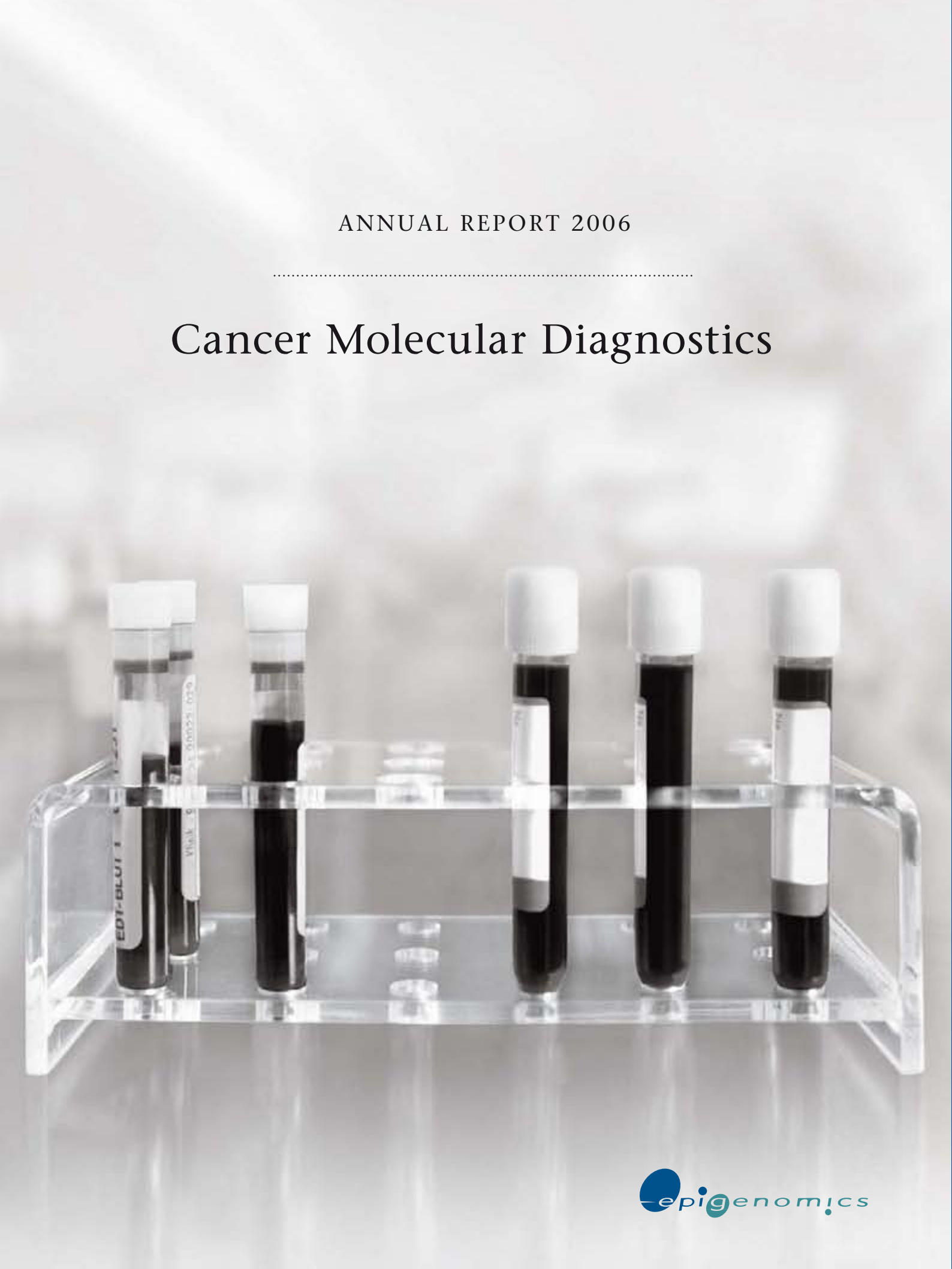
ANNUAL REPORT 2006

# Cancer Molecular Diagnostics



epigenomics

# Key Figures

2006/2005

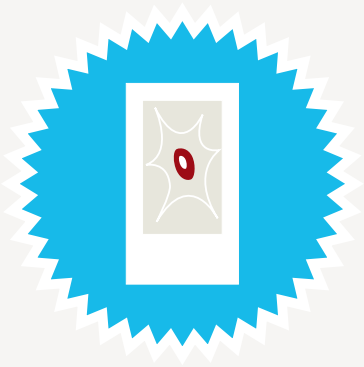
| EUR thousand unless stated otherwise | 2006 | 2005 |
|---|---|---|
| Revenue | 3,504 | 9,594 |
| Research and development costs | –8,702 | –8,121 |
| Earnings before interest and taxes (EBIT) | –15,761 | –10,234 |
| Earnings before interest, taxes, depreciation and amortization (EBITDA) | –14,193 | –8,560 |
| Net loss for the year | –15,402 | –8,788 |
| Average number of shares issued (notional par value: EUR 1) | 16,686,707 | 16,373,948 |
| Earnings per share (basic) in EUR | –0.92 | –0.54 |
| Cash flow from operating activities | –14,378 | –7,501 |
| Cash flow from investing activities | 2,610 | –1,689 |
| Cash flow from financing activities | 807 | 228 |
| Cash flow total (incl. currency adjustments) | –10,953 | –8,647 |

| | Dec 31, 2006 | Dec 31, 2005 |
|---|---|---|
| Liquid assets at balance sheet date (incl. marketable securities) | 17,341 | 32,692 |
| Total equity at balance sheet date | 26,198 | 39,375 |
| Equity ratio in % | 86.9 | 87.5 |
| Total assets at balance sheet date | 30,134 | 44,997 |
| Share price at balance sheet date in EUR (Xetra) | 3.50 | 6.45 |
| Number of employees at balance sheet date | 145 | 141 |

# Core Business Areas

## Cancer Screening Diagnostics

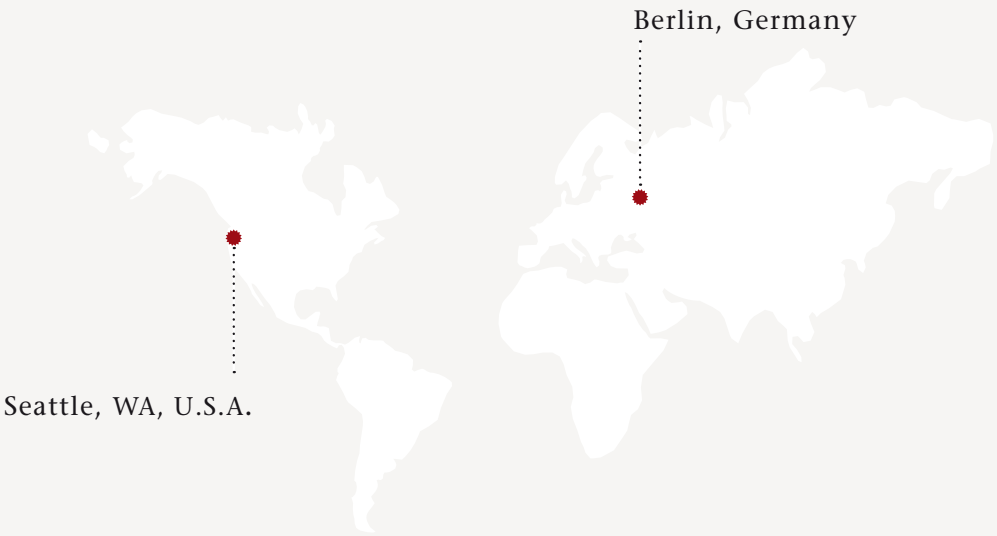
Development and commercialization of molecular diagnostic test products for the improved organ-specific early detection of cancer in body fluids addressing high-volume markets with up to 300 million men and women eligible for cancer screening.



## Cancer Specialty Diagnostics

Development and commercialization of innovative molecular diagnostic test products for cancer specialty applications with high medical needs such as surveillance and monitoring of high-risk groups and cancer prognosis.

# Locations



EPIGENOMICS

MISSION STATEMENT

To build a world-leading cancer molecular diagnostics company based on DNA methylation.

# Contents



## EXECUTIVE BOARD

**Oliver Schacht, Ph.D.**
CFO (36)

**Geert Walther Nygaard**
CEO (46)

**Christian Piepenbrock**
COO (38)

**Dr. Kurt Berlin**
CSO (39)

# Letter to Shareholders

Dear Shareholders,

2006 has been a year of unprecedented challenges for Epigenomics but also a year of considerable clinical and commercial progress. Not surprisingly, our Company has been in the public spotlight mostly for its challenges: After the resignation of the founder and CEO of Epigenomics AG Alexander Olek, Ph. D., in summer 2006, the management team decided to focus on the key value drivers of the business. As a consequence, Epigenomics was restructured in October 2006, resulting in a far more streamlined organization with fewer early stage research programs, clear emphasis on later stage clinical research and development projects, exclusively focused on oncology tests, but also in the loss of 34 jobs in Berlin. Finally, close to year-end, Roche Diagnostics determined to end the partnership in the field of blood-based early cancer detection tests after four years of collaboration.

Today, Epigenomics is stronger than ever: Geert Walther Nygaard, a senior Abbott executive, has joined our team as the Company's new CEO. Mr. Nygaard will lead the team into the next phase of clinical development, strategic partnering, financing and commercialization. Having enjoyed a long, distinguished career in the diagnostics industry, he brings the experience that will help us to get our diagnostic products into the hands of doctors, patients and our partners as quickly and decisively as possible.

Looking back on 2006, there are many achievements standing out giving us the confidence that we are making very good progress on the right path:

In 2006, our blood-based test for the early detection of colorectal cancer has been validated yet again in several large clinical studies. With the identification of an additional biomarker we were able to improve the product: It now detects two-thirds of all colon cancer patients from a simple blood draw – compared to half of them a year ago. We have also demonstrated several paths for even further enhancements and are committed to finding the best possible partners for both a reference laboratory version of colon cancer testing as well as IVD and platform partners for the commercialization of a kit.

In prostate cancer early detection we have conducted a first clinical study in blood and urine. We were able to show that our technology and workflow function extremely well in this indication. Also, we could demonstrate that urine is the better sample source for prostate cancer detection compared to blood. Finally, we already have several biomarkers that have shown excellent performance in some of the relevant clinical questions in prostate cancer with almost three-quarters of all prostate cancers found with very few false positive results.

Having received approximately EUR 30 million in funding from Roche Diagnostics since the establishment of the partnership in 2002, we now own and control the worldwide rights to all of our diagnostic products. We are now free to progress our partnering discussions based on all data and results to date with interested parties on any or all of these programs and intend to do so with full force.

Since we took the decision in late 2005 to forward integrate to become a full diagnostics company bringing our own products to the market, we successfully transformed Epigenomics into a product development organization. We progressed in our tissue test development programs exactly as planned and promised and, most importantly, established our proprietary IVD platform through partnering: The preanalytics module will be provided by our partner Qiagen who already successfully launched a kit for preanalytics in April 2006 into the research market. Further, we were able to sign a strategic alliance with Affymetrix, the world's leading provider of microarray- or chip-based molecular diagnostics platforms and solutions. Not only did we obtain access to their established IVD platform, but also did Affymetrix make a commitment to Epigenomics and DNA methylation by becoming a shareholder in summer of 2006. By year-end we have successfully transferred our most advanced product, a test for the aggressiveness and relapse probability of prostate cancer following surgical removal of the prostate, onto the Affymetrix platform. These important steps towards our own products now clear the way for an early launch of our prostate molecular classification test as a testing service in a centralized reference laboratory in 2008.

Biomarkers in drug development, whose importance was once only advocated by some visionaries in the industry, finally are recognized as key success factors for future drugs. Our Clinical Solutions business has established seven new commercial collaborations with leading drug companies such as Johnson & Johnson, AstraZeneca, Centocor and others. This is the highest number of new deals of any year in our Company history and a strong indication that DNA methylation biomarkers and our biomarker discovery capabilities are increasingly recognized as competitive advantage in the pharmaceutical and biotechnology industries. More than ever, this success validates our Clinical Solutions business and its potential to fuel the Epigenomics diagnostic product pipeline in the future.

Let's be realistic: 2007 will be a challenging and decisive year in many ways for Epigenomics. A year in which we will find new partners for our cancer screening products; the year we plan to prepare for launch of our prostate cancer tissue test; a year we expect to further leverage our Clinical Solutions offering and intellectual property via licensing and collaborations; and, most importantly, the year we will need to take fundamental decisions and actions as to our further financing and strategic direction ahead – a direction that is guided by an unwavering commitment to build one of the world's leading cancer molecular diagnostics companies and help save people's lives by detecting cancer early and help cancer patients and doctors make the best treatment decisions.

Sincerely,

Geert Walther Nygaard

Christian Piepenbrock

Oliver Schacht, Ph.D.

Dr. Kurt Berlin

# Executive Board

### Geert Walther Nygaard

CEO (46)

Geert Walther Nygaard has an academic background in chemical engineering from Technical University Copenhagen and received marketing and management training at INSEAD in France. He started his career in Denmark, working for Diagnostics companies Beckman Instruments and Dako A/S in national and international positions. Before he joined Epigenomics in February 2007, he held a position as Managing Director and member of the Management Board of Abbott GmbH & Co. KG in Wiesbaden, Germany. At Epigenomics, Mr. Nygaard has been appointed Chief Executive Officer.

### Oliver Schacht, Ph.D.

CFO; CEO Epigenomics, Inc. (36)

Oliver Schacht earned his diploma in European Business Administration from the European School of Business Reutlingen, Germany, and received his Ph.D. in Management Studies from the University of Cambridge (U.K.). With Mercer Management Consulting since 1995, Oliver Schacht has been with Epigenomics since June 1999. As CFO, he heads accounting and finance, corporate communications and HR. At the beginning of 2006, he also took over the position as CEO of Epigenomics, Inc., Seattle.

### Christian Piepenbrock

COO, Head of Diagnostics (38)

Christian Piepenbrock graduated with a diploma in bioinformatics from the University of Bielefeld in 1995 and spent one year at Harvard University and the Massachusetts Institute of Technology (MIT) before joining the Technical University of Berlin where he dealt with neural data processing. Being with Epigenomics since November 1998, Christian Piepenbrock heads its operating business as well as the Diagnostics business.

### Dr. Kurt Berlin

CSO (39)

Dr. Kurt Berlin gained his Ph.D. in organic chemistry at the University of Bonn, before moving on to Tufts University in Boston, MA, and joining the Max-Planck-Institute for Molecular Genetics in Berlin in 1997. Dr. Kurt Berlin has been with Epigenomics since November 1998, leading as CSO the biomedical research and development activities. He is also responsible for business development as well as intellectual property.

# Report of the Supervisory Board


During the fiscal year 2006, the Supervisory Board fulfilled all its duties according to legal requirements as well as the Articles of Association. The Supervisory Board advised and supported the Executive Board in managing the Company. Based on detailed reports of the Executive Board and intensive discussion of relevant issues concerning financial and operational business aspects as well as the Company's strategy during the Supervisory Board's meetings, such advice could be given to further Epigenomics's best interests. Due to the resignation of the Company's CEO Alexander Olek, Ph. D., in August 2006, the dialog between all members of the Supervisory Board and the Executive Board was further intensified and frequent conference calls as well as individual discussions were held. Thus, the Supervisory Board was kept continuously informed about the Company's business strategy, corporate planning including financial, capital expenditure and human resources planning, as well as the general performance of business. The Supervisory Board was also kept informed of all steps concerning the reorganization and unanimously supported the actions proposed and implemented by the Executive Board.

All documents pertaining to the Executive Board's decisions or actions that required Supervisory Board approval were inspected by the Supervisory Board at its plenary meetings – prepared in detail by its two committees – or were approved on the basis of documents circulated to its members.

