | | | | |
| Change in tax rate from 28% to 25% | 15,411 | - | 15,411 | - |
| Different percentage in foreign subsidaiaries | - | - | 933 | 456 |
| Tax values in foreign subsidairies, not included | - | - | 7,818 | 8,063 |
| Loss of tax loss carry-forwards | - | 2,330 | - | 2,330 |
| Permanent differences | 111 | 32 | 111 | 32 |
| Other corrections | - | 2,315 | 479 | 1,794 |
| **Tax on income for the year** | **9,805** | **(46,730)** | **13,011** | **(43,856)** |
| **Deferred tax** | | | | |
| Recognised deferred tax assets relates to temporary differences between valuations for accounting and taxation purposes and tax losses carried forward in the Parent company: | | | | |
| Non-current assets | (28,562) | (29,564) | (27,531) | (26,424) |
| Patent costs | (345) | (85) | (345) | (85) |
| Obligations | 2,038 | - | 2,038 | - |
| Financial instruments | 23,732 | - | 23,732 | - |
| Prepayment from customers | 69,160 | - | 69,160 | - |
| Tax losses carried-forward | 68,004 | 173,481 | 68,004 | 173,481 |
| **Recognised tax assets** | **134,027** | **143,832** | **135,058** | **146,972** |

Deferred tax assets arising from temporary differences for tax purposes and tax losses carried forward are recognised as these will be offset against future taxable income,

Not calculated unlimited tax asset 15,881 DKK thousands.

## 9. Earnings per share (EPS)

| Amounts in DKK thousands | Koncern 2007 | Koncern 2006 |
|---|---|---|
| Profit for the Parent company´s shareholders | (63,504) | (160,937) |
| Weighted average of shares (thousand units) | 7,478 | 6,248 |
| Earnings per share of DKK 10.00 | (8,5) | (25,8) |
| Diluted earnings, per share of DKK 10.00 | (8,5) | (25,8) |

There is not calculated any effect on diluted earnings per share in agreement with IAS 33 because it will improve the result per share.

## 10. Intangible assets - Parent company 2007

| Amounts in DKK thousands | Rights | Software | Intangible assets under construction | 2007 total |
|---|---|---|---|---|
| Costs as of 1 January | 6,864 | 16,466 | - | 23,330 |
| Additions during the year | - | - | 16,941 | 16,941 |
| Disposals during the year | - | (59) | - | (59) |
| Exchange rate adjustments | - | - | - | - |
| **Cost as of 31 December** | **6,864** | **16,407** | **16,941** | **40,212** |
| Amortisation as of 1 January | 3,278 | 7,273 | - | 10,551 |
| Amortisation during the year | 448 | 4,917 | - | 5,365 |
| Disposals during the year | - | (59) | - | (59) |
| Exchange rate adjustments | - | - | - | - |
| **Amortisation as of 31 December** | **3,726** | **12,131** | **-** | **15,857** |
| **Book value as of 31 December** | **3,138** | **4,276** | **16,941** | **24,355** |

## 10. Intangible assets - Group 2007

| Amounts in DKK thousands | Rights | Software | Intangible assets under construction | 2007 total |
|---|---|---|---|---|
| Costs as of 1 January | 6,864 | 17,700 | - | 24,564 |
| Additions during the year | - | - | 16,941 | 16,941 |
| Disposals during the year | - | (263) | - | (263) |
| Exchange rate adjustments | - | - | - | - |
| **Cost as of 31 December** | **6,864** | **17,437** | **16,941** | **41,242** |
| Amortisation as of 1 January | 3,278 | 8,317 | - | 11,595 |
| Amortisation during the year | 448 | 5,099 | - | 5,547 |
| Disposals during the year | - | (263) | - | (263) |
| Exchange rate adjustments | - | - | | - |
| **Amortisation as of 31 December** | **3,726** | **13,153** | **-** | **16,879** |
| **Book value as of 31 December** | **3,138** | **4,284** | **16,941** | **24,363** |

Intangible assets under construction include development costs connected to registration of IMVAMUNE® under the RFP-3 contract.

## 10. Intangible assets - Parent company 2006

| Amounts in DKK thousands | Rights | Software | Intangible assets under construction | 2006 total |
|---|---|---|---|---|
| Costs as of 1 January | 6,864 | 16,221 | - | 23,085 |
| Additions during the year | - | 245 | - | 245 |
| Disposals during the year | - | - | - | - |
| Exchange rate adjustments | - | - | - | - |
| **Cost as of 31 December** | **6,864** | **16,466** | **-** | **23,330** |
| Amortisation as of 1 January | 2,631 | 2,191 | - | 4,822 |
| Amortisation during the year | 647 | 5,082 | - | 5,729 |
| Disposals during the year | - | - | - | - |
| Exchange rate adjustments | - | - | - | - |
| **Amortisation as of 31 December** | **3,278** | **7,273** | **-** | **10,551** |
| **Book value as of 31 December** | **3,586** | **9,193** | **-** | **12,779** |