An important challenge for the Supervisory Board was its new composition following the Annual General Shareholders' Meeting on July 10, 2006, at which a group of shareholders had proposed an alternative candidate to join Epigenomics's Supervisory Board. Following the open general debate and the elections, the majority of shareholders supported the proposal made by the Supervisory Board to elect Günter Frankenne as new member of the Supervisory Board following the decision of John Berriman not to run for re-election after more than five years in office. At a Supervisory Board meeting immediately after the Annual General Shareholders' Meeting, Professor Dr. Dr. Uwe Bicker was unanimously elected deputy chairman and Professor Dr. Dr. h.c. Rolf Krebs confirmed as chairman of the Supervisory Board.

Recently, Bruce Carter, after having seen Epigenomics through the IPO from a venture capital backed firm to a publicly listed diagnostics company, decided to step down to allow further strengthening of the commercial diagnostics side of the Board. To replace Bruce Carter, the Supervisory Board will propose Heino von Prondzynski, former CEO of Roche Diagnostics, for election into the Board on the next Annual General Shareholders' Meeting. The Supervisory Board is extremely pleased that Heino von Prondzynski agreed to stand for election.

The Supervisory Board also continuously reviewed compliance to corporate governance principles by Epigenomics. Both the Executive Board and the Supervisory Board believe that the commitment to corporate governance is an important measure for enhancing the confidence of current and future shareholders, corporate partners and employees. The Company has committed itself to the German Corporate Governance Code, and only in some cases adopted company-specific principles deviating from these proposals.

During fiscal year 2006, six plenary meetings of the Supervisory Board with the Company's Executive Board took place. Bruce Carter could only take part in less than half of the meetings of the Supervisory Board during the fiscal year 2006. The Supervisory Board meetings were held in Berlin and Frankfurt am Main to minimize expenses and maximize efficiency. Also, five conference calls between the Supervisory Board and the Executive Board were held at regular intervals in summer and fall of 2006 to discuss the important aspects of the reorganization, strategic planning as well as the search for a new CEO. The work of the Supervisory Board was supported by its two committees: The Audit and Corporate Governance Committee

as well as the Personnel and Compensation Committee. In order to increase the efficiency of the Supervisory Board's work, both committees held four conference calls in 2006. The respective committee chairmen reported regularly to the Supervisory Board on the work of the Committees.

The auditing company UHY Deutschland AG Wirtschaftsprüfungsgesellschaft, Berlin, has audited the annual financial statements of Epigenomics AG for fiscal 2006 in compliance with the principles of the German Commercial Code (HGB) as well as the consolidated financial statements and the related notes for fiscal 2006 according to International Financial Reporting Standards (IFRSs) including the management reports. UHY Deutschland AG did not raise any objections for both financial statements and issued unqualified opinions. The Supervisory Board accepted and confirmed the results of the audit. Following its own review, the Supervisory Board approved the annual financial statements and the consolidated financial statements as of December 31, 2006, without exception and modification in its meeting of March 1, 2007, in the presence of the auditors. According to section 172 of the German Stock Corporation Act (AktG), the annual financial statements of Epigenomics AG are thus adopted.

Regarding the existing risk management system as the Company's early warning system, the auditors stated that in their opinion the system is suitable to meet all legal requirements.

The Consolidated Management Report includes the information required pursuant to Section 315 (4) of the German Commercial Code (Handelsgesetzbuch - HGB). The Executive Board has described the information in a statement which will be available for inspection on the Company's website and at its premises from the date the Annual General Shareholders' Meeting is convened. It will also be available to shareholders at the Annual General Shareholders' Meeting. The Supervisory Board reviewed the information and the statement of the Executive Board. The result of the review confirms the accuracy of the information provided. The Supervisory Board therefore concurs with the explanations provided by the Executive Board in the statement required pursuant to Section 315 (4) of the German Commercial Code.

The Supervisory Board would like to thank the Executive Board, the senior management as well as all employees for their commitment and efforts during a very difficult and challenging year 2006.

The Supervisory Board would like to thank its former members John Berriman and Bruce Carter for their valuable contributions over many years. The Supervisory Board expresses special thanks to former CEO and founder Alexander Olek, Ph. D., for his entrepreneurial contribution and strategic vision from the early start-up days through almost eight years of successful corporate development and a transition of Epigenomics to become a product development and commercially focused company.

Berlin, March 2007

Professor Dr. Dr. h.c. Rolf Krebs
Chairman of the Supervisory Board

«We can only detect colorectal cancer at an early stage in patients who are tested regularly but compliance of patients to the often inconvenient current screening methods is low. A simple blood-based colorectal cancer screening test would find a higher acceptance in individuals at risk and would greatly increase the chances of finding this cancer early, when it still can be cured.»

Dr. Robert Grützmann,
Assistent Professor, General Surgeon
University Hospital Carl Gustav Carus,
Dresden, Germany

Epigenomics develops a colorectal cancer screening test that detects this cancer at early stages with much higher sensitivity and fewer false-positive results than the currently most widely used stool test (FOBT) – by using a simple routine blood sample.

# Meeting the New CEO

"At Epigenomics we have a unique technology that allows us to address diagnostics needs that could not be addressed easily so far."

Geert Walther Nygaard (CEO)

**Mr. Nygaard, what motivated you to move from the second-largest diagnostics industry player Abbott to a dynamic but small biotech company?**

After some years with an established company like Abbott, I got to the point where I wanted to leverage my experience and expertise in the diagnostics market by helping to bring innovative products to the market that have the potential to make a real difference to the patients. When Epigenomics approached me, I found everything I was looking for: Superior technology with a competitive advantage, a highly committed team, a board with very experienced senior diagnostics and industry experts, and products in the pipeline that have an outstanding potential to change cancer diagnostics from how we knew it. A perfect fit.

**What is your personal outlook on the diagnostics market and industry?**

There is a lot going on right now. The landscape is changing with Siemens taking over Bayer Diagnostics and Abbott Diagnostics selling parts of the business to GE Healthcare. This reflects the development of the big players to integrated health-care solution providers. At the same time, new technologies allow to address unmet diagnostics needs, in particular in cancer which is expected to show the largest growth rates in the diagnostics arena. These technologies lie in the hands of smaller companies like Epigenomics, who have the chance to position themselves as content providers for the large players. The fact, that most of the new biomarkers are proprietary puts these smaller players into a pretty strong position.

**Do you have experience with the markets addressed by Epigenomics's products?**

I worked in both, in large screening markets as well as in specialized diagnostics markets. Dako is one of the leading providers of tissue tests mostly relying on immunohistochemistry. Dako also was the first diagnostics company to offer a test that predicted response to an oncology drug, the HercepTest. Only breast cancer patients that test positive in the HercepTest should receive treatment with Herceptin, an oncology drug developed by Roche and Genentech. And at Abbott, I was strongly involved in the large screening markets. Both types of products require their own commercialization strategy.

**What are Epigenomics's competitive advantages?**

Well, at Epigenomics we have a unique technology that allows us to address diagnostics needs that could not be addressed easily so far. Thus, we can detect cancer in an organ-specific manner reliably in body fluids by measuring free-floating tumor DNA. DNA is very stable and can be easily amplified allowing for very sensitive assays. But the technology can also be applied to many other diagnostic questions in a generic way. Thus, once there are DNA methylation platforms on the market, it will be easy to add additional parameters to the test portfolio.

Interview by Dr. Achim Plum, Vice President Corporate Communications, Epigenomics AG



**What are Epigenomics's value drivers?**

Epigenomics's lead product is the colorectal cancer screening test. After the improvements made throughout 2006 on the assay performance, this test is ready for IVD development and I believe it can be positioned very well in the market. And this screening market with a potential of over a billion euros is huge. However, we need partners for these big markets while we can commercialize more specialized cancer diagnostics ourselves. Here, our prostate cancer molecular classification test is of importance as it can reach the market as early as 2008. This will generate first revenues from product sales and at the same time validate our approach commercially.

**What will be key to realize the potentials of Epigenomics's products? Do you plan major changes in the Company's strategy?**

No, I do not think that major changes in the strategy of Epigenomics are required. The products are well on track but it will be key to focus our development and our commercial efforts. This will allow us to identify the right partners for the commercialization of these products. We also need to make sure to structure these partnerships in a way that we realize the full value potential of our products – for Epigenomics as well as for our shareholders. In the meantime we will assign the resources we have to the most advanced products, namely the colorectal and prostate cancer screening tests and the prostate cancer molecular classification test.

Geert Walther Nygaard, 46, was appointed Epigenomics's new CEO in January 2007. He joined Epigenomics in February 2007 from a position as Managing Director and member of the Management Board of Abbott Germany, where he held the commercial responsibility for the Diagnostic Division. Geert Nygaard, a Danish citizen, started his career in Denmark, working for Diagnostics companies Beckman Instruments and Dako A/S in national and international positions. He joined Abbott in 1999 as the company's Country Manager in Denmark from a position as Managing Director of Dako AG in Switzerland. He then moved on into positions with increasing responsibilities, including business development and marketing for Abbott Diagnostics in Europe. Geert Nygaard is married and has two children, a daughter, 18, and a son, 15.

**From your point of view: What do you consider the opportunities and challenges that lie ahead for Epigenomics in the next twelve months?**

Our opportunities lie in our products, all of which have a unique potential and in the fact, that we are in full control of them and we own the worldwide rights. However, we need partners to commercialize the cancer screening products. Currently we are very actively negotiating with several potential industry partners. Our negotiation position is quite strong since our biomarkers address highly unmet diagnostic needs, perform strongly and are proprietary to us. We will also need to augment our financial resources for the development period between 2008 and the time when our products generate significant revenues. On the financing side, we are systematically evaluating all strategic options to address our funding requirements.

**How did you experience your first weeks at Epigenomics?**

Oh, I was very happy with the warm-hearted way I was welcomed on my first day. This made it easy to start right away. I spent some time to get to know the people in Berlin and Seattle, and the more of them I met, the more convinced I was that we have a great and very professional team.

**You are married and have two children. How did they and you experience Berlin so far? Are you and your family going to move here?**

Right. My family is as excited about Berlin as I am. We moved around quite a bit and after several years in the quiet Taunus highlands, they and I are more than happy with the prospect of moving to one of the most exciting cities of the world.

**Thank you, Mr. Nygaard.**

# Epigenomics in a Nutshell

**Cancer is a dreaded and often fatal disease. However, given today's treatment options, outcomes could be greatly improved if more cancers were detected in early stages and treatments were better tailored to individual patients' needs. This unmet medical need makes IVD (in vitro diagnostic) tests for cancer the segment with the biggest future growth potential in the multi-billion euro molecular diagnostics market. Epigenomics is a molecular diagnostics company focusing entirely on the development and commercialization of in vitro diagnostic tests for cancer screening and cancer specialty applications such as monitoring and classification.**

**Cancer screening tests.** Our screening tests aim at finding cancer at early stages before symptoms occur and are carried out conveniently on body fluids such as blood plasma or urine. These tests address millions of individuals in each of the major markets such as the United States, Europe, and Japan and provide product opportunities each with peak sales potentials of several hundred millions of euros.

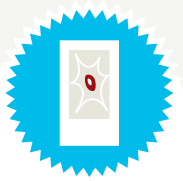
In 2006, we concluded an extensive research phase of our colorectal cancer screening test development, we also demonstrated the feasibility of detecting prostate cancer with high sensitivity in urine, and discovered candidate biomarkers for lung cancer. Following the termination of our collaboration with Roche Diagnostics, we are now in full control of all our product development programs and have entered into strategic partnering discussions with suitable industry partners to develop and commercialize these IVD tests. Even before their launch as IVD kits, we aim at giving doctors and patients access to these tests via centralized reference laboratories.

**Cancer specialty diagnostics.** Our cancer specialty diagnostic tests are directed at people at high risk of developing cancer or at cancer patients. The specialty tests for the surveillance of individuals at high risk and cancer recurrence monitoring of patients are based on testing blood plasma or other body fluids for our DNA methylation biomarkers. In 2006, we demonstrated that combinations of our colorectal cancer biomarkers can be optimized for the detection of precancerous lesions or applications that require a high sensitivity for cancer such as surveillance or monitoring. Negotiations with centralized reference laboratories are underway to make our colorectal cancer biomarkers available to patients as early as 2008.

Those cancer specialty tests that are based on routinely obtained tumor tissue from newly diagnosed cancer patients are directed at classifying them by their disease prognosis (e.g. "good" or "poor") or their responsiveness to a particular therapy. These tests address high-margin specialty markets with sales potentials of several tens of millions of euros each. Significant progress was made in

## Cancer screening diagnostics

- Early detection of cancer
- Addressing healthy people
- Noninvasive blood or urine tests
- Mass marketing to GPs and payors
- Partnering strategy with multiple leading diagnostics industry players
- Early market access via reference laboratories



## Cancer specialty diagnostics

- Support of cancer management
- Addressing high-risk groups and cancer patients
- Body fluid or tumor tissue tests
- Focused marketing to specialists
- Development & commercialization by Epigenomics
- Early market access via reference laboratories

## Methylation technologies

- IP Portfolio of 200 filed patents families of which 61 patents are granted in one or more countries.
- Access to Epigenomics's proprietary DNA methylation technologies for research and IVD development through biomarker services, R&D collaborations, and licensing

2006 after focusing product development on our proprietary prognostic biomarker PITX2 in prostate cancer. Through strategic partnerships with industry leaders Qiagen and Affymetrix, we secured access to the preanalytic and diagnostic platform modules of our products. We successfully transferred our biomarker PITX2 onto the Affymetrix IVD instrument. We strive to give doctors and patients access to this prognostic tool through centralized reference laboratories from 2008 onwards. Longer term, our strategy remains to launch the prostate cancer molecular classification test as an IVD test kit.

Epigenomics's diagnostic tests detect differences in DNA methylation patterns between healthy and sick individuals as well as between subgroups of patients with different prognoses. Epigenomics is the industry leader in DNA methylation technologies and biomarkers. Industry partners can access Epigenomics's intellectual property portfolio of more than 200 patent families and biomarker expertise through biomarker services, IVD development collaborations, and licensing. In 2006, we extended two R&D partnerships with AstraZeneca and Philip Morris and started five new ones with Johnson & Johnson, Centocor and others. Our licensing partnership with Qiagen resulted in the successful launch of the EpiTect® Bisulfite Kit, a first product based on Epigenomics's technology on the global research markets.

In 2006, we have also focused our business strategy on the development and commercialization of key value drivers in our product pipeline and have streamlined our organization accordingly.

# Business Model

Our two complementary core businesses, cancer screening diagnostics and cancer specialty diagnostics, address fundamentally different markets that require tailored business strategies:

The market for cancer screening tests is huge as the target population includes all individuals above the age of 50, i.e. up to 300 million people in major market countries. Accordingly, each of the cancer screening tests could potentially achieve peak sales in the hundreds of millions of euros p.a. with an overall early cancer detection market in the billions.

These huge markets require an IVD platform capable of processing large sample numbers, a significant installed base, as well as marketing and a sales force to reach GPs (general practitioners) and local clinical diagnostic laboratories. Our business model for addressing these screening markets is based on partnering with global diagnostics players. In these partnerships we identify the biomarkers, develop the assays and demonstrate their clinical utility while our partners turn them into in vitro diagnostic test kits and commercialize them. By pursuing a nonexclusive licensing strategy, we strive for higher market shares of Epigenomics's products through access to the combined installed base of several partners in each geography. Many industry examples also show that the market uptake of innovative diagnostics greatly benefits from the combined marketing effort of several players and time to peak sales tends to shrink.

In this model, Epigenomics generates revenue and ultimately profits based on upfront, R&D, and milestone payments during product development and royalties on our partners' net sales once the products are being sold in the market. As peak sales estimates for individual products can reach up to 1 billion euros p.a., these products are the key value drivers of Epigenomics's product portfolio.