## 10. Intangible assets - Group 2006

| Amounts in DKK thousands | Rights | Software | Intangible assets under construction | 2006 total |
|---|---|---|---|---|
| Costs as of 1 January | 6,864 | 17,448 | - | 24,312 |
| Additions during the year | - | 245 | - | 245 |
| Disposals during the year | - | - | - | - |
| Exchange rate adjustments | - | 7 | - | 7 |
| **Cost as of 31 December** | **6,864** | **17,700** | **-** | **24,564** |
| Amortisation as of 1 January | 2,631 | 2,951 | - | 5,582 |
| Amortisation during the year | 647 | 5,358 | - | 6,005 |
| Disposals during the year | - | - | - | - |
| Exchange rate adjustments | - | 8 | - | 8 |
| **Amortisation as of 31 December** | **3,278** | **8,317** | **-** | **11,595** |
| **Book value as of 31 December** | **3,586** | **9,383** | **-** | **12,969** |

## 11. Tangible assets - Parent company 2007

| Amounts in DKK thousands | Land and buildings | Leasehold improvement | Plant and machinery | Equipment | Pre-payment of assets | 2007 Total |
|---|---|---|---|---|---|---|
| Costs as of 1 January | 165,525 | - | 221,610 | 15,428 | - | 402,563 |
| Additions during the year | 449 | - | 541 | 85 | 2,691 | 3,766 |
| Transfer from subsidiary | - | - | - | 108 | - | 108 |
| Disposals during the year | - | - | - | (1,214) | - | (1,214) |
| Exchange rate adjustments | - | - | - | - | - | - |
| **Cost as of 31 December** | **165,974** | **-** | **222,151** | **14,407** | **2,691** | **405,223** |
| Depreciation of 1 January | 1,193 | - | 86 | 10,134 | - | 11,413 |
| Transfer from subsidiary | - | - | - | 108 | - | 108 |
| Depreciation during the year | 5,583 | - | 21,483 | 1,788 | - | 28,854 |
| Disposals during the year | - | - | - | (1,214) | - | (1,214) |
| Exchange rate adjustments | - | - | - | - | - | - |
| **Depreciation as of 31 December** | **6,776** | **-** | **21,569** | **10,816** | **-** | **39,161** |
| **Book value as of 31 December** | **159,198** | **-** | **200,582** | **3,591** | **2,691** | **366,062** |
| **Book value of leased assets as of 31 December** | **-** | **-** | **35,546** | **-** | **-** | **35,546** |

## 11. Tangible assets - Group 2007

| Amounts in DKK thousands | Land and buildings | Leasehold improvement | Plant and machinery | Equipment | Pre-payment of assets | 2007 Total |
|---|---|---|---|---|---|---|
| Costs as of 1 January | 165,525 | 7,449 | 221,610 | 61,464 | - | 456,048 |
| Additions during the year | 449 | - | 541 | 2,606 | 2,691 | 6,287 |
| Transfer | - | 1,745 | - | (1,745) | - | - |
| Disposals during the year | - | (223) | - | (6,361) | - | (6,584) |
| Exchange rate adjustments | - | (179) | - | (436) | - | (615) |
| **Cost as of 31 December** | **165,974** | **8,792** | **222,151** | **55,528** | **2,691** | **455,136** |
| Depreciation of 1 January | 1,193 | 4,938 | 86 | 41,774 | - | 47,991 |
| Transfer | - | 349 | - | (349) | - | - |
| Depreciation during the year | 5,583 | 1,302 | 21,483 | 6,224 | - | 34,592 |
| Disposals during the year | - | (223) | - | (5,842) | - | (6,065) |
| Exchange rate adjustments | - | (35) | - | (580) | - | (615) |
| **Depreciation as of 31 December** | **6,776** | **6,331** | **21,569** | **41,227** | **-** | **75,903** |
| **Book value as of 31 December** | **159,198** | **2,461** | **200,582** | **14,301** | **2,691** | **379,233** |
| **Book value of leased assets as of 31 December** | **-** | **-** | **35,546** | **-** | **-** | **35,546** |

As of 31 December 2007 mortgage deeds of total of DKK 125 million have been issued for safety on loan of DKK 68 million against credit institutions on the property Bøgeskovvej 9/Hejreskovvej 10, Kvistgård, Denmark.

## 11. Tangible assets - Parent company 2006

| Amounts in DKK thousands | Land and buildings | Leasehold improvement | Plant and machinery | Equipment | Pre-payment of assets | 2006 Total |
|---|---|---|---|---|---|---|
| Costs as of 1 January | 170,280 | - | 133,666 | 31,495 | - | 335,441 |
| Additions during the year | 1,020 | - | 71,514 | 1,615 | - | 74,149 |
| Transfer | - | - | 16,430 | (16,430) | - | - |
| Disposals during the year | (5,775) | - | - | (1,252) | - | (7,027) |
| Exchange rate adjustments | - | - | - | - | - | - |
| **Cost as of 31 December** | **165,525** | **-** | **221,610** | **15,428** | **-** | **402,563** |
| Depreciation of 1 January | 747 | - | 16 | 6,682 | - | 7,445 |
| Depreciation during the year | 446 | - | 70 | 4,655 | - | 5,171 |
| Disposals during the year | - | - | - | (1,203) | - | (1,203) |
| Exchange rate adjustments | - | - | - | - | - | - |
| **Depreciation as of 31 December** | **1,193** | **-** | **86** | **10,134** | **-** | **11,413** |
| **Book value as of 31 December** | **164,332** | **-** | **221,524** | **5,294** | **-** | **391,150** |
| **Book value of leased assets as of 31 December** | **-** | **-** | **50,100** | **-** | **-** | **50,100** |