After termination of the contract with Roche Diagnostics in 2006 and the return of all rights to Epigenomics, our screening test programs for colorectal, prostate, lung, and breast cancer now provide highly attractive partnering and licensing opportunities for diagnostics industry partners. We also have the flexibility to place our assays into reference laboratories and thus make them available to patients and opinion leaders even before their launch as IVD test kits.

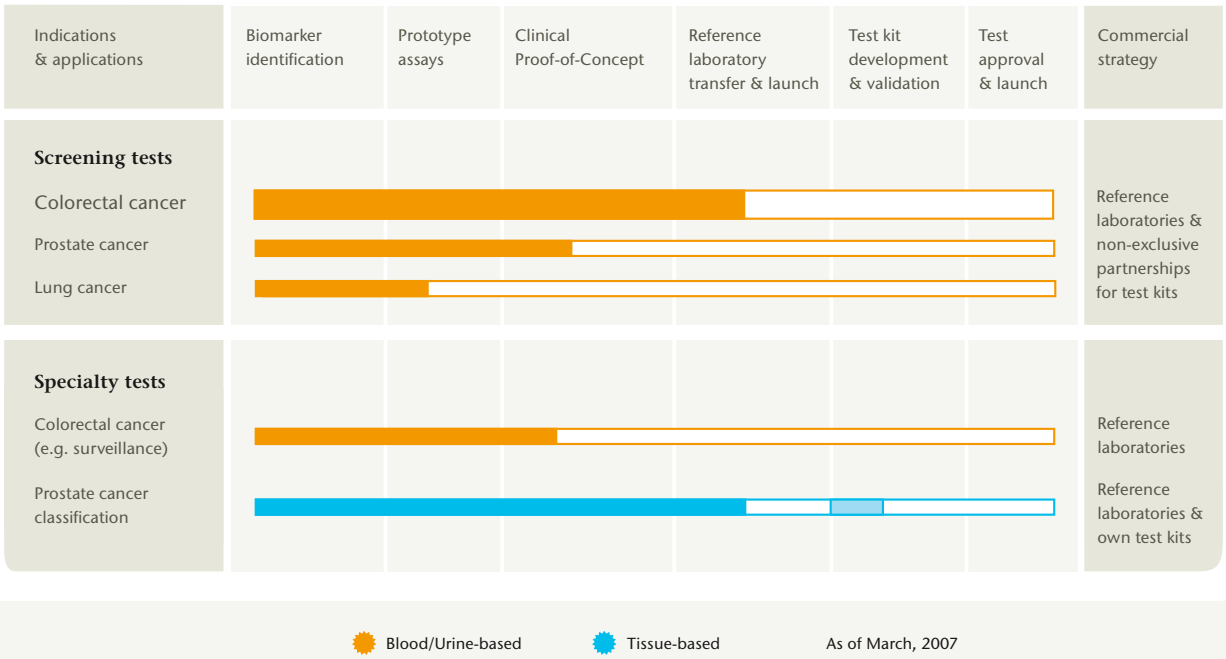
Our cancer specialty diagnostics are intended for individuals at high risk of developing cancer or experiencing cancer recurrence and patients newly diagnosed with cancer. Marketing and sales will target oncologists, pathologists and centralized laboratories. These specialty markets are characterized by high medical needs, premium pricing and high margins and can be addressed with comparably small, specialized sales forces. The business model is either based on offering the test assay through partners' centralized reference laboratories or through selling IVD test kits directly to customers or to distributors. Epigenomics intends to retain control over the entire process of clinical development,

validation, and positioning of these products, as well as obtaining a European CE mark followed by U.S. regulatory approval through the FDA, if appropriate.

Although Epigenomics will act as the legal test kit manufacturer, production of cancer specialty diagnostic tests will be outsourced to OEMs (Original Equipment Manufacturers). For our tissue based cancer molecular classification tests we partnered with Qiagen for the preanalytics module and with Affymetrix for the GeneChip™ microarrays. Through our partnership with Affymetrix we also gained access to the entire installed base of the GeneChip™ IVD instrument on which our test will be run in diagnostic laboratories. We expect the market launch of our prostate cancer molecular classification test and our colorectal cancer biomarkers for surveillance and monitoring applications through centralized reference laboratories in 2008.

Apart from the two core elements of our business strategy, pharmaceutical, diagnostics and biotechnology partners can access our portfolio of proprietary DNA methylation technologies through biomarker services and licensing. Both businesses, the R&D services and collaborations offered by our Clinical Solutions team and the Licensing, have a short-term cash and revenue component but also an upside component in the mid to long term. We expect our R&D services and collaborations to gradually evolve into an engine that fuels our pipeline with innovative IVD products based on the biomarkers discovered and validated in our partnerships. We also expect to benefit from other companies' molecular diagnostics successes in the form of royalties on their products based on licensed DNA methylation technologies.

## Product development pipeline



# Cancer Screening Diagnostics

Each of our cancer screening tests in R&D aims at delivering real benefits to doctors and patients and a unique position in the competitive landscape with respect to sensitivity, specificity, convenience, and cost-effectiveness. Most importantly, our screening tests do not require invasive procedures other than a simple blood draw. They are performed on blood plasma or urine samples that are equally accepted by doctors and patients and facilitate high compliance.

Our screening tests are designed to have a high specificity, so to minimize the number of healthy people falsely assumed to be at risk of having cancer and have to undergo further diagnostic procedures for a definite diagnosis. Since follow-up procedures after a positive first screening result are usually expensive, often invasive and sometimes even risky, high specificity is the key to generate acceptance in the medical community and to make a business case that favors reimbursement.

In sensitivity, i.e. the proportion of cancer patients correctly identified by the test, we strive for competitive performance with currently available in vitro diagnostic screening tests in the respective indications. Our biomarkers for the early detection of colorectal and prostate cancer outperform the currently most widely used IVD screening tests for these indications, FOBT (fecal occult blood testing) and PSA (prostate-specific antigen), respectively.

Our cancer screening tests rely on the sensitive detection of tumor DNA shed to the blood stream, urine or other body fluids the tumors are exposed to. This DNA differs little from any healthy DNA in its sequence but has a cancer-specific DNA methylation pattern in certain genes. Epigenomics's highly sensitive assay technologies detect these patterns in specific genes and thus require only minute amounts of tumor DNA in body fluids as a diagnostic biomarker.

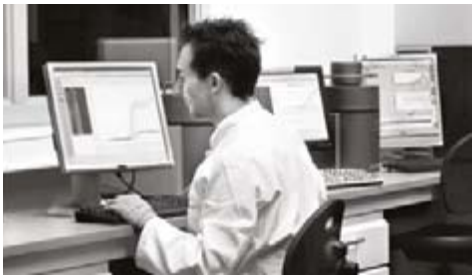
We actively pursue three cancer screening test development programs in colorectal, prostate and lung cancer. As part of our initiative to further enhance our lead program in colorectal cancer, we put our program in breast cancer on hold for now.

**Colorectal cancer screening.** The most advanced of our cancer screening test development programs is in colorectal cancer. In five clinical studies with about 3,000 healthy individuals, cancer patients and critical controls from patients with gastrointestinal conditions or other cancers and chronic diseases, we have successfully demonstrated that we are able to detect colorectal cancer reliably by measuring our proprietary DNA methylation biomarkers in blood plasma. Much of 2006 was dedicated to improving test performance by adding further biomarkers to the "anchor" marker Septin 9 and by further optimizing the assay procedure. In a prospective clinical study in December 2006, we demonstrated that by measuring a DNA methylation biomarker panel that included our proprietary biomarker Septin 9 in blood plasma we could detect 66 % of all colorectal cancers (i.e. a sensitivity of 66 %) at a very high specificity of 93 % (i.e. only 7 % false positive test results). With the improved workflow, the leading marker Septin 9 alone detected 63 % to 70 % of the colorectal cancers depending on the accepted rate of false positive results (specificity of 97 % to 90 %, respectively).

The gold standard screening test in colorectal cancer is colonoscopy, an invasive test, whereby the physician visually inspects the inside of the colon. This procedure has excellent specificity and sensitivity characteristics. However, as this is a high-cost invasive procedure with some

## Market potential and characteristics of cancer screening tests

| | Colorectal cancer screening | Prostate cancer screening | Lung cancer screening |
|---|---|---|---|
| Target population | Men and women aged 50+ | Men aged 50+ | Men and women aged 45+ |
| Sample | Blood plasma | Urine | Blood plasma |
| Markers and status | Biomarker panel including Septin 9, clinically validated | Biomarkers identified and clinically demonstrated | Biomarkers identified |
| Size of target population (U.S.A., Europe, Japan) | ~300 million | ~150 million | ~300 million |
| Peak market potential | > EUR 1,000 million | > EUR 500 million | > EUR 300 million |
| Partnering | Late-stage partnering opportunities | Advanced partnering opportunities | Early-stage partnering opportunities |
| Upcoming development milestones | H2/2007: Routine assay procedure developed;<br>2008: Launch testing service by reference laboratory;<br>2008: Start of IVD test development by diagnostics partner(s) | 2007: Biomarker panel optimization and further study in urine | 2007: Biomarker selection and clinical demonstration in blood plasma |

morbidity and mortality, it is currently not used for first-line screening for average risk individuals in intervals less than five years. A noninvasive first-line screening test could be used to screen larger numbers of individuals more frequently to identify those with high likelihood of having the cancer who would then undergo colonoscopy. Currently, most noninvasive screening is carried out with the FOBT procedure using stool samples. This test is usually performed at home and due to the nature of the test, the compliance rate is low (approximately 16 % in the United States). Clinical experts believe that a blood-based test for which the blood sample may be taken at the GP's (general practitioner's) office would greatly increase compliance. With sensitivities of 60% or more, this could also increase the chance for early detection of the cancer at a stage where it can be treated more effectively. Epigenomics's colorectal cancer test is uniquely positioned to meet these requirements. Accordingly, the market potential for this test with a target group of more than 300 million individuals in the major markets is estimated to be well above 1 billion euros.

Development in the colorectal cancer program focuses on defining the routine product's assay procedures with the use of generic preanalytics solutions. Prototype assay procedures and biomarker assays will be transferred into centralized reference laboratories for early market access. As diagnostic partners for IVD test kit development and commercialization are identified, the biomarker assays will be established on the partners' IVD platforms.

**Prostate cancer screening.** The current American Cancer Society guidelines for prostate cancer screening advise testing for elevated PSA (prostate-specific antigen) and DRE (digital rectal examination) annually, beginning at the age of 50, and in certain risk groups at the age of 45. Positive findings in either of these examinations may be followed by prostate biopsy. PSA testing, although widely used, has some major drawbacks: PSA as a tumor biomarker has a moderate specificity, i.e. it is also elevated in a number of benign prostate conditions leading to a large number of unnecessary prostate biopsies in men without prostate cancer. Furthermore, despite acceptable sensitivity of PSA, a subgroup of cancer patients does not show elevated PSA. Improved tests with increased specificity and sensitivity are clearly needed and peak sales potential estimates are in the several hundred million euro range for this test.

The objective of Epigenomics's prostate cancer screening test program is to develop a screening test for men over 50 years of age that is more specific than PSA testing or can be used as a diagnostic follow-on for men with PSA elevated to 2.5 ng/ml or more.

**Our cancer screening tests will be conveniently performed on blood plasma or urine. Taken in the doctor's office, the samples will be analyzed in diagnostic labs. Here, our IVD test kits will be used to detect tumor DNA in the samples based on DNA methylation biomarkers. The doctor will inform the patient and, if necessary, advise on follow-up procedures.**

In December 2006, in a first study on blood plasma and urine from prostate cancer patients and healthy controls, we demonstrated that we detect cancers with a sensitivity of up to 74 % at a specificity of 96 % using a single biomarker. The study also demonstrated that urine is the most suitable analyte for the detection of prostate cancer by using these DNA methylation biomarkers.

We will further optimize our biomarker panel with a focus on biomarkers that can distinguish prostate cancer form noncancerous prostate conditions, a shortfall of many competing tests. Using these biomarkers, another study will be performed in 2007 using prospectively collected urine samples and workflows further optimized for this sample type.

**Lung cancer screening.** In 2006, we have initiated a cancer screening test development program for the early detection of lung cancer. We successfully identified numerous candidate biomarkers specific for lung cancer. Most encouraging, a considerable number of these biomarkers were present in very different subtypes of lung cancer. The most appropriate of these biomarkers will now be selected in larger studies on tissues and further critical controls before we develop sensitive assays and test them in blood plasma.

Noninvasive or minimally invasive screening tests for lung cancer with high sensitivity and specificity that can be applied to large populations in a convenient, safe, and cost-effective way are needed urgently. As symptoms occur late, the majority of lung cancer cases are diagnosed in stages too advanced for effective treatment making this common cancer the leading cause of cancer-related deaths.

Lung cancer screening tests are a highly attractive product opportunity in the diagnostics market. With a high-risk target population of about 90 million smokers aged 45 or older, the peak market potential of this product reaches 150 million euros and, if extended to the general population aged 45 or older, of more than 300 million euros.

### DNA-METHYLATION

DNA methylation is a natural and tightly controlled biological process that serves the regulation of our genes and the stability of our genome. Cytosine, one of the four chemical "letters" of our genetic code, can be modified by the addition of a chemical methyl group. DNA methylation in gene regulatory regions shuts off gene activity. As different cells shut off different genes, every cell type has its unique DNA methylation "fingerprint". This fingerprint changes in diseases providing a rich source of biomarkers for disease diagnosis and classification. Epigenomics has the technologies and the know-how to read and interpret DNA methylation patterns and use them for the development of IVD tests.

# Cancer Specialty Diagnostics

Cancer specialty tests address high medical needs in cancer management such as the surveillance of individuals that have a high risk of developing cancer, the monitoring of recurrence in cancer patients, and cancer molecular classification for prognosis and drug response prediction. We have initiated dedicated product development programs for a colon cancer surveillance test and a prognostic prostate cancer molecular classification test.

**Prostate cancer molecular classification test.**
The uncertainty on prognosis once a tumor is diagnosed is a huge challenge for doctors and patients in cancer management. It leads to substantial overtreatment in some patients while others experience an early relapse and could have benefited from more vigorous adjuvant treatment. Novel classification tests that read the molecular signature of a tumor are urgently needed to add prognostic information where current clinical and pathological parameters fall short.

Epigenomics develops a prognostic cancer molecular classification test in prostate cancer, leveraging proprietary biomarkers that were identified and characterized in numerous clinical studies in prostate and breast cancer indications. Unlike cancer screening tests, the test is performed on tissues from surgical or biopsy samples obtained anyway in clinical routine.

Our prostate cancer molecular classification test is based on our proprietary biomarker, PITX2. It aims at distinguishing between patients with high and low probability of early relapse after the primary tumor has been removed by a radical prostatectomy. There is a demand for such a molecular diagnostic test among physicians, since our biomarker PITX2 can add significant information to established prognostic clinical parameters such as tumor size, Gleason Score and presurgery PSA levels and thus may help to better predict which patients will eventually relapse.

The target population for this test are those 40 % of all prostate cancer patients that undergo radical prostatectomy. The peak market potential for this test is in the thirty million euro range.

Since our decision in early 2005 to develop this product ourselves, we have made outstanding progress. We have established our proprietary IVD platform through partnering with Qiagen and Affymetrix.

Using routinely available paraffin sections from surgical or biopsy samples, DNA is extracted with commercially available DNA purification kits and prepared for DNA methylation analysis with bisulfite using a preanalytics kit developed according to Epigenomics's specifications by our partner Qiagen. The DNA methylation markers are then tested by a PCR (polymerase chain reaction) and a DNA methylation biochip using an Epigenomics IVD test kit and the Affymetrix GeneChip System IVD instrumentation. The components of this kit are specified and designed by Epigenomics but produced by Affymetrix (Biochip) and other contract manufacturers.