## 11. Tangible assets - Group 2006

| Amounts in DKK thousands | Land and buildings | Leasehold improvement | Plant and machinery | Equipment | Pre-payment of assets | 2006 Total |
|---|---|---|---|---|---|---|
| Costs as of 1 January | 170,280 | 7,449 | 134,380 | 71,666 | 528 | 384,303 |
| Additions during the year | 1,020 | - | 71,514 | 6,781 | - | 79,315 |
| Transfer | - | - | 15,716 | (15,188) | (528) | - |
| Disposals during the year | (5,775) | - | - | (1,795) | - | (7,570) |
| Exchange rate adjustments | - | - | - | - | - | - |
| **Cost as of 31 December** | **165,525** | **7,449** | **221,610** | **61,464** | **-** | **456,048** |
| Depreciation of 1 January | 747 | 3,612 | 28 | 33,829 | - | 38,216 |
| Depreciation during the year | 446 | 989 | 70 | 10,440 | - | 11,945 |
| Disposals during the year | - | 337 | (12) | (2,495) | - | (2,170) |
| Exchange rate adjustments | - | - | - | - | - | - |
| **Depreciation as of 31 December** | **1,193** | **4,938** | **86** | **41,774** | **-** | **47,991** |
| **Book value as of 31 December** | **164,332** | **2,511** | **221,524** | **19,690** | **-** | **408,057** |
| **Book value of leased assets as of 31 December** | **-** | **-** | **50,100** | **-** | **-** | **50,100** |

As of 31 December 2007 mortgage deeds of total of DKK 125 million have been issued for safety on loan of DKK 68 million against credit institutions on the property Bøgeskovvej 9/Hejreskovvej 10, Kvistgård, Denmark.

## 12. Investment in subsidiaires

| Amounts in DKK thousands | Parent company 2007 | Parent company 2006 |
|---|---|---|
| Cost of subsidiaries as of 1 January | 80,423 | 40,820 |
| Additions during the year | - | 40,121 |
| Disposals during the year | - | (521) |
| Exchange rate adjustment | - | 3 |
| **Cost of subsidiaries as of 31 December** | **80,423** | **80,423** |
| Write-down as of 1 January | - | (521) |
| Disposals during the year | - | 521 |
| **Write down as of 31 December** | **-** | **-** |
| **Book value as of 31 December** | **80,423** | **80,423** |

### Company summary

| Subsidiaries | Domicile | Ownership % | Voting rights % |
|---|---|---|---|
| Bavarian Nordic GmbH | Germany | 100 | 100 |
| Bavarian Nordic Holding | USA | 100 | 100 |
| - Bavarian Nordic Inc. | USA | 100 | 100 |
| - BN ImmunoTherapeutics Inc. | USA | 90 | 90 |

| Representative office | |
|---|---|
| Bavarian Nordic A/S | Singapore |

BN ImmunoTherapeutics is owned by Bavarian Nordic Holding Inc., which solely acts as the holding company in the USA. The remaining 10% of the shares of BN ImmunoTherapeutics is owned by the company´s CEO in USA, who is secured a 10% ownership in the company as part of his employment contract. Half of the allocation (5%) is restricted for a five-year period (until 2010). Moreover, an additional 10% of the shares (not yet issued) is allocated to current and future key employees of BN ImmunoTherapeutics, who, as part of their employment contract, will receive shares or stock options. The company´s future ownership of BN ImmunoTherapeutics via Bavarian Nordic Inc. will be reduced to an anticipated 80%.

The companies in USA are not under audit obligations

## 13. Raw materials and supply materials

| Amounts in DKK thousands | Parent company 2007 | Parent company 2006 | Group 2007 | Group 2006 |
|---|---|---|---|---|
| Raw materials and supply materials | 11,318 | 11,162 | 13,345 | 12,882 |
| Writedown of stock | (1,724) | - | (1,724) | |
| **Raw materials and supply materials** | **9,594** | **11,162** | **11,621** | **12,882** |

## 14. Trade receivables

| Amounts in DKK thousands | Parent company | | Group | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Trade receivables from contract work | 6,490 | 24,257 | 6,552 | 24,257 |
| Milestone payment on RFP-3 Contract | 138,320 | - | 138,320 | - |
| **Total** | **144,810** | **24,257** | **144,872** | **24,257** |

## 15. Other receivables

| Amounts in DKK thousands | Parent company | | Goup | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Financial instruments to fair value | 94,089 | - | 94,089 | - |
| Other receivables | 15,752 | 6,115 | 16,462 | 7,499 |
| **Total** | **109,841** | **6,115** | **110,551** | **7,499** |

## 16. Financial risks and financial instruments

**Policy for financial risks**
Through operations, investments and financing the Group is exposed to changes in exchange and interest rates. Financial risks are managed centrally and, accordingly, all derivative instruments are managed and controlled by the Parent company. The framework is determined by the financial policy approved annually by the Board of Directors. The policy operates with a low risk profile, so that exchange-, interest- and credit risks only arise in commercial relation. The core principle is for financial risk to be managed with a view to reducing significant risk.