## Market potential and characteristics of cancer specialty tests

| | Prostate cancer classification | Colorectal cancer surveillance |
|---|---|---|
| Target population | Patients with confirmed prostate cancer undergoing prostatectomy | Patients at high risk for or with personal history of colorectal cancer |
| Sample | Tissue section of surgical prostatectomy sample (fixed, paraffin-embedded) | Blood plasma |
| Biomarker | PITX2 | Septin 9 and other proprietary biomarkers |
| Status | Biomarkers clinically validated, Development of assay procedure and test for initial launch in reference laboratory | Development of assay procedure for testing in reference laboratories |
| Size of target population in major markets | ~150,000 patients | ~250,000 patients |
| Peak market potential | > EUR 30 million | > EUR 50 million |
| Partners | Qiagen (preanalytics) and Affymetrix (IVD platform, microarrays) Reference laboratory partnering opportunity | Reference laboratory partnering opportunity |
| Upcoming milestones | 2008: Launch as testing service by reference laboratory | 2008: Launch of testing service by reference laboratory |



EpiTect® Bisulfite Kit


Design Model

In late 2006 we demonstrated that we are able to measure our lead biomarker for prostate cancer prognosis, PITX2, reliably on this platform. This clears the way for the development of the final test workflow. In 2008, the test is expected to be launched in a centralized reference laboratory to give patients and opinion leaders access to this high medical need application as a homebrew test. Longer term, we will further pursue the development of a CE-marked kit for product launch in Europe and possibly an FDA-approved kit for the U.S. market. In two encouraging initial meetings with the FDA we already discussed the most appropriate intended use as well as the design of the pivotal clinical trial necessary for FDA approval.

As extended applications, our proprietary prognostic biomarkers can eventually be developed for prostate cancer prognosis on biopsy samples and breast cancer prognosis.

**Colon cancer surveillance test.** Over half of the 14 million annual colonoscopies in the U.S.A. are performed not for cancer screening, but for surveillance or monitoring of patients at high risk of developing colorectal cancer or experiencing cancer recurrence. We are currently preparing clinical studies to establish our colorectal markers for such patients at high risk. In our studies in 2006 we have already demonstrated that our biomarkers may be tuned for cancer detection rates of 70 % or more as well as detection of precancerous lesions. We are currently optimizing our assay procedure for homebrew testing in centralized reference laboratories and aim to make it available to patients and gastroenterologists as early as 2008.

Surveillance and monitoring applications provide highly attractive product opportunities in the diagnostics market as 22 million people in the major markets live with a history of cancer (all indications) and are monitored up to several times each year. Due to the high medical need, the compliance among patients is very high. As the patients see specialists rather than GPs for cancer follow-up and monitoring, the market can be addressed through centralized reference laboratories and focused marketing as well as a comparatively small sales force.

Tumor samples are routinely processed for microscopic evaluation by the pathologist. Our cancer molecular classification tests will use these samples to gain further information on the prognosis. In diagnostic labs DNA will be extracted and prepared using solutions by our partner Qiagen. Our proprietary DNA methylation biomarkers will be measured using our test kit on instrumentation provided by our partner Affymetrix. With the result at hand, the oncologist together with the patient can decide on the best way forward.

**Our strategic partners.** In 2006 we established strategic partnerships with two industry leaders that will contribute modules to our IVD platform for the testing of DNA methylation biomarkers:

**Qiagen.** Qiagen is the leading provider of innovative technologies and products for preanalytical sample preparation and molecular diagnostics solutions. After entering into a strategic collaboration with Epigenomics in 2005, Qiagen successfully launched a first product based on Epigenomics technology on the research market in spring 2006: The EpiTect® Bisulfite Kit for conversion and cleanup of DNA for methylation analysis. For Epigenomics's IVD products, Qiagen could also provide the preanalytics modules necessary to extract and prepare DNA for measuring DNA methylation biomarkers.

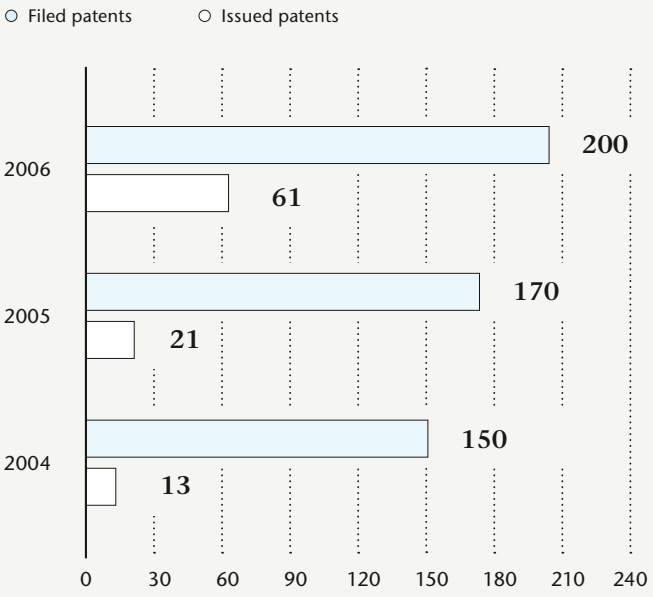
**Affymetrix.** Affymetrix the industry leader in microarray (biochip) technology and products. In June 2006, Epigenomics and Affymetrix entered into a strategic diagnostics platform agreement. Under the Powered by Affymetrix® program, Epigenomics is granted access to the technology from Affymetrix to develop diagnostic microarray products. This includes the GeneChip® System 3000Dx (GCS3000Dx), the first microarray instrumentation system cleared for molecular diagnostic use in the United States and Europe. With the cancer molecular classification test, Epigenomics will place the first DNA-Methylation test onto Affymetrix' platform and Epigenomics's IVD test kits will contain customized Affymetrix microarrays as consumables. Affymetrix further strengthened the partnership by becoming a shareholder of Epigenomics in July 2006.

# R&D, Licensing, Biomarker R&D Services & Collaborations

**R&D organization.** As part of our efforts to streamline the organization in 2006, we reorganized our R&D. While our development is entirely focused on moving our screening and specialty test programs through IVD development, our research is dedicated to the discovery and clinical proof-of-concept of novel biomarkers and the development of new sample processing workflows for our product development programs. Additionally, we continue to venture into new DNA methylation technologies; a substantial part of our research in this field is supported by public grants.

**Intellectual property.** We continue to defend and extend our leadership in the DNA methylation intellectual property (IP) estate through research into biomarkers and new technologies and an aggressive in- and outlicensing strategy. Our IP covers all aspects and elements of the biomarker value chain in molecular diagnostics and pharmacodiagnostics. Epigenomics's patent portfolio contains over 200 filed patent families, of which 61 patents are now granted in one or more countries and 19 of which are exclusively inlicensed patent families. During 2006, more than 20 new patent applications were filed, including several that contain proprietary biomarkers for our diagnostics products under development.

**PATENT PORTFOLIO** [cumulative per year]




▸ GLOSSARY: BACK COVER

**Licensing.** We started leveraging this broad intellectual property portfolio by granting certain licenses on research products for preanalytics and real-time PCR (polymerase chain reaction) detection to Qiagen. With the very successful launch of Qiagen's EpiTect® Kit for bisulfite treatment of DNA (a necessary step to make DNA methylation visible), our licensing collaboration bears first fruits. We plan to expand our "Open Access" outlicensing initiative with the goal of establishing de facto standards in DNA methylation. We will make nonexclusive licenses available to several of our core technologies in areas of the research and IVD market that do not impede our ability to develop products with our partners or on our own.

**Biomarker R&D services and collaborations.** In its collaborations with pharma and biotech partners, Epigenomics aims at supporting the development of new drugs and their positioning on the market by DNA methylation biomarkers. In the majority of these collaborations, we work with our partners to find novel biomarkers for identifying patients that have a higher likelihood of responding to a particular drug. These biomarkers can be used to select patients in clinical trials and can eventually be developed into a predictive IVD test that is launched and marketed together with the drug. Oncologists would use such drug response tests to take more individualized treatment decisions thereby potentially improving treatment success.

As our prognostic cancer molecular classification tests, these tests will most likely be performed on routinely available tissue samples offering the opportunity to develop them for Epigenomics's proprietary DNA methylation IVD platform that will be launched as early as 2008.

In 2006, our Clinical Solutions team, now operating as a department in our research, further streamlined their operations and biomarker R&D offerings and successfully introduced new technology offerings such as DMH (differential methylation hybridization) and OncoSign™ for fast and efficient genome-wide discovery of DNA methylation biomarkers. These efforts paid off in a total of seven collaboration agreements signed throughout the year with some of the world's top pharma and biotech companies including a follow-on deal with AstraZeneca and new deals with Johnson & Johnson Pharmaceutical R&D, Centocor, and others.

In four of these collaborations we will make use of our proprietary DMH technology. With Epigenomics's DMH biochips, more than 50,000 human genomic fragments can be profiled for their methylation status in a single experiment. DMH is robust and delivers highly reproducible results. This makes DMH a fast and cost-effective tool to discover novel DNA methylation markers for diagnostic applications.

Together with our partner CellTrend GmbH, we offer OncoSign™, a fast and effective tool to discover drug response markers based on DMH and a panel of the 60 most commonly known cancer cell line models. Using OncoSign™, we discovered and patented novel candidate biomarkers that predict response to prominent drug classes like EGFR (Epidermal Growth Factor Receptor) inhibitors, Aurora Kinase inhibitors, Taxanes, and Topoisomerase inhibitors.

«Current screening for prostate cancer with Prostate Specific Antigen (PSA) is very inaccurate: In about three quarters of all biopsies taken after a positive PSA test result, the diagnosis of cancer can not be confirmed. A non-invasive test that delivers less false-positive test results but reliably finds the cancer in affected individuals is urgently needed to avoid unnecessary and painful biopsies.»

Dr. Axel Semjonow,
Assistant Professor, Urologist
University Hospital Münster,
Germany

Epigenomics's prostate cancer screening test program aims at developing a reliable urine-based test that alone or as a follow-up to PSA testing will help to avoid unnecessary prostate biopsies.

# Our Stock

**SHARES**

**MASTER DATA**

ISIN:
DE000A0BVT96

Security Code Number:
A0BVT9

Fiscal 2006 has been another excellent year for biotech companies in the public markets. A series of U.S. and European IPOs in the biotechnology sector and follow-on transactions were successfully completed during the year. The Frankfurt Stock Exchange witnessed four new biotech IPOs with issuing volumes of more than EUR 5 million and four smaller listings. Further listings are expected going forward. Against the background of excellent overall market conditions with major indices such as the DAX up by more than 20 % year on year, performance of European as well as U.S. biotech stocks, however, has lagged behind other sectors.

As illustrated in the chart on the page 31, Epigenomics's stock price significantly underperformed relevant indices in 2006.

Despite solid fundamental performance and improved clinical data, the announcement of new cooperation partners and the progress in the product development of our tissue test, the news on the resignation of Epigenomics's CEO, the Company's reorganization, staff reduction in October, lower than expected revenue with consequently higher losses as well as the termination of the Roche Diagnostics partnership in December 2006 put heavy pressure on our share price. As a result, on December 29, 2006, our stock closed at EUR 3.50 (Xetra), down 45.7 % from its prior year-end price of EUR 6.45.

Trading volumes in Epigenomics stock (Ticker symbol: ECX) have decreased somewhat during 2006 except for the second half of December, which showed drastically increased trading volumes following the announcement of the end of the Roche Diagnostics collaboration. While first-quarter average was at around 36 thousand shares traded per day, second-quarter average at 28 thousand and third-quarter average at 22 thousand, the fourth quarter of 2006 saw a significant increase in liquidity and trading volumes. During the last three months of the year, a total of 5.3 million Epigenomics shares changed owners, averaging a daily trading volume of more than 84 thousand shares.

As of December 31, 2006, a total of 16,916,125 shares were issued and several major shareholder groups each controlled more than 5 % of Epigenomics's total share capital:

| Voting Rights Threshold | Shareholders |
|---|---|
| >15 % | DVC Gesellschaften (VC) |
| >10 % | – |
| >5 % | 3i Group |
| | Abingworth Management Ltd |
| | BB Biotech AG |
| | MPM-Gesellschaften (VC) |
| | Omega Fund II, L.P. |
| | Wellcome Trust |
| >3 % | – |

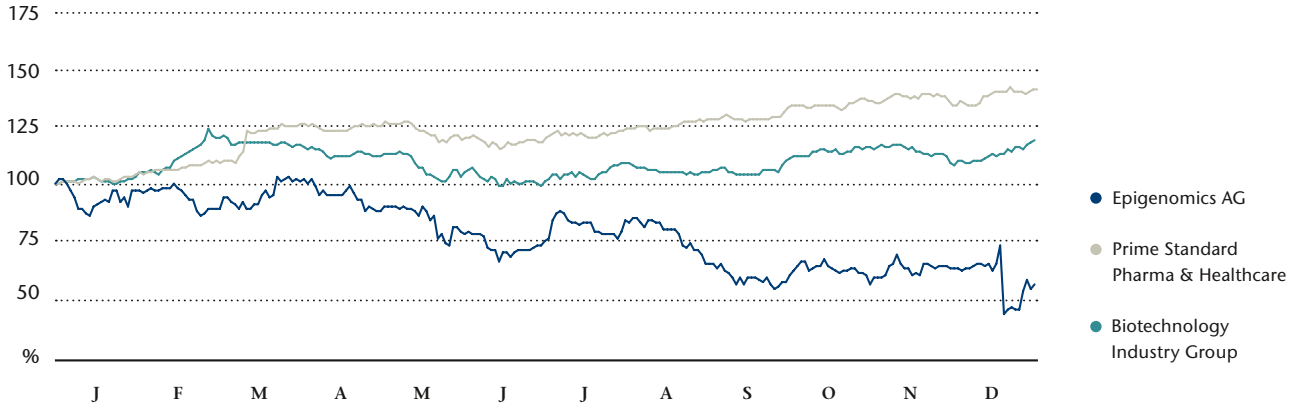
Several analysts regularly and continuously maintained coverage of Epigenomics's stock to date providing updates on their views and recommendations. DZ Bank's Patrick Fuchs, Morgan Stanley's Dan Mahony, and independent analyst Thomas Schiessle (via Midas Group) had varying recommendations and views on the stock as of the end of 2006, ranging from a price target of EUR 5.00 per share and a "Buy" recommendation, via a "Speculative Buy" and EUR 6.00 per share target to an "Overweight-V" recommendation with a EUR 18.00 per share price target.

**Corporate Communications.** Also in 2006, we continuously provided all our shareholders with timely, accurate and comprehensive information giving them the best possible basis for making informed investment decisions in Epigenomics's stock. We invited to an annual press conference and an analyst meeting in Berlin, hosted our Annual General Shareholders' Meeting in Berlin on July 10, 2006, with a participation of approximately 70 % of the share capital and offered several conference calls on important Company updates.

As already in the past, our investor and public relations team continuously maintained the dialog with institutional and private investors, many analysts, the press, and the general public. We take advantage of all communication channels available to distribute information about our Company, including emails, our corporate website, conference calls, personal meetings and a strong presence at industry and trade show meetings. The Company uses the Internet to provide up-to-date information on relevant news and ongoing investor relation activities. For further details please refer to www.epigenomics.com.

At numerous conferences in the United States as well as in Europe, Epigenomics has presented updates to investors during the past business year. A series of targeted road shows have also been organized in major financial centers such as Frankfurt am Main, Hamburg, Zurich, London, New York, Boston, San Francisco, and Chicago to update both current and potential institutional investors on the progress of Epigenomics. We aim at further strengthening this effort in 2007 and beyond.

**EPIGENOMIC'S STOCK PRICE DEVELOPMENT**
**FROM JANUARY 1 TO DECEMBER 29, 2006**



# Consolidated Management Report

## ECONOMIC ENVIRONMENT

**High energy prices, a significantly weaker U.S. dollar, continually rising interest rates, a stronger German economy, and moderate economic growth dominate.**

The year 2006 has been characterized by moderate economic growth in major European countries and continuing high energy prices. They were accompanied by rising interest rates in the U.S.A. during the first half and continued tightening of interest rate policies throughout 2006 by the European Central Bank. The political situation in Germany with the grand coalition government has increased stability and continued some reforms, which have boosted the German economic outlook considerably. 2006 was a solid and strong year for the equity capital markets worldwide, in Europe and in Germany in particular.

The U.S. capital market saw continuing IPO activity and follow-on offerings in many sectors, including several in biotechnology. Europe saw increased equity issuing activity and several biotech IPOs getting completed.

The significant softening of the U.S. dollar vis-à-vis the euro decreased our U.S. cost base in euro terms during the year, but has again increased pricing pressure on our R&D offering to the pharmaceutical and biotechnology industries, which typically is guided by U.S. dollar benchmarks.

The U.S. and European economies have improved throughout 2006. There are expectations for continuously improving investment and equity financing climate in Europe and particularly in Germany. However, the debates on healthcare and social reforms as well as tax increases could dampen 2007 growth prospects.

## ANALYSIS OF OUR BUSINESS – A REVIEW

**Major events: Roche Diagnostics ends licensing and R&D collaboration with Epigenomics despite successful completion of major clinical studies in cancer screening; tissue product development progress on track; important new deals; financials and new business generation lag behind expectations.**

Epigenomics is a molecular diagnostics company active in two areas of product development: blood-based early detection tests for cancer (screening & monitoring) and tissue-based cancer classification tests. In our product develop-

ment efforts we are focused on developing novel molecular diagnostic tests, i.e. products that shall provide significant benefit to patients in terms of accuracy, convenience and ultimately acceptance of these tests. With our Clinical Solutions biomarker research and development (R&D) in close collaboration with pharmaceutical and biotechnology partners as well as with our licensing efforts we plan to leverage our DNA methylation technologies and set an international standard in molecular diagnostics.

In the year 2006, the Executive Board of Epigenomics AG has undergone significant changes with the resignation of founding CEO Alexander Olek in August 2006. Furthermore, Christian Piepenbrock (COO and Head of SBU Diagnostics), Oliver Schacht (CFO), and Kurt Berlin (CSO) have been on the Executive Board of Epigenomics AG.

Throughout 2006, we have systematically progressed our product development programs in oncology. In our Roche program, we completed clinical studies and analytical marker validation in body-fluid-based settings (blood and urine) for our colon cancer screening (CCS) and prostate cancer screening (PCS) tests. Despite successful completion of these clinical studies and significant improvement in the CCS program, Roche Diagnostics ended the R&D and licensing collaboration with Epigenomics in its entirety in mid December 2006 after more than four years. Therefore, all results and property rights fully lie with Epigenomics.

We concluded the value chain for our tissue-based diagnostic test development with the signing of the Affymetrix partnership. This strategic alliance provides Epigenomics with access to an established molecular diagnostics platform (DX3000®) under the "Powered by Affymetrix"® program. By the end of 2006, the transfer of our first product (prostate cancer molecular classification test – PCMCT) onto the Affymetrix platform has been successfully completed. This will allow initiating the pivotal clinical trial on that platform in 2007.

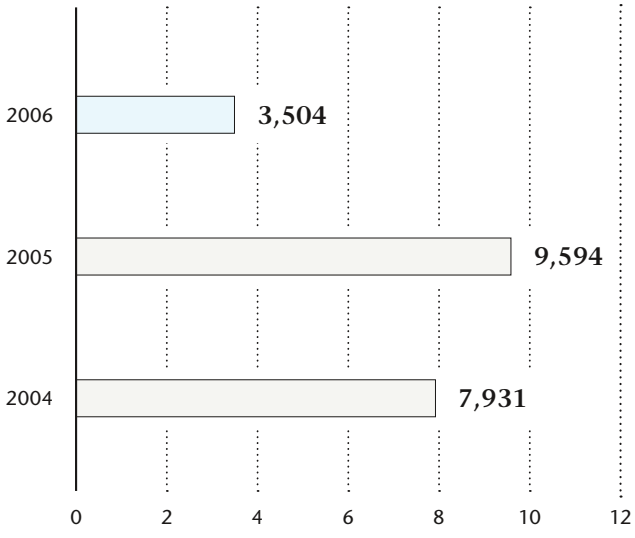
With continued improvement of our DNA methylation technologies we strengthened our property rights and contributed to the overall scientific understanding of methylation as a key component of human (epi)genetic information. Epigenomics with over 200 patent families owns the world's leading IP portfolio in DNA methylation.

Due to the termination of the Roche Diagnostics partnership, our financial position with liquidity of EUR 17.3 million available at year-end 2006 was EUR 0.7 million below our previous guidance.

Revenue for 2006 was down by 64 % to EUR 3.5 million compared to previous year's EUR 9.6 million. This was mainly due to the pattern of payments in the Roche collaboration with no major milestones in 2006 to match the fourth quarter of 2005 as well as slower than anticipated new business generation from licensing and in our SBU Clinical Solutions.

Having kept the size and scale of operations virtually constant throughout 2005 and most of 2006, management in the fourth quarter decided to focus on later-stage clinical studies and product development and a corresponding re-

**GROUP REVENUE** [in EUR thousand]



design of the organization in Berlin. This is going to lead to an anticipated reduction by more than 30 positions across research, IT and G&A functions by the end of Q1 2007. EBIT for 2006 read EUR –15.8 million compared to previous year's EUR –10.2 million. Our 2006 net loss amounted to EUR 15.4 million against a loss of EUR 8.8 million the year before.

Total net cash flow for 2006 was EUR –11.0 million versus EUR –9.0 million in 2005 (before currency adjustments), mainly driven by a cash outflow from operations and increased investment into own programs in tissue test development with not yet any significant financing cash inflows in 2006.

**Controlling system.** The Company's controlling system is primarily based on miscellaneous planning and reporting tools. Qualitative information derives from a self-developed project documentation database and quantitative information is processed by common ERP (Enterprise Resource Planning) software. Our accounting and controlling department reports to the CFO providing all relevant controlling information to the Executive Board on a monthly basis.

For internal control purposes we set up a financial budget on an annual basis developed from the actual mid- to long-term planning of the Company. The budget is made out bottom-up from the cost centers and the projects with assigned individual responsibilities. A final approval of the annual budget from our Supervisory Board is mandatory.

The focus of the monthly and quarterly internal management reporting lies on actual versus budget comparisons for the specific set of numbers, which comprises the external quarterly reports. It is supplemented with additional data requested by the Executive Board and the Supervisory Board as well as the controlling team (for example: a profit and loss statement according to the function of expense method, headcount statistics, cash inflow analysis, analysis of foreign currency effects and a cost per head calculation). Each quarterly report is accompanied by an internal budget update (the "forecast"), which gives us the opportunity to always have an up-to-date estimate of expected full-year numbers.

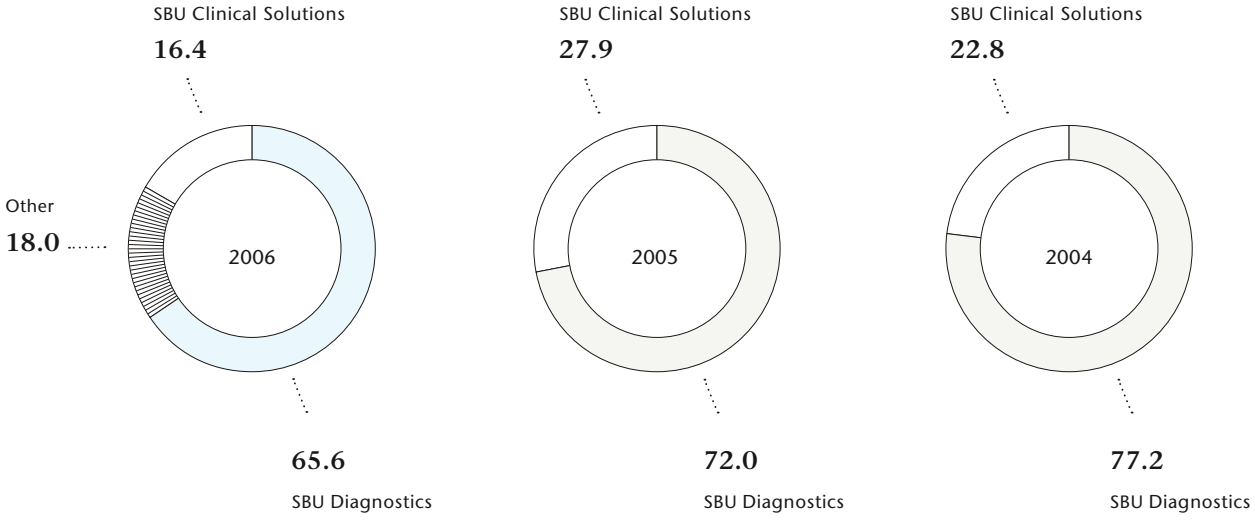
**Marketing and business development.** In 2006, all our offerings were marketed in a business-to-business model driven by strategic R&D and commercialization alliances. The primary focus has been on oncology programs in 2006, as had already been the case in previous years. We have expanded the universe of partners to include molecular diagnostics, pharmaceuticals, biotechnology and research products companies. Partnership models range from strategic collaborative alliances (e.g. Affymetrix, Qiagen) to mere R&D and service cooperations (e.g. Johnson & Johnson, AstraZeneca, Philip Morris Research Labs) to straightforward outlicensing agreements.

Total expenses of our marketing and business development activities in 2006 added up to EUR 2.7 million (2005: EUR 1.5 million).

Our Roche Diagnostics partnership had been extended in spring 2006 by a further 18 months to September 30, 2007, but was unexpectedly terminated by Roche Diagnostics in mid December 2006. The partnership had been focused exclusively on three cancer screening tests for colon, prostate and breast cancer early detection. All rights and licenses worldwide have thereby reverted back to Epigenomics. There are no repayment obligations of any kind from Epigenomics to Roche Diagnostics. During the four-year partnership, Roche Diagnostics had paid more than EUR 30 million in cash to Epigenomics.

For our own product development efforts, negotiations with diagnostic platform providers were finalized and led to the signing of the strategic deal with Affymetrix in summer 2006 under the "Powered by Affymetrix"® program. Epigenomics thereby has obtained access to the world's premier microarray-based diagnostics platform that is readily available, approved for molecular diagnostics in a regulated setting, scalable in terms of number of biomarkers per product and has a significant installed base even today.

**GROUP REVENUE SHARE BY SBU** [in %]




The Qiagen partnership aims at establishing a gold standard in the research market for preanalytical bisulfite treatment for DNA methylation testing with the EpiTect® kit launched in April 2006. It also has an OEM (Original Equipment Manufacturer) component that would expand it into the molecular diagnostics field and for the pre-analytics IVD solution to our tissue tests in the future.

The emphasis in our Clinical Solutions business has successfully added partnerships and broadened the customer base during 2006 through follow-on collaborations with AstraZeneca and Philip Morris as well as new partners Johnson & Johnson and Centocor and three undisclosed partnerships with leading pharmaceutical and biotechnology companies. Signed business collaborations already have secured a significant portion of 2007 revenue and will be executed largely during the first half of 2007. Combined with a healthy pipeline of ongoing new deal discussions, this should contribute to significant double-digit revenue growth in 2007.

## SEGMENT REPORT

### Termination of Roche partnership despite successful clinical studies in Diagnostics; new business generation in Clinical Solutions business; end of segment reporting following reorganization.

In 2006, Epigenomics continued to be active in two business segments. Both had been structured into independent strategic business units (SBUs) to focus on their respective distinct customer and partnership base. The SBU Diagnostics develops molecular diagnostic tests for the early detection, classification and monitoring of cancer and commercializes these tests through in vitro diagnostics partnerships. The SBU Clinical Solutions focuses on programs that are geared towards developing biomarkers for specific cancer drugs and assisting partnering pharmaceutical and biotechnology companies in their respective drug development programs.

Starting January 1, 2007, all activities and businesses have been combined. Following a major reorganization in October 2006 as well as the end of the Roche Diagnostics partnership in December 2006, an ongoing separate presentation of the current segments in this format no longer seems appropriate. In all our businesses (Diagnostics screening, Diagnostics tissue tests, Clinical Solutions, Licensing), a mix of collaborative R&D partnerships as well as certain license grants and sharing in the economic potential via milestones or royalties can be expected. The Clinical Solutions team has been combined into a single department. The same holds true for our Diagnostics development team for tissue tests and the Diagnostics screening teams in Seattle. Overall, the matrix organization has been largely dismantled and staff as well as other resources have been allocated directly to the departments involved in the various aspects of our R&D.

Therefore, 2006 will be the last year of separate reporting on our financials in the two current segments in this format. However, as far as revenue generation is concerned, we expect to continue to provide transparency as to what types of deals and partnerships will have contributed to overall revenue. Despite the discontinued reporting of the separate SBUs, all current businesses continue to be an integral part of Epigenomics for the time being.

In 2006, the SBU Diagnostics continued to contribute the lion's share of revenue (65 %) based on the execution of the Roche screening programs, which progressed significantly. The relative share of Clinical Solutions revenue decreased from 28 % in 2005 to 16 % in 2006. However, all revenue generating new business deals and commercial agreements in 2006 have come from our Clinical Solutions business. The geographic split of our 2006 revenue was still almost entirely Europe-based with 96 % of total revenue coming from European partners and the remaining 4 % from U.S. partners.

**SBU Diagnostics.** Revenue of EUR 2.3 million in 2006 generated by our SBU Diagnostics was down by 67 % from EUR 6.9 million in 2005. The Diagnostics's business continued to show significant revenue fluctuations due to the timing of major one-off milestone payments in our collaborations. While achieving such a milestone in the development of a colorectal cancer screening (CCS) test for Roche in December 2005 was associated with multi-million euro revenue from a one-off milestone, there were no corresponding payments for the clinical studies in 2006 (CCS and prostate cancer screening (PCS)). The termination of the Roche Diagnostics R&D and licensing collaboration by Roche in December 2006 has led to accelerated recognition of deferred upfront payments as revenue by the end of Q1 2007. The end of the deal has also led to the recognition of certain milestone payments as revenue in Q4 2006.

Under the Roche Diagnostics partnership, Epigenomics's SBU Diagnostics completed several major clinical studies in colon cancer (marker discovery, tissue study, training set, test set) using both tissue samples as well as blood plasma samples. Performance of our CCS product was improved significantly to 66 % sensitivity at 93 % specificity using Septin 9 as anchor marker in combination with a second proprietary marker.

In prostate cancer early detection, a first study using blood plasma as well as urine samples was successfully conducted. Performance of up to 74 % sensitivity at 96 % specificity was observed in urine and provides the basis for further development and partnering discussions.

The strategy and business model for our blood- and urine-based early cancer detection (screening) products remain one of partnering. With all rights and licenses from the Roche Diagnostics collaboration back in Epigenomics's hands we anticipate heavy emphasis on finding suitable and committed partners for these tests in 2007 to take the tests through the final phases of their development and starting to commercialize the products worldwide.

As part of Epigenomics's internal tissue test development programs, the SBU Diagnostics has successfully completed a concordance study in prostate cancer classification. Using a single biomarker (PITX2) in paraffin-embedded tissue samples from surgically removed prostates of cancer patients, we were able to demonstrate excellent reproducibility of results that had previously been shown on the Roche real-time PCR systems on the Affymetrix diagnostics platform. The strategic partnership signed between Epigenomics and Affymetrix in summer 2006 provided us with access under the "Powered by Affymetrix"® program to put our own tissue-based diagnostic tests onto the Affymetrix diagnostics device for clinical development, regulatory approval as well as commercialization. Two meetings with the U.S. FDA were successfully held and confirmed the clinical trial design and strategy of Epigenomics for this prostate cancer molecular classification test (PCMCT).