The capital structure is continuously evaluated by the Management and the Board of Directors compared to the Group cash flow situation and cash flow budgets.

**Policy for currency risks**
The Group exposures are primarily in USD and EUR. The exchange risk in USD is minimum with adjusting incoming and outgoing payments in USD. In connection with the RFP-3 contract the Group established a forward exchange contract on USD 300 million to hedge future cash flows on this contract.

**Policy for interest and cash risks**
It is the Group´s policy to cover interest rate risk when the payments of interest can be secured on a satisfactory level in proportion to the cost for such a contract. The variable interest rate will be replaced by a fixed rate. The interest risk will be placed in cash equivalents and securities and will be controlled on basis of duration.

It is the Group's policy through loan and deposit to ensure high flexibility in consideration of the pricing in order to fulfil its business targets.

The company´s bank equivalents is primarily deposits in financial institutions due within 1 year.

### Securities

| Amounts in DKK thousands | Parent Company and Group 2007 | | Parent Company and Group 2006 | |
|---|---|---|---|---|
| | Securities | Effective interest | Securities | Effective interest |
| Due within 1 year | 168,915 | 6,9% | 151,563 | 6,0% |
| Due between 2-5 years | 18,520 | 3,8% | 36,641 | 4,1% |
| Due after 5 years | 37,369 | 5,7% | 43,118 | 4,0% |
| **Total** | **224,804** | **6,2%** | **231,322** | **5,7%** |

The company´s securities are pledged for non-mortgage loans in credit institutions for a total of DKK 80 million in 2007 (DKK 115 million in 2006).

### Cash and cash equivalents

| Amounts in DKK thousands | Parent Company | | Group | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Cash and cash equivalents | 683,119 | 98,441 | 688,783 | 101,366 |
| **Total** | **683,119** | **98,441** | **688,783** | **101,366** |

Cash equivalents are primarily deposits in financial institutions.

Fluctuations in interest rate will have an effect on the Group´s securities, cash equivalents, bank loan and mortgage. Increase in interest rate with 1% compared to the rate as of 31 December 2007 will have a negative effect on t.DKK 1.570 on the Group´s equity related to loss on securities.

Increasing on the variable interest rate on bank loan and mortgage with 1% compared to the rate as of 31 December 2007 will have positive effect on Income Statement and Equity with DKK thousands 6,400. Equivalent fall in the interest rate will have equivalent negative effect.

## 16. Financial risks and financial instruments - *Continued*

**Credit risk**
The primary credit risk is trade receivables. Bavarian Nordic´s all-important customers are governments and military authorities. Therefore, the real risk in relation to receivables from sale and other income is considered to be very low.

It is Management's opinon that there are no real risks in relations to cash equivalents.

**Currency risk concerning assets and obligations**
To secure included and not included transactions Bavarian Nordic use forward exchange contracts

### 2007 Parent Company

| Amounts in DKK thousands | Bank, cash equivalents and securities | Receivables | Non-current liabilities | Net position | Covered | Non-secure net position |
|---|---|---|---|---|---|---|
| DKK | 907,923 | 109,841 | (225,146) | 792,618 | | 792,618 |
| EUR | - | 27,819 | - | 27,819 | | 27,819 |
| USD | - | 144,810 | (44,183) | 100,627 | (138,320) | (37,693) |
| **As of 31 December 2007** | **907,923** | **282,470** | **(269,329)** | **921,064** | **(138,320)** | **782,744** |

### 2007 Group

| Amounts in DKK thousands | Bank, cash equivalents and securities | Receivables | Non-current liabilities | Net position | Covered | Non-secure net position |
|---|---|---|---|---|---|---|
| DKK | 907,923 | 106,892 | (225,148) | 789,667 | | 789,667 |
| EUR | 1,934 | 3,659 | (8,324) | (2,731) | | (2,731) |
| USD | 3,730 | 144,872 | (4,275) | 144,327 | (138,320) | 6,007 |
| **As of 31 December 2007** | **913,587** | **255,423** | **(237,747)** | **931,263** | **(138,320)** | **792,943** |

### 2006 Parent Company

| Amounts in DKK thousands | Bank, cash equivalents and securities | Receivables | Non-current liabilities | Net position | Covered | Non-secure net position |
|---|---|---|---|---|---|---|
| DKK | 329,763 | 6,116 | (250,833) | 85,046 | | 85,046 |
| EUR | - | 12,123 | (3,642) | 8,481 | | 8,481 |
| USD | - | 25,112 | (54,601) | (29,489) | | (29,489) |
| **As of 31 December 2006** | **329,763** | **43,351** | **(309,076)** | **64,038** | **-** | **64,038** |