Overall, 2006 revenue was attributable to upfront payments, R&D funding and reimbursements of costs incurred for patient samples for all our Roche programs. The following product development projects contributed to the 2006 Diagnostics revenue and were all partnered with Roche:

- Colon Cancer Screening Test (CCS)
- Prostate Cancer Screening Test (PCS)

Corresponding cost of sales for the execution of our partnered Roche programs were lower in 2006 at EUR 4.5 million (2005: EUR 6.4 million) due to the clinical validation studies run in the CCS and PCS programs. Due to the considerably lower revenue, gross profit in our Diagnostics business decreased to EUR –2.2 million with the gross margin down to –95 % compared to the previous year's EUR 0.5 million and 8 %, respectively.

Research and development expenses in 2006 for the Diagnostics business amounted to EUR 6.1 million versus EUR 3.1 million the year before. Key drivers were the progress of our own product development in tissue classification tests and diagnostic platform activities. We also continued to work on enhancing a high-throughput workflow for processing large numbers of blood or urine samples for later-stage product development in the early detection of cancer.

Following the major reorganization in October 2006, the SBU Diagnostics has focused entirely on the blood-based early cancer detection tests (Seattle) as well as the clinically most advanced tissue test programs (Berlin). Several early-stage research projects, technology development, IT infrastructure projects and noncancer indications were terminated.

Efforts in Diagnostics business development totaling EUR 0.6 million in 2006 (previous year: EUR 0.6 million) focused on the continued evolution of the Roche Diagnostics deal until its termination in December 2006, putting in place the Affymetrix platform agreement, as well as endeavors towards entering into a reference laboratory partnership for blood-based cancer testing.

The overall segment earnings contribution from our SBU Diagnostics in 2006 was negative at EUR 8.2 million, compared to a negative contribution of EUR 3.0 million in 2005.

**SBU Clinical Solutions.** Revenue of EUR 0.6 million in 2006 generated by the SBU Clinical Solutions was down by almost 79 % from previous year (EUR 2.7 million). This drop was mainly attributable to the loss of revenue recognition from our Roche program in the tissue test development in breast cancer and prostate cancer classification indications. Generation of new business was below expectations for most of the year. However, with two deals signed in December 2006 alone, there has been recent traction in new dealflow. While 2005 had only seen one new partnership agreement signed (PMRL) plus the Qiagen research products licensing agreement, our SBU Clinical Solutions team was able to sign seven new collaborative R&D agreements in 2006. Both Astra Zeneca and PMRL are repeat business and expansions of previously successfully completed biomarker studies. Johnson & Johnson, Centocor

# Five-Year Overview

## according to consolidated financial statements

| EUR thousand unless stated otherwise | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|
| **INCOME STATEMENT** | | | | | |
| Revenue | 3,504 | 9,594 | 7,931 | 10,778 | 1,775 |
| Gross profit | –1,516 | 1,904 | 1,509 | 5,438 | 838 |
| R&D costs | –8,702 | –8,121 | –7,336 | –7,642 | –9,442 |
| EBIT | –15,761 | –10,234 | –10,351 | –6,306 | –13,935 |
| EBITDA | –14,193 | –8,560 | –8,907 | –4,953 | –12,685 |
| Net loss for the year | –15,402 | –8,788 | –10,975 | –6,745 | –13,868 |
| EPS in EUR (basic) | –0.92 | –0.54 | –0.80 | –0.80 | –1.25 |
| **BALANCE SHEET** | | | | | |
| Non-current assets | 10,559 | 9,471 | 9,677 | 8,430 | 8,783 |
| Current assets | 19,575 | 35,526 | 43,607 | 22,877 | 8,202 |
| Total assets | 30,134 | 44,997 | 53,284 | 31,307 | 16,985 |
| Equity | 26,198 | 39,375 | 47,739 | 17,713 | 3,578 |
| Equity ratio (in %) | 86.9 | 87.5 | 89.6 | 56.6 | 21.1 |
| Non-current liabilities | 0 | 4 | 41 | 6,375 | 6,041 |
| Current liabilities | 3,935 | 5,618 | 5,504 | 7,218 | 7,366 |
| **CASH FLOW STATEMENT** | | | | | |
| Cash flow from operating activities | –14,378 | –7,501 | –8,885 | –6,338 | –6,954 |
| Cash flow from investing activities | 2,610 | –1,689 | –10,214 | –1,763 | –885 |
| Cash flow from financing activities | 807 | 228 | 32,757 | 20,446 | –172 |
| Net cash flow (currency-adjusted) | –10,953 | –8,647 | 13,747 | 11,858 | –8,270 |
| Cash and cash equivalents at year-end | 12,566 | 23,519 | 32,166 | 18,419 | 6,852 |
| **OTHER INFORMATION** | | | | | |
| Investments in non-current assets | 2,920 | 1,007 | 964 | 946 | 675 |
| Number of employees at year-end | 145 | 141 | 146 | 143 | 135 |
| Share price at year-end (in EUR) | 3.50 | 6.45 | 8.67 | n/a | n/a |

(also a Johnson & Johnson company), two undisclosed major pharmaceutical companies as well as one of the world's top biotechnology companies (undisclosed) have been added to the growing list of Epigenomics's partners and customers.

The following R&D collaborations have contributed to 2006 revenue generation and cost of sales in the SBU Clinical Solutions:

- Philip Morris Research Labs (lung-cancer-related work)
- AstraZeneca
- Johnson & Johnson
- undisclosed pharmaceutical partners.

The two partnerships signed in December 2006 (Centocor and an undisclosed biotechnology partner) have not yet contributed to either revenue or cost of sales in 2006 but are expected to do so in 2007.

In 2006, cost of sales for the execution of our partnered programs were also lower at EUR 0.6 million against EUR 1.2 million in the previous year. Due to the lower revenue, gross profit on sales in our Clinical Solutions business decreased to EUR 0.02 million with the gross margin down to 3% compared to previous year's EUR 1.4 million and 54%, respectively.

Research and development expenses for our Clinical Solutions business in the reporting year increased from EUR 1.2 million in 2005 to EUR 1.4 million. This was in line with the strengthened focus on later-stage clinical product development programs and commercial opportunities.

Our significant efforts in the Clinical Solutions's business development totaling EUR 0.6 million in 2006 (previous year: EUR 0.6 million) started to bear fruit. We initiated seven new partnerships in 2006 and had a healthy pipeline of R&D collaboration discussions at the end of 2006 with some potential for growing and further diversifying revenue generation in 2007 and beyond.

The overall segment earnings contribution from our SBU Clinical Solutions in 2006 was still negative at EUR –1.7 million, compared to the 2005 contribution of EUR –0.4 million.

## FINANCIALS

### Liquidity position of EUR 17.3 million; revenue and earnings below expectations.

**Financial position and cash flow.** Due to the aforementioned slow-down in Epigenomics's revenue in 2006, cash flow and financial position developed below plans. At the end of the reporting year, the Company counted cash, cash equivalents and marketable securities of EUR 17.3 million – a sharp decrease compared to EUR 32.7 million on January 1, 2006.

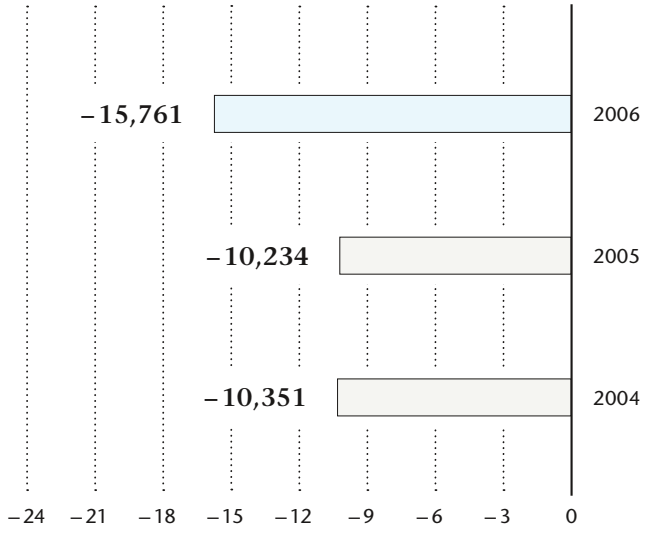
Total net cash flow (currency adjusted) in 2006 amounted to EUR –11.0 million compared to a cash flow of EUR –9.0 million in the previous year. Cash outflow from operating activities in 2006 amounted to EUR 14.4 million and nearly doubled the 2005 number of EUR 7.5 million. As our operating expenditures remained almost unchanged compared to 2005, the widened net outflow is mainly a result of reduced cash inflows but as well attributable to a significant drop in net assets (especially in deferred income and other liabilities) of EUR 1.1 million.

The cash flow from investing activities was positive at EUR 2.6 million. The significant reduction of our securities portfolio overcompensated the payments for the purchase of non-current assets. In the previous year, we recorded an investing cash outflow of EUR 1.7 million. The net cash outflow for investments in tangible and intangible assets (including inflows from investment grants) totaled EUR 1.3 mil-

lion in 2006 compared to EUR 1.0 million in the year before. More than 80 % of these outflows were spent at our Berlin site, where we put particular emphasis on investing in the setup of our diagnostic product development platform. In this context, one must consider that the liability to Affymetrix for the development license acquired from Affymetrix in June 2006 was contributed in kind and paid for in shares and didn't burden us with additional cash outflow.

All investments in marketable securities have been made under the Company's investment policy. Under the rules of this policy, investments in marketable securities are only allowed up to a given limit for each position for diversification purposes. The securities must be nominated in Euro currency to limit currency risks and an investment grade rating for the issuer or the security itself is mandatory to limit credit risks. The investment policy is approved by the Supervisory Board and is under regular review by the Executive Board and our management for compliance as well as adequacy.

**EBIT** [in EUR thousand]




Net cash inflow from financing activities amounted to EUR 0.8 million in 2006 – mainly due to inflows from stock option exercises (2005: EUR 0.2 million).

**Results of operations.** The strong financial performance of our SBU Clinical Solutions in 2005 could not be repeated in the reporting year based no longer on any Roche Diagnostics partnership revenue from tissue test development. Simultaneously the Diagnostics unit could not repeat its success story from the year before when a significant milestone in the Roche partnered colon cancer program had boosted our revenue. We recognized total revenues in 2006 of EUR 3.5 million, an unexpectedly sharp decrease from the previous year's number of EUR 9.6 million. As described before, this decrease was attributable to both SBUs: Diagnostics's revenues dropped by EUR 4.6 million and Clinical Solutions's revenues by EUR 2.1 million. Therefore, the total revenue number is composed of:

- Diagnostics revenue: EUR 2.3 million (65.6 %)
- Clinical Solutions revenue : EUR 0.6 million (16.4 %)
- Other revenue: EUR 0.6 million (18.0 %)

The other revenue in 2006 was recognized from outlicensing and research activities.

Cost of sales for the execution of partnered programs decreased in 2006 compared to 2005 only disproportionately by EUR 2.7 million to EUR 5.0 million. The decrease of revenue led to a gross margin of –43 %, strongly influenced by a gross loss of EUR 2.2 million in the SBU Diagnostics. The decision of our partner Roche to end the joint product development activities is the main reason for a revenue number below the cost of sales. Previously expected milestone payments therefore fell short.

Other income grew to EUR 1.9 million compared with EUR 1.5 million in 2005. Two-thirds of this amount were attributable to income from granted projects.

In 2006, EBIT added up to EUR –15.8 million, a significant drop from previous year's EUR –10.2 million. While our operating costs remained virtually constant, the afore-

mentioned shortfall in revenues could not be compensated. Costs for R&D increased year on year from EUR 8.1 million to EUR 8.7 million and Marketing and business development costs from EUR 1.5 million to EUR 2.7 million due to reinforced pre-launch measures with regard to our product development activities. General and administrative costs of EUR 4.1 million could be kept nearly unchanged despite the burden of our restructuring activities in October 2006.

Other expenses finally increased to EUR 0.7 million from EUR 0.2 million in 2005. This increase can be explained mainly by foreign currency exchange losses in the reporting year in the context of the strong euro or the weak U.S. dollar, respectively.

As said before, in 2006, total operating costs remained virtually constant vis a vis the previous year at EUR 20.8 million. Compared to 2005, significant increases other than the aforementioned currency exchange losses could be observed for marketing costs (+118%), external service fees (+33%), support contracts (+22%), legal and consulting costs (+18%), statutory costs[1] (+14%) and license fees (+6%). Back royalties increased even stronger but on a low absolute level.

Those increases were compensated by decreases in externally purchased R&D services (–49%), sample costs (–34%), training and education costs (–23%) and especially staff costs (–6% or EUR 0.5 million). 2005 staff costs had been impacted by the retirement of two Executive Board members. In addition, the stock option expenses in 2006 decreased strongly as a result of the forfeiture of many options.

After a disappointing performance in 2005, our financial result recovered in 2006 at EUR 0.7 million and met our internal goals.

[1] Statutory costs comprise all expenses, which are related to or caused by the legal form of the Company and its stock exchange quotation (e.g. expenses for shareholders' meetings and Supervisory Board fees, listing fees, corporate disclosure requirements).

In the previous year, the U.S.-based Epigenomics, Inc. capitalized deferred taxes as a consequence of its guaranteed profitability due to the transfer pricing agreement with the German Epigenomics AG. The partial utilization of those tax assets is mirrored in the Group's 2006 tax expense of EUR 0.3 million.

Our net loss deteriorated from previous year's EUR 8.8 million to EUR 15.4 million in 2006. This decrease is mainly a result of the shortfall in our revenues.

**Net assets position.** Epigenomics's balance sheet total decreased from EUR 45.0 million as of December 31, 2005, to a total of EUR 30.1 million at year-end 2006. Key driver was again the net consumption of liquidity by operations.

Total non-current assets increased from the previous year's EUR 9.5 million to EUR 10.6 million at the end of 2006 and contained goodwill of EUR 2.6 million, which did not suffer any impairment upon annual testing. The increase was mainly driven by the purchase of a technology access license from Affymetrix in the context of our capital increase in June 2006. In detail, intangible assets therefore increased from EUR 5.2 million to EUR 6.5 million. As in former years, Epigenomics has not capitalized own patents in accordance with the accounting rules. Also, no development expenses were capitalized since the probability of future economic benefit is still hard to prove in this field. However, the activities of filing intellectual property are still strong and the number of patents granted has further increased during the reporting year. This leads to the conclusion that a significant amount of undisclosed reserves may lie within the portfolio of intangible assets.

Tangible assets remained virtually constant at EUR 2.1 million. The purchase of high-value technical equipment for our technology platform development was compensated by the impairment of some lab equipment after the restructuring measures in October 2006.

Current assets decreased from EUR 35.5 million to EUR 19.6 million, mainly due to the cash outflow from operations and investments.

Our subscribed capital increased by 512,947 shares at a notional par value of EUR 1 each. Capital reserve was reduced by EUR 6.8 million from EUR 32.1 million as of the end of 2005 to EUR 25.3 million at the end of 2006 mainly due to the deduction of the net loss of the previous financial year. This effect was partly compensated by our capital increase in June 2006, by the exercise of stock options granted to employees in previous years and by expensed stock options. Together with the net loss for the year of EUR 15.4 million, the equity ratio of 86.9 % remained at a high level (Dec 31, 2005: 87.5 %).

The balance sheet is free of long-term debt. Current liabilities added up to EUR 3.9 million at year-end 2006, significantly down from a total of EUR 5.6 million twelve months ago.

## EMPLOYEES

The Epigenomics Group employed a total staff of 145 as of December 31, 2006, a slight increase against the figure of 141 at the end of the year before. The average number of employees during 2006 stayed flat at around 145. During 2006, at Epigenomics AG in Berlin we employed an average of 106 people and in our Epigenomics, Inc. subsidiary in Seattle 39 employees (2005: Berlin 109 and Seattle 36). The number of employees for the Berlin operations includes three apprentices.

Following the major reorganization of our Berlin operations and headquarters, we anticipate significantly lower staff numbers at Epigenomics AG from the end of Q1 2007 onwards and comparable staffing levels to 2006 at our Seattle operations. At the end of 2006, Epigenomics AG was involved in some ongoing legal disputes with employees terminated as part of the reorganization measures. Mutually acceptable solutions were sought with all former Epigenomics staff. Given the economic constraints on Epigenomics's finances and the fact that rather than paying significant severance payments beyond observing all applicable termination periods, the management of Epigenomics has opted for support of outplacement initiatives to allow its former employees to seek new employment opportunities, management believes it has done everything possible to mitigate the situation as best as possible. Appropriate provisions for legal costs and dispute solution have been made.

Overall personnel costs totaled EUR 8.9 million in 2006, down 6 % versus 2005. The stronger euro against the U.S. dollar in the later months of 2006 kept staff costs at Epigenomics, Inc. at comparable industry levels. Following the reorganization, staff costs in 2007 are expected to drop significantly.

During 2006, fluctuation remained relatively low even after the reorganization and all vacant jobs could be filled at very short notice. Several key vacancies such as Senior Vice President Marketing & Sales as well as Medical Director were successfully filled in 2006.

## RESEARCH & DEVELOPMENT

### Expanded leading IP portfolio; streamlined research organization.

In 2006, Epigenomics continued its strong emphasis on maintaining its leading position in DNA-methylation-based products and technologies. Despite significantly reorganizing and streamlining the R&D organization and operations, we spent a total of EUR 8.7 million in R&D versus the 2005 level of EUR 8.1 million. This amount comprises R&D spending in the SBU Diagnostics of EUR 6.1 million, EUR 1.4 million in the SBU Clinical Solutions and other R&D of EUR 1.2 million. A much clearer organizational division between research on the one hand and clinical development on the other hand has been achieved in the restructuring of October 2006.

Other R&D expenses include the strengthening of our intellectual property portfolio, improvements in our biomarker discovery and development processes, enhanced sensitive detection workflows, and optimized tissue-based assay formats.

In particular, Epigenomics continued to expand its leadership in DNA methylation marker development by establishing standardized selection processes for biomarkers, especially for our body-fluid-based screening programs. A major part of the recent development is based on the proprietary DMH technology and quantitative real-time PCR procedures. Further strengthening of the Company's position in the methylation marker development was achieved by in-licensing another array-based genome-wide methylation analysis technology as well as support vector machine technologies for the identification of DNA methylation marker panels.

Significant R&D went into the further development of sample collection and preanalytical processes. The optimization of these procedures enabled Epigenomics to report significantly improved data on its colorectal cancer screening lead diagnostic product. Significant improvements were also achieved in the area of methylation analysis from paraffin-embedded patient samples for our tissue-based products. Higher sensitivities of this method are expected to allow the sensitive and accurate measurement also of biopsy specimens in the future.

Significant amounts of data were generated and patents were filed on data of three human chromosomes from the Human Epigenome Project as well as from 60 cancer cell lines by DMH. While the first project identified a high number of methylation marker candidates for different indications, the second effort provided a valuable data set as a standard to measure the effect of future cancer treatments on the DNA methylation level. It is expected that these data will provide new business for Epigenomics's Clinical Solutions unit.

As of December 31, 2006, our property rights portfolio was composed of more than 200 patent families. This corresponds to nearly 600 domestic patents and patent filings. 19 of those patent families are licensed exclusively by Epigenomics.

Our strong filing activities from previous years were continued in 2006. More than 20 new inventions have been filed with the patent authorities.

With the patent grants received in 2006, the total number of our granted patents (in at least one country) was brought up to 61. Several of these manifest key components of our competitive advantage in DNA methylation, e.g. in the areas of bisulfite treatment, microarray, sequencing/primer extension and real-time PCR detection of DNA methylation. The coverage of these basic technologies is important also for the out-licensing business of Epigenomics. In 2006, several particularly important patents in these areas were granted either in the United States or selected European countries.

The Company also participated in several publicly funded projects that relate to our current and potential future business opportunities. From these projects, the Company received other income amounting to EUR 1.2 million in the reporting year. We also expect significant cash inflows from grants in 2007.

## SUPPLEMENTARY REPORT

### Important events after the end of the reporting period.

- Several candidates for the vacant CEO position were identified, evaluated and interviewed in 2006. Our candidate of choice, Geert Walther Nygaard, accepted an offer extended by the Supervisory Board of Epigenomics AG on January 16, 2007.

On January 16, 2007, we released the following ad hoc announcement about it: "Epigenomics AG (Frankfurt, Prime Standard: ECX) today announced that its Supervisory Board has unanimously decided to appoint Geert Walther Nygaard as the Company's new Chief Executive Officer (CEO). Nygaard, 46, a Danish citizen, will enter his new position effective February 1, 2007.

Nygaard has a distinguished career in the global Diagnostics industry. He joins Epigenomics from a position as Managing Director and member of the Management Board of pharmaceutical and diagnostics company Abbott GmbH & Co. KG in Wiesbaden, Germany, where he held the commercial responsibility for the Diagnostic Division."

- On January 4, 2007, Epigenomics announced the start of a new cancer biomarker collaboration with Centocor Research & Development, Inc. This is the second successful R&D agreement signed with a Johnson & Johnson company. Also, it has been the fourth collaboration based on using Epigenomics's proprietary DMH discovery technology for novel DNA methylation marker identification.

## CORPORATE GOVERNANCE

To the Executive and Supervisory Boards "Corporate Governance" lies at the heart of responsible and ethical management at Epigenomics. The very interactive dialogue and regular communication with the Supervisory Board and its committees aimed at generating long-term value to our shareholders are central to good Corporate Governance. Openness and transparency in our corporate communications with all shareholder groups, employees, the general public, and other stakeholders are the overarching principle.

Corporate governance has been of prime importance in challenging times during 2006 for all of us at Epigenomics. We fully welcome the German Corporate Governance Code and its most recent amendments. We systematically and regularly check compliance with the German corporate governance principles making amendments wherever possible to ensure fair and responsible corporate management according to the new and amended version of the German Corporate Governance Code.

Epigenomics's corporate governance principles in certain aspects go well beyond legal requirements and recommendations of the German Code. For example, we have established binding internal guidelines on insider trading and made these part of all employment agreements. We have appointed a Corporate Governance Compliance Officer to ensure best practice is adhered to wherever possible. The Compliance Officer is required to submit regular compliance reports to the Executive Board which are then passed on to the Supervisory Board. All 2006 reports confirmed Epigenomics to be in line with corporate governance principles.

There are some notable exceptions where based on certain company specifics and peculiarities we chose to deviate from the German Corporate Governance Code. These exceptions are detailed below. There is a clear commitment to adhere to the Code going forward to the greatest extent possible.

**Financial Market Reporting.** In line with fair and open disclosure and the requirements of the Prime Standard segment of the Frankfurt Stock Exchange, quarterly financial reports are made available within 60 days of a quarter's end and annual financial statements within 90 days of year-end. All information is made available simultaneously on our website http://www.epigenomics.com. All material news are announced following the latest guidelines and legal requirements on ad hoc notification.

**Executive Board.** The Executive Board is responsible for independently managing and running operations, developing and implementing corporate strategy, financial and budgetary planning, appointing and guiding senior management and overseeing general management of the Company. There is a continuous and highly interactive dialogue between Executive Board and Supervisory Board and their respective members. In its charter, the Executive Board has

# DECLARATION OF COMPLIANCE WITH THE GERMAN CORPORATE GOVERNANCE CODE

The Executive Board and the Supervisory Board of Epigenomics AG hereby declare pursuant to section 161 of the German Stock Corporation Act (AktG) that since the last statement of compliance in December 2005, Epigenomics AG has complied with the recommendations of the German Government Commission on the Corporate Governance Code in the version of June 2, 2005, and June 12, 2006, respectively, and will comply with the recommendations of the German Government Commission on the Corporate Governance Code in the version of June 12, 2006, with the following exceptions, partly due to specific corporate particularities:

**Section 3.8 Paragraph 2.**
The D&O (directors' & officers') liability insurance taken out by Epigenomics AG for its Executive Board and Supervisory Board members includes a deductible. However, we think a deductible is not a precondition for responsible management; responsible management rather is a self-evident duty of all board members. Therefore, the "adequacy" of the amount of a deductible is not of particular importance. Accordingly, we did not and will not comply with the recommendation in Section 3.8. paragraph 2 regarding the adequacy of the deductible.

**Section 4.2.3 Paragraph 3.**
The stock options granted to Executive Board members in the past were not related to relevant comparison parameters. With regard to existing stock option programs a retroactive change of performance targets is not excluded, and for extraordinary, unforeseen developments a possibility of limitation (cap) has not been agreed upon. We think that the responsibility and motivation of Executive Board members are not improved by referring to comparison parameters and that a possibility of limitation (cap) is not necessary due to the structure of the existing stock option programs. Therefore, the aforementioned recommendations pursuant to Section 4.2.3 paragraph 3 of the Code were not adhered to with regard to stock options granted in the past and with regard to existing stock option programs and will not be complied with.

**Section 5.1.2 Paragraph 2.**
An age limit for members of the Executive Board has not been specified. Such a general limit could restrict the members of the Supervisory Board in their selection of particularly qualified and experienced candidates. From our point of view, age is not necessarily an adequate criterion for the disqualification of candidates. Furthermore, the age structure of the Executive Board does not suggest the adoption of an age limit within the foreseeable future. Accordingly, we did not and will not comply with the recommendation in Section 5.1.2 paragraph 2 regarding an age limit for members of the Executive Board.

**Section 5.4.1**
Due to the aforementioned reasons, an age limit for members of the Supervisory Board has neither been specified. An age limit would inappropriately narrow the shareholders' right to elect the members of the Supervisory Board. Accordingly, we did not and will not comply with the recommendation in Section 5.4.1 sentence 2 regarding an age limit for members of the Supervisory Board.

**Section 5.4.7 Paragraph 1.**
The Company adheres to the recommendation in Section 5.4.7 paragraph 1 concerning compensation for committee work with the exception that there will be no separate compensation for the mere membership in committees apart from presidency. Since the committee work is evenly distributed among the members of the Supervisory Board, a differentiated compensation appears not necessary regarding the bare membership in committees.

**Section 5.4.7 Paragraph 2.**
The compensation of the Supervisory Board members contains no performance-related component. A performance-related compensation would not lead to an additional increase in incentive or motivation. The adoption of performance-related compensation components in the future shall be subject of a future decision of the Annual General Shareholders' Meeting, as the case may be.

Berlin, December 2006

The Supervisory Board

The Executive Board

been given a clear set of rules and procedures for certain actions and decisions that would require Supervisory Board approval as well as defined reporting and information guidelines.

**Executive Board Compensation.** The appropriateness of compensation for all Executive Board members is reviewed annually by the Supervisory Board and put in context of national and international comparables. Compensation takes into account the economic and financial situation as well as size and complexity of international operations and responsibilities. Each Executive Board member's compensation consists of three elements: a fixed annual salary, a performance-related cash bonus and from time to time – upon approval by the annual general shareholders' meeting – the possibility of stock option grants. The individual bonuses for fiscal 2006 depend on achieving Company goals as well as individual goals.

For the year 2006, total paid compensation of the Executive Board members amounted to EUR 795 thousand (previous year: EUR 1,167 thousand).

After his retirement in 2005, former Executive Board member Aron Braun received payments in the amount of EUR 113 thousand by the Company related to his former management contract. These payments have already been expensed completely in 2005 and had therefore no impact on the Company's result in 2006.

After his retirement as Chief Executive Officer of Epigenomics, Inc. effective December 31, 2005, R. Gary Schweikhardt has still received his previous monthly remuneration including social security payments until December 2006. The amount of EUR 188 thousand that the Company has paid to Mr. Schweikhardt in the reporting year had already been completely expensed in 2005.

The individual compensation is shown below, whereby 'other compensation' consists of payment for vacation days not taken.

**MEMBERS OF THE EXECUTIVE BOARD AND THEIR COMPENSATION**

| | Fixed compensation 2006 (2005) in EUR | Variable compensation 2006 (2005) in EUR | Other compensation 2006 (2005) in EUR | Total compensation 2006 (2005) in EUR |
|---|---|---|---|---|
| **Alexander Olek, Ph.D. (until Aug 17, 2006)** | | | | |
| Chief Executive Officer | 180,000 | 56,000 | 0 | 236,000 |
| Berlin (D) | (180,000) | (60,000) | (0) | (240,000) |
| **Dr. Kurt Berlin** | | | | |
| Chief Scientific Officer | 135,641 | 50,000 | 4,500 | 190,141 |
| Stahnsdorf (D) | (135,319) | (37,500) | (4,500) | (177,319) |
| **Christian Piepenbrock** | | | | |
| Chief Operating Officer | 135,000 | 35,000 | 5,000 | 175,000 |
| Berlin (D) | (135,000) | (37,500) | (1,000) | (173,500) |
| **Oliver Schacht, Ph.D.** | | | | |
| Chief Financial Officer | 158,501 | 34,942 | 0 | 193,443 |
| Seattle, WA (USA) | (161,814) | (43,750) | (0) | (205,564) |

In 2006, no stock options were granted to members of the Executive Board and no stock options were exercised by them (for details see "Stock option grants in the reporting year" in our Consolidated Financial Statements for 2006).

**MEMBERS OF THE SUPERVISORY BOARD IN 2006[1]**

Prof. Dr. Dr. h.c. Rolf Krebs – Mainz (D)
Chairman
former speaker of the Executive Board of Boehringer Ingelheim GmbH
Other mandates as of Dec 31, 2006: Ganymed Pharmaceuticals AG, Air Liquide S.A., E. Merck OHG, Merz KGaA und Merz Pharma KGaA, E. Merck KGaA
Mandates terminated in 2006: GEA Group AG, Vita 34 AG

Prof. Dr. Dr. Uwe Bicker – Bensheim-Auerbach (D)
Deputy Chairman (since July 10, 2006)
Associated Professor at University of Heidelberg
Other mandates as of Dec 31, 2006: Dade Behring Marburg GmbH (Chairman), Definiens AG, Future Capital AG
Mandates terminated in 2006: Cambridge Antibody Technology Ltd.

Bruce Carter, Ph.D. – Seattle, WA (USA)
Deputy Chairman (until July 10, 2006)
President & CEO of ZymoGenetics Inc.
Other mandates as of Dec 31, 2006: Renovis Inc., ARK Therapeutics Group plc, QLT Inc.
Mandates terminated in 2006: BioImage A/S

John Berriman – Reading (GB) (until July 10, 2006)
Executive Deputy Chairman of Oxxon Therapeutics Holdings Inc.
Other mandates as of Dec 31, 2006: Ablynx NV, Algeta ASA (Chairman), Micromet Inc.
Mandates terminated in 2006: n/a

Prof. Dr. Günther Reiter – Pfullingen (D)
Professor at European School of Business, Reutlingen
Other mandates as of Dec 31, 2006: Deltoton AG (formerly Frankoniawert AG)
Mandates terminated in 2006: Actium Beteiligungs AG

Dr. Ann Clare Kessler – San Diego, CA (USA)
Consultant
Other mandates as of Dec 31, 2006: MedGenesis Therapeutix
Mandates terminated in 2006: n/a

Günter Frankenne – Berg/Neumarkt (D) (since July 10, 2006)
Managing Partner STRATCON Strategy Consulting
Other mandates as of Dec 31, 2006: Concentro AG (Chairman), KeyNeurotek AG (Chairman), LCG LifeScience Consulting Group International AG (Chairman), November AG (Chairman), Verbena AG, Virologik GmbH (Chairman), iMTM GmbH, siRion GmbH,
Mandates terminated in 2006: Sirenade AG

[1] Mandates indicated are memberships in other supervisory boards or comparable boards with supervisory function in Germany or abroad.

**Supervisory Board.** Epigenomics AG's Supervisory Board consists of six members. All members have extensive experience in the pharmaceutical, biotech and financial industries. Election of the members of the Supervisory Board took place at the annual general shareholders' meeting held on July 10, 2006.