## 16. Financial risks and financial instruments - *Continued*

### 2006 Group

| Amounts in DKK thousands | Bank, cash equiva-lents and securities | Receivables | Non-current liabilities | Net position | Covered | Non-secure net position |
|---|---|---|---|---|---|---|
| DKK | 329,762 | 5,166 | (250,978) | 83,950 | | 83,950 |
| EUR | 2,393 | 1,478 | (10,106) | (6,235) | | (6,235) |
| USD | 533 | 25,112 | (1,937) | 23,708 | | 23,708 |
| **As of 31 December 2006** | **332,688** | **31,756** | **(263,021)** | **101,423** | **-** | **101,423** |

As of 31 December 2007 fair value of derivative instruments to secure included assets is t.DKK 94.089. Fair value is included in the secured asset.

**Currency risk to hedge future cash flows**
Bavarian Nordic´s currency risk is estimated exposure in USD. It is the opinion of Management that influence from fluctuations in USD/DKK is insignificant on Income Statement and Equity as the majority of the exposure the coming three years is hegde by the forward exchange contract and income from RFP-2 contract consider exchange is insensitive as RFP-2 contract is based on cost-plus element with current payments.

**Cash flow hedges**
Bavarian Nordic is using forward exchange contracts to secure income in USD and interest rate swap to secure payment of interest on long term loans. Fair value of these derivatives at year end are booked directly on equity class with relevant item of an account in line with realization of the financial contracts

Settled interest on SWAP’s to cover interest risk enter directly in Income Statement because they do not qualify as hedging of future cash flows. In 2007: income DKK thousands 1.293 (2006: DKK 252 thousands)

The forward exchange contracts has a maturity between three months and nine months and will hedge the expected payments under RFP-3 contract for next three years.

Interest rate swap is due until repayment of the secured loan.

| | 2007 | | 2006 | |
|---|---|---|---|---|
| Amounts in DKK thousands | Contract amount based on agreed rates | Fair value as of 31 December | Contract amount based on agreed rates | Fair value as of 31 December |
| **Forward exchange contract (sales)** | | | | |
| USD - 200 Million | 1,106,590 | 91,927 | - | - |
| **Interest rate swap** | | | | |
| DKK/DKK - pays fixed rate of 2.79% p.a. | 68,000 | 2,162 | 68,000 | 2,371 |
| | 1,174,590 | 94,089 | 68,000 | 2,371 |

## 16. Financial risks and financial instruments - *Continued*

| Amounts in DKK thousands | Parent company 2007 | Parent company 2006 | Group 2007 | Group 2006 |
|---|---|---|---|---|
| Derivative financial instruments as of 31 December 2007 to secure fair value of included assets and liabilities | 11,820 | - | 11,820 | - |
| Derivative financial instruments as of 31 December 2007 to hedge future cash flows | 92,765 | - | 92,765 | - |
| **Financial assets used as hedging instruments as of 31 December 2007 measured at fair value** | **104,585** | **-** | **104,585** | **-** |
| Trade receivables | 132,990 | 24,257 | 133,052 | 24,257 |
| Receivables from subsidiaries | 27,819 | 12,979 | - | - |
| Other receivables | 109,841 | 6,115 | 110,551 | 7,499 |
| Cash and cash equivalents | 683,119 | 98,441 | 688,783 | 101,366 |
| **Loan and receivables measured at amortised cost** | **953,769** | **141,792** | **932,386** | **133,122** |
| Other securities | 224,804 | 231,322 | 224,804 | 231,322 |
| **Financial assets available for sale measured at fair value** | **224,804** | **231,322** | **224,804** | **231,322** |
| Mortgage | 46,288 | 47,615 | 46,288 | 47,615 |
| Bankloan | 68,000 | 103,000 | 68,000 | 103,000 |
| Financial leasing | 35,546 | 50,100 | 35,546 | 50,100 |
| Accounts payable | 17,420 | 18,040 | 21,589 | 19,689 |
| Other debts | 57,892 | 32,078 | 65,600 | 38,085 |
| Payables to subsidiaries | 44,183 | 58,243 | - | - |
| **Financial obligations measured at amortised cost** | **269,329** | **309,076** | **237,023** | **258,489** |

**Optimisation of capital structure**
The Group's financial structure is continuously being assessed by Management in order to ensure that this is in line with interest of the company and its shareholders. The overall objective is to ensure a financial structure which supports the long-term objectives.

Under consideration of the Group's development programmes and the upcoming stock building under the RFP-3 contract, it is estimated that present capital structure is suitable.

## 17. Provisions

There are no provisions in Parent company in 2006 and 2007

| Amounts in DKK thousands | Group | | |
|---|---|---|---|
| | Other provisionsr | 2007 Total | 2006 Total |
| Provisions as of 1 January | - | 4,302 | 6,867 |
| Additions during the year | - | - | - |
| Disposals during the year | - | (3,632) | (2,557) |
| Exchange rate adjustments | - | - | (8) |
| **Provisions as of 31 December** | **-** | **670** | **4,302** |

| **Other provisions** | Due within 1 year | Due between 1 and 5 years | Due after 5 years | Total |
|---|---|---|---|---|
| 2007 | 670 | - | - | 670 |
| 2006 | 2,682 | 1,620 | - | 4,302 |

Other provisions cover remaining rent obligations for premises.

## 18. Credit institutions 2007

| Amounts in DKK thousands | Parent company and Group | | | |
|---|---|---|---|---|
| | Due within 1 year | Due between 1 and 5 years | Due after 5 years | 2007 Total |
| Mortgage, DKK, fixed interest interval 5.26-5.33% p.a. | 1,386 | 6,195 | 38,707 | 46,288 |
| Financial leasing, fixed interest interval 2.2-7.6% p.a. | 13,775 | 21,771 | - | 35,546 |
| Construction loan, variable interest [1), 3)] | - | 68,000 | - | 68,000 |
| **Interest carrying obligations, total** | **15,161** | **95,966** | **38,707** | **149,834** |

1) Fair value for fixed interest debt to credit institutions is calculated as net present value of future re-payment and interest payment using the actual market rate amounted to DKK 56.2 million (2006: DKK 52.3 million).

**2006**

| Amounts in DKK thousands | Parent company and Group | | | |
|---|---|---|---|---|
| | Due within 1 year | Due between 1 and 5 years | Due after 5 years | 2006 Total |
| Mortgage, DKK, fixed interest interval 5.26-5.33% p.a. | 1,327 | 5,929 | 40,359 | 47,615 |
| Financial leasing, fixed interest interval 2.2-7.6% p.a. | 15,412 | 34,688 | - | 50,100 |
| Construction loan, variable interest [2), 3)] | - | 68,000 | - | 68,000 |
| Construction loan, variable interest 3.315% p.a. | 35,000 | - | - | 35,000 |
| **Interest carrying obligations, total** | **51,739** | **108,617** | **40,359** | **200.715** |

2) The value of the variable interest loan to credit institutions is estimated to fair value.

3) The variable loan is changed to a loan with fixed interest via a SWAP with Nordea Bank with interest 2.79% p.a.

## 18. Credit institutions - *continued*

| Minimum financial lease payments | Due within 1 year | Due between 1 and 5 years | Due after 5 years | Total | Future interest rate on lease | Present value of payments |
|---|---|---|---|---|---|---|
| 2007 | 14,664 | 22,336 | - | 37,000 | (1,454) | 35,546 |
| 2006 | 16,133 | 36,825 | - | 52,958 | (2,858) | 50,100 |

## 19. Pre-payment from customers

| Amounts in DKK thousands | Parent company | | Group | |
|---|---|---|---|---|
| | **2007** | **2006** | **2007** | **2006** |
| Pre-payment from customers | 276,640 | - | 276,640 | - |
| **Total** | **276,640** | **-** | **276,640** | **-** |

Pre-payment USD 50 million as a part of RFP-3 contract for 20 million doses of IMVAMUNE®.
The amount will be recognised as income in line with delivery of vaccines.
If Bavarian Nordic fails to fulfil the RFP-3 contract the company has a repayment obligation.

## 20. Related party transactions

The Management and Board of Directors of Bavarian Nordic as well as NeuroSearch A/S are considered related parties as they have significant influence. NeuroSearch A/S is considered to be a related party in that Mr. Asger Aamund is Chairman of the Board for both NeuroSearch A/S and Bavarian Nordic A/S.

**Inter-company purchases from the subsidiaries comprise:**

| Amounts in DKK thousands | **2007** | **2006** |
|---|---|---|
| **Research and development costs** | | |
| Bavarian Nordic A/S purchase of research and development services from Bavarian Nordic GmbH | 109,898 | 104,613 |
| Bavarian Nordic A/S purchase of research and development services from Bavarian Nordic Inc | 7,392 | 3,643 |
| **Management fee** | | |
| BN ImmunoTherapeutics Inc, purchase of management services from Bavarian Nordic A/S | 244 | 272 |
| **Leasing** | | |
| Bavarian Nordic GmbH rents equipment from Bavarian Nordic A/S | 1,498 | 1,485 |

Information on further inter-company transactions and balances can be found in notes 6 and 7.

Apart from Group intercompany transactions, renumeration of the Board of Directors (note 3), and the warrants programme (note 21), there are no significant transactions with related parties.

## 21. Warrant programmes

**Share-based payment and remuneration**
For motivation and keeping key personnel Bavarian Nordic A/S and Bavarian Nordic GmbH has established stock option programmes for the Management, managers and other employees. The purpose of the stock option programmes is to ensure common goals for the Management, employees and shareholders.

**Warrant programme**
The Board of Directors has in January 2004, August 2006, August 2007 and November 2007 awarded warrants to the Management, managers, other employees in Bavarian Nordic and the Board of Directors as shown in the table below.

The allocation is in compliance with the Annual General Meeting given to the Board of Directors. The Board of Directors has determined the conditions for and the size of the allocation with regard to the Annual General Meeting´s authority, a valuation of the expectations for the performance of the recipient, contribution to the Bavarian Nordic growth and for the motivation and keeping key personnel. In compliance with the rules in "Aktieoptionsloven" are there rules regarding resignation before exercise of the shares.

The warrant programme has a regulation, if the decision is taken to increase the capital in Bavarian Nordic, it means that the shares in Bavarian Nordic can apply for quotation, which is lower than the market quotation, will the number of shares, subscribe for regarding the warrant programme will the exercise price for the share be adjusted to compensate the warrantholder for dilution. The warrant programme from 2006 is adjusted regarding these rules as a result of the Rights Issue in March 2007.

Further terms for the warrant programme is in the Articles of Association (§§ 5c,d and e) of Bavarian Nordic A/S.

The share exercise price and exercise period is mentioned below under each programme.

In order to exercise warrants, the employee must not have resigned his/her position in Bavarian Nordic before end of the exercise period.

**Exercise of 2004 programme**
During the period from 18 April 2007 to 2 May 2007 the Board, Management and other employees exercised warrants awarded in 2004. The subcription price of the new shares was DKK 291 per share. The warrantholders subscribed for a total of 164.162 new shares of a nominal value of DKK 10. The programme is herafter expired and fullfilled.

The average share price on execute was DKK 558.
The average exercise price was DKK 291.

**Phantom share programme**
In the phantom share programme each full-time employee will be awarded, free of charge 3 phantom shares per month during the period 1 November 2006 to 31 October 2009. Accordingly, each full-time employee may be awarded up to a maximum of 108 phantom shares. New employees will join the program at the time as they join Bavarian Nordic.

Settlement of the phantom share programme may take place in a period of two weeks after disclosure of Bavarian Nordic Interim Report for third quarter 2009. The owner of the phantom share receive the deviation between the share price at the allocation time, 394 DKK, and average share exercise price for the Bavarian Nordic shares on OMX during the period of 10 days on the stock exchange before the first day in the exercise period only if the the exercise price is minimum 10% higher than the price at the allocation. If the share exercise price is lower than 10% all given share will be annulled with out any warning or compensation. The phantom share program has an adjustment mechanism in case of changes in the Bavarian Nordic's capital structure, including raise in capital to price under market level. In compliance of these rules are the average price reducted from 422 DKK to 394 DKK because of the diluted value of the programme based on Bavarian Nordic succesfully completed a rights issue in March 2007.

In certain circumstances the program has a possibility or duty to extraordinary settlement of the phantom shares in case of merger, demerger, dequotation, changes in management.

*Continues >*

## 21. Warrant programmes - *continued*

### 2006 DK programmes

| | Outstanding as of 1 January 2006 | Addition during the year | Options exercised | Annulled | Terminations | Outstanding as of 31 December 2006 |
|---|---|---|---|---|---|---|
| Board of Directors | 21,592 | 21,116 | - | - | - | 42,708 |
| CEO & President | 16,195 | - | - | - | - | 16,195 |
| Group Management | | 79,191 | - | (15,000) | - | 64,191 |
| Other management | 59,921 | 56,484 | - | - | - | 116,405 |
| Other employees | 34,018 | 6,861 | - | - | - | 40,879 |
| Retired employees as of 31 December | 44,270 | 21,116 | - | - | - | 65,386 |
| **Total** | **175,996** | **184,768** | **-** | **(15,000)** | **-** | **345,764** |

| | |
|---|---|
| Numbers of warrants which can be exercised as of 31 December 2006 | 0 |

### 2007 DK programmes

| | Outstanding as of 1 January 2007 | Addition during the year | Options exercised | Annulled | Terminations | Outstanding as of 31 December 2007 |
|---|---|---|---|---|---|---|
| Board of Directors | 42,708 | 20,000 | (21,592) | - | - | 41,116 |
| CEO & President | 16,195 | 30,000 | (16,195) | - | - | 30,000 |
| Group Management | 64,191 | 70,000 | - | (15,000) | - | 119,191 |
| Other management | 116,405 | 61,000 | (59,921) | - | - | 117,484 |
| Other employees | 40,879 | 4,000 | (34,018) | - | - | 10,861 |
| Retired employees as of 31 December | 65,386 | 15,000 | (32,426) | - | (11,844) | 36,116 |
| **Total** | **345,764** | **200,000** | **(164,152)** | **(15,000)** | **(11,844)** | **354,768** |

| | |
|---|---|
| Numbers of warrants which can be exercised as of 31 December 2007 | 0 |

## 21. Warrant programmes - *continued*

### Outstanding warrants as of 31 december 2007

| | 2006 | 2007 | 2007 | Total |
|---|---|---|---|---|
| Terms in years: | 2 | 3 | 3 | |
| *Number of warrants:* | | | | |
| Board of Directors | 21.116 | 20.000 | - | 41.116 |
| CEO & President | - | 30.000 | - | 30.000 |
| Group Management | 64.191 | 45.000 | 10.000 | 119.191 |
| Other management | 56.484 | 61.000 | - | 117.484 |
| Other employees | 6.861 | 4.000 | - | 10.861 |
| Retired employees | 21.116 | 15.000 | - | 36.116 |
| **Total** | **169.768** | **175.000** | **10.000** | **354.768** |

**Specification of parameters to BlackScholes model**

| | | | |
|---|---|---|---|
| Average share price (DKK) | 433,00 | 436,50 | 410,00 |
| Average share exercise price (DKK) | 542,00 | 549,00 | 505,00 |
| Expected volatility rate | 36.00% | 31.00% | 30.00% |
| Expected option life | 3,3 | 3,3 | 3,1 |
| Expected dividend rate share | - | - | - |
| Risk-fee interest rate | 3.00% | 4.00% | 4.50% |
| Fair value of the share exercise price is based on BlackScholes model in DKK. | 49 | 65 | 97 |

The expected volatility is based on the historic volatility adjusted for the expected changes regarding public information.

The expense on the warrant programme is DKK thousands 3,749 in 2007 and DKK thousands 1,100 in 2006.

**Exercise periods**

2007 programmes
The warrants can be exercised wholly or partly in a period of 14 days commencing from the day of publication of the company's quarterly report for the third quarter in the year of 2010 and/or in a period of 14 days commencing from the day of publication of the company's annual results for 2010 (spring 2011).

2006 programmes
The warrants can be exercised wholly or partly in a period of 14 days commencing from the day of publication of the company's quarterly report for the third quarter in the year of 2009 and/or in a period of 14 days commencing from the day of publication of the company's annual results for 2009 (spring 2010).

## 21. Warrant programmes - *continued*

### Phantom shares - 2006 programme

| | 2007 | 2006 |
|---|---|---|
| Outstanding as of 1 January 2007 | 1,216 | - |
| Addition during the year | 7,591 | 1,216 |
| **Outstanding as of 31 December 2007** | **8,807** | **1,216** |

| | |
|---|---|
| Average share price (DKK) | 515 |
| Average share exercise price (DKK) | 394 |
| Expected volatility rate | 54.00% |
| Expected option life | 1.9 |
| Expected dividend rate share | - |
| Risk-fee interest rate | 3.00% |

The expected volatility is based on the historic volatility adjusted for the expected changes regarding public information.

The expense on the phantom share programme is DKK thousands 868 in 2007 and DKK thousands 196 in 2006.

| | 2007 | 2006 |
|---|---|---|
| Obligation as of 31 December regarding phantom shares | 1,064 | 196 |

### Warrant programmes - US

| | 2006-program |
|---|---|
| Outstanding warrants as of 31 December 2006 | 0 |
| Addition during the year | 190,500 |
| **Outstanding warrants as of 31 December 2007** | **190,500** |

There is a deviation in US programme compared to DK programme.
Each warrant has a fair value to 1 USD according to the information available for the Board of Directors.

The programme includes all employees in USA.

The expense on the warrants is DKK thousands 340 in 2007 and DKK thousands 0 in 2006.

## 22. Contingent liabilities, contractual obligations

| Amounts in DKK thousands | Parent company and Group | |
|---|---|---|
| | **2007** | **2006** |
| The Parent company stands surety for a credit facility to the subsidiary of a maximum of: | 1,267 | 10,000 |
| Bank guarantees issued as deposits for laboratory and office buildings in Martinsried, Germany. | 2,054 | 2,054 |
| **Operational leasing** | | |
| Leasing obligations for cars. The rental agreements are irrevocable up to 34 months. | | |
| - Due during the next year | 1,544 | 2,312 |
| - Due between 1 and 5 years | 2,620 | 2,286 |
| - Due after 5 years | - | - |
| **Rental commitments** | | |
| Rental agreements for laboratory and offices facilities. | | |
| The rental agreements are irrevocable from 6 to 72 months. | 27,750 | 35,696 |
| The above-mentioned rental agreements have bound payment obligations as follows: | | |
| - Due during the next year | 11,068 | 10,596 |
| - Due between 1 and 5 years | 16,682 | 22,285 |
| - Due after 5 years | - | 2,815 |
| **Collaborative agreements** | | |
| The company has contractual obligations with research partners for long-term research projects. | | |
| - Due during the next year | 16,124 | 8,833 |
| - Due between 1 and 5 years | 8,190 | 1,599 |
| - Due after 5 years | - | - |
| **Other contractual obligations:** | | |
| - Due during the next year | 10,386 | 3,753 |
| - Due between 1 and 5 years | 914 | 2,480 |
| - Due after 5 years | 100 | 2,160 |

**Lawsuits**
Bavarian Nordic is not involved in any significant lawsuits or arbitration cases which could have essential influence on the income statement of the Parent company or the Group's financial position or result.

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**About the Annual Report**

This annual report is available in Danish and English. The Danish version is legally binding.

The annual report is available in PDF format on the corporate website. The print version is available on request from Bavarian Nordic's head office.

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In 2007, Bavarian Nordic established a new commercial function with the purpose of increasing the sales promotion for IMVAMUNE® and ensuring that the company's research and development is increasingly commercialised and that necessary market knowledge at an early stage is integrated in the decision-making processes within clinical development.