The Supervisory Board of Epigenomics AG has established two committees: first, an Audit and Corporate Governance Committee assisting the Supervisory Board in approving all financial statements, commissioning the auditors, choosing appropriate topics for the main focus of the audit, determining the audit fees, and ensuring the independent status of the auditors as well as all aspects of corporate governance. Second, a Personnel and Compensation Committee dealing with all aspects of Executive Board members' nomination, compensation as well as preparing other compensation-related decisions that require Supervisory Board approval.

The Supervisory Board, upon discussion with the Executive Board, also sets the strategic, financial and business goals for each fiscal year that form the basis for measuring performance of each member of the Executive Board as pertains to the respective variable compensation component.

**Supervisory Board Compensation.** In fiscal 2006, we expensed a total compensation to our Supervisory Board members of EUR 158 thousand (previous year: EUR 116 thousand), which was in line with decisions approved by the annual general shareholders' meeting.

**MEMBERS OF THE SUPERVISORY BOARD AND THEIR COMPENSATION**

| | Annual retainer compensation 2006 in EUR | Meeting fees 2006 in EUR | Compensation as committee chairman 2006 in EUR | Total compensation 2006 in EUR |
|---|---|---|---|---|
| Prof. Dr. Dr. h.c. Rolf Krebs | 30,000 | 6,000 | 5,000 | 41,000 |
| Bruce Carter, Ph.D. | 15,000 | 4,000 | 0 | 19,000 |
| John Berriman | 5,000 | 4,000 | 0 | 9,000 |
| Dr. Ann Clare Kessler | 10,000 | 12,000 | 0 | 22,000 |
| Prof. Dr. Dr. Uwe Bicker | 15,000 | 12,000 | 0 | 27,000 |
| Prof. Dr. Günther Reiter | 10,000 | 12,000 | 5,000 | 27,000 |
| Günter Frankenne | 5,000 | 8,000 | 0 | 13,000 |
| **Total Compensation 2006** | **90,000** | **58,000** | **10,000** | **158,000** |

In addition the members of the supervisory board accounted for expenses of EUR 31 thousand in 2006.

The compensation approved by the annual general shareholders' meeting has been based on an annual cash retainer, meeting-related fees plus additional payments for committee chairing work. The compensation did not comprise any equity-linked elements or long-term incentive components.

During the reporting year, the members of the Supervisory Board held neither shares nor stock options or any other convertible instrument nor any other equity-linked compensation entitlement of the Company.

**Directors' Dealings and Directors' Share Ownership.** According to Section 15 a of the German Securities Trading Act (Wertpapierhandelsgesetz) and Section 6.6 paragraph 1 of the Corporate Governance Code persons discharging managerial responsibilities within an issuer of financial instruments are required to disclose their personal transactions in shares of the issuer and financial instruments based on them, especially derivatives, to the issuer and to the German Federal Financial Supervisory Authority (BaFin). The duty to disclose applies to the members of the Executive Board and of the Supervisory Board. Moreover, the duty of disclosure now also applies to persons who have regular access to inside information about the company and are empowered to make significant managerial decisions. The duty to disclosure also applies to persons and certain legal entities closely associated with a person discharging managerial duties at the company. The duty to disclose does not apply if the purchase and sale transactions do not exceed EUR 5 thousand in a calendar year.

The transactions since January 1, 2006, were as follows (until December 31, 2006):

| Date | Executive Board Member | Transaction | Total amount of shares as of Dec. 31, 2006 | Total amount in EUR as of Dec. 31, 2006 |
|---|---|---|---|---|
| Jul 31 | Alexander Olek, Ph.D. | Buy | 2,000 | 7,000 |

In accordance with Section 6.6 paragraph 2 of the Corporate Governance Code the ownership of shares in the Company or related financial instruments by the Executive Board and Supervisory Board will be reported if these directly or indirectly exceed 1 % of the shares issued by the Company. As founders of the Company, our Executive Board members hold a significant number of shares and stock options. As of December 31, 2006 the members of our Executive Board held the following numbers of our shares and stock options:

**MEMBERS OF THE EXECUTIVE BOARD**

| | Owned shares as of Dec 31, 2006 (Dec 31, 2005) | Stock options as of Dec 31, 2006 (Dec 31, 2005) | Exercised options in 2006 (2005) |
|---|---|---|---|
| **Alexander Olek, Ph.D. (until Aug 17, 2006)** | | | |
| Chief Executive Officer | n/a | 0 | 0 |
| Berlin (D) | (375,711) | (86,613) | (0) |
| **Dr. Kurt Berlin** | | | |
| Chief Scientific Officer | 114,750 | 56,613 | 0 |
| Stahnsdorf (D) | (114,750) | (56,613) | (0) |
| **Christian Piepenbrock** | | | |
| Chief Operating Officer | 117,300 | 56,613 | 0 |
| Berlin (D) | (117,300) | (56,613) | (0) |
| **Oliver Schacht, Ph.D.** | | | |
| Chief Financial Officer | 104,550 | 69,363 | 0 |
| Seattle, WA (USA) | (104,550) | (69,363) | (0) |

Therefore, the current members of the Executive Board held as of the reporting date, 336,600 shares (approx. 2%) of the Company (Dec 31, 2005: 712,311 shares).

**Information on the Company's stock option programs.** Please refer for all information on the Company's stock option programs to the notes of the 2006 Consolidated Financial Statements.

## OPPORTUNITIES AND RISKS

### Clinical risk reduced and partnering risk increased in screening; clinical and regulatory risks well under control in tissue test development; financing risks increasingly relevant.

Epigenomics is a globally operating biotechnology company and as such subject to many industry and company-specific risks and opportunities. In line with the German "Corporation Sector Supervision and Transparency Act" ("Gesetz zur Kontrolle und Transparenz im Unternehmensbereich" – KonTraG), Epigenomics has an established, comprehensive and effective system to identify early, assess, communicate and manage risks across all of its functions and operations. The underlying principles and guidelines have been documented in a groupwide "Risk Management Policy". The goal of this policy and all related systems is to identify risks systematically at the earliest possible stage, estimate their likelihood of occurrence as well as potential qualitative and quantitative impact, and design and implement effective countermeasures. The risk management has been regularly discussed and is being developed further at the Executive Board and the Supervisory Board levels.

Core principle is a transparency of risks across functions and businesses, interactive evaluation of these risks and a culture of accepting risks as integral part of doing business in biotechnology, but doing so responsibly and seeking an optimal balance of opportunities and risks. Every risk has a clearly identified "Risk Owner" whose responsibility it is to continuously monitor and control it as well as manage implementation of any countermeasures. At quarterly intervals, these risk owners report to the corporate "Risk Manager" who in turn communicates the risks to the Executive Board and the Supervisory Board of the Company. In case of any material risk, this risk is immediately brought to the attention of the corporate Risk Manager and discussed at the appropriate board levels.

Hence, our management structure, our organizational forums for identifying and assessing risks, the monthly internal as well as external reporting and our controlling systems all form an integral part of the overall risk management system in a standardized fashion across all functions and locations. All of these tools are regularly monitored for effectiveness and optimized as well as reviewed by our auditors and the Audit and Corporate Governance Committee of our Supervisory Board.

There are a number of major risks that Epigenomics faces, which individually or in combination could severely impact our revenue, earnings and financial situation as well as our stock price. These are addressed below:

Despite all of the progress made, a substantial amount of risk remains and pertains to our businesses, products, partnerships, technologies, IP, operations, financials and ultimately our stock. These risks were described in great detail in our IPO prospectus and are summarized in this Risk Reporting section. None of our products have yet completed clinical trials nor are they approved by any regulatory authority or marketed and sold yet.

**Business-related opportunities and risks.** Our revenue in 2006 as well as for the near future depends almost entirely on our partners funding parts of research and development. The dependency on Roche Diagnostics as a part-

ner with over 64 % of 2006 total revenue stemming from that partnership has effectively been reduced to zero upon termination of this agreement. At the same time, the new risk of having to find suitable development and commercialization partners for our major IVD products in early cancer detection has been added. While new collaboration agreements in our SBU Clinical Solutions have allowed us to somewhat diversify our revenue generation basis, all of these partnerships are relatively early-stage and need to demonstrate their commercial potential in the future. The year-end picture is hence characterized by certain challenges and short-term risks on the partner-driven revenue generation.

However, the post-Roche era with Geert Walther Nygaard having joined Epigenomics as its new CEO as well as the fact that we received back all rights and licenses to our screening products from Roche Diagnostics also presents unique opportunities to identify the best-suited partners for each of our products and programs. After having significantly reduced the technical and clinical risks during the past year, Epigenomics is in an excellent position to leverage its position in any partnering negotiation.

Due to the stage of maturity of our products, a risk is the ability of DNA methylation assays to achieve the expected performance for the diagnostic tests we develop. This will determine the success of our clinical studies as well as revenue from our partnerships and ultimately product-based revenue or royalties on partners' net sales.

In a space as dynamic and attractive as molecular diagnostics, there is an ever-intensifying degree of competition that could reduce or eliminate the competitive edge of our approach. The DNA methylation space has seen significantly intensified competition over the past two years. OncoMethylome Sciences (Belgium) has successfully completed its IPO and licensed initial biomarkers to its IVD partner Veridex (a Johnson & Johnson company). Both Orion Genomics and Rubicon Genomics have continued their efforts to make inroads into the DNA methylation market. Following the launch of Qiagen's preanalytics research kit (EpiTect®) based on Epigenomics's licensed IP and technology, Applied Biosystems (USA) has launched a competing research kit in fall of 2006. Several other research products companies have indicated or are believed to be working on DNA-methylation-based research products (e.g. Illumnia, Agilent, Sequenom, Nimblegen, etc.).

Epigenomics clearly plans to partner and license some or all of these body-fluid-based early detection tests with (a) strategic IVD partner(s). Such partnering discussions and negotiations will require a significant amount of time in any realistic scenario. While the opportunity is to find a partner that is more committed and better able to take these products to market expeditiously at commercially more attractive terms to Epigenomics, the risk is that no such partner can be found in 2007 or terms are less favorable for Epigenomics. Another risk-mitigating strategy has been the search for a reference laboratory partner to provide early access to the clinical opinion leaders and the home-brew testing market for some of our blood-based tests.

Delays or failure to develop these tests or to continue to have patient sample access, failure to obtain regulatory approval, failure of the underlying drug programs in pharmacodiagnostics, lack of market acceptance and penetration, resistance by the pharmaceutical industry against pharmacodiagnostics, payor resistance to reimburse our tests would all have material impact on our revenue, earnings, financial position and our ability to raise further capital. Similar risks exist in all other partnered programs as well and might also make the entering into additional alliances harder.

Epigenomics today does not yet have access to an own hardware or device platform to run blood-based and urine-based commercial diagnostic tests and therefore heavily relies on its future IVD partner(s) for such a market outlet. In tissue testing the platform risk has been reduced substantially by entering into the "Powered by Affymetrix"®

deal. The remaining risk around the Affymetrix platform has to do with its regulatory approval for DNA methylation (considered minor) as well as the long-term competitiveness of the Affymetrix system in the marketplace vis-à-vis competing systems.

Also, during 2006, Epigenomics successfully established the capabilities required to run clinical trials and to obtain regulatory approval for its first tissue tests. Manufacturing as well as marketing and selling of these products still require additional partnerships and are subject to risks of delays, unfavorable economic terms or the inability to identify suitable partners.

Epigenomics is furthermore subject to significant dependencies on its suppliers of critical patient samples, components of our tests and materials for all our R&D programs. Delays, higher costs, lack of available supplies in a timely and effective manner could seriously hamper individual product development projects and operations inside Epigenomics. To mitigate this risk, we work with second-source suppliers wherever possible, have supplier audits in place for critical components and continuously strive towards optimizing our purchasing efforts.

All of the above we try to manage effectively by keeping close relations and open interactions with all our partners, by creating a balanced portfolio of varying types of risks and opportunities in terms of required technologies, assay systems, clinical questions, timelines and by having a set of partners as well as own in-house product development programs we work on. We also strive towards obtaining access to those components of the value chain we currently do not control through partnering and other commercial arrangements, gradual forward integration and selective investment into such complementary skills and capabilities. Wherever possible and economically viable, we have taken out insurance against loss of data and facilities, downtime, theft, hazards, liabilities etc. and we regularly monitor the appropriateness of the level of our insurance coverage.

Also, to successfully implement our business strategy, we rely on highly skilled, motivated, and loyal employees. We have therefore continued and broadened management assessment programs, tailored training and coaching measures as well as incentive and retention programs to ensure the continued success in hiring the best teams for our businesses especially after the reorganization in October 2006. Our internal policies aim at establishing, nurturing and maintaining a culture of awareness and feeling responsible for the management of opportunities and risks at every level.

**IP-related opportunities and risks.** Our business relies very heavily on commercializing our intellectual property in the form of know-how as well as licenses to patents and patent applications. Therefore, any negative impact on scope, duration, depth and breadth of claims granted, regional coverage, competing IP that we could depend on, difficulties in enforcing the protection, inadvertently infringing other IP, preventing others from infringing our IP, our ability to inlicense key IP etc., would negatively impact our cost base, our ability to compete as well as to commercialize our products and to close alliances, our revenue and ultimately our earnings and overall commercial success.

At the same time, the progress made in expanding its IP portfolio puts Epigenomics in a unique position to provide attractive licensing opportunities for the growing number of commercial players active in DNA methylation.

**Opportunities and risks related to the regulatory environment.** The regulatory environment in molecular diagnostics and pharmacodiagnostics is evolving rapidly and this could significantly impact the timing, cost and our ability to meet such regulatory standards. In parts, the regulatory frameworks are not fully established or clarified. This in turn could negatively impact on revenue generation, burden our cost base and earnings, financial position and ability to compete effectively. To mitigate this risk, we have established a corporate function dealing with quality systems as well as clinical and regulatory affairs

and we rely on experienced advisors to prepare the organization for any potential issues. Seeking an early dialog with the U.S. FDA and other relevant authorities is an integral part of our risk management policies.

To that end we have made excellent progress in establishing a productive dialog with the regulatory bodies. The opportunity to take a first DNA-methylation-based molecular diagnostic test through clinical trials in a 'retrospective-prospective' study lies before Epigenomics in 2007/2008.

**Financial opportunities and risks.** Looking at the available liquidity as of year-end 2006 of EUR 17.3 million it becomes apparent that at current and expected net cash consumption by our operations there is a need to augment our liquidity position. Current funding reaches well into 2008 so that a 'going concern' for the next 12-month period is ensured. However, to also have the going concern basis ensured for a 24-month period and beyond, additional liquidity needs to be obtained or the operating cost base would need to be adjusted accordingly. Both are subject to inherent risks and uncertainties. However, management sees several significant opportunities to achieve just that and in fall of 2006 has initiated a concrete project addressing all strategic and tactical financing options. The expected successful completion of such financing transaction has been built into the operational and business planning for 2007, 2008 and beyond to ensure a medium- and long-term going concern.

Operating in Germany as well as in the U.S.A. means we are subject to a foreign exchange rate risk even though it is almost exclusively limited to the euro-U.S. dollar relation. We monitor this risk on a regular basis and evaluate as the cases arise whether hedging transactions could minimize the exposure. We also take advantage of the opportunities that lie in higher interest rates in the U.S. dollar compared to the euro wherever possible within our investment policies.

Our portfolio of securities and cash equivalents also bears a liquidity risk as the issuers of those securities could be temporarily or permanently late in repayments or distributions and therefore we might not be able to obtain the necessary liquidity. We are addressing this risk by continuous market observation and reacting immediately to threatening bottlenecks.

Our portfolio of securities faces also price risks in the form of interest rate, issuer and impairment risks. Our investment policy stipulates to open only positions with an "investment grade" rating. As a consequence of previous year's treasury risks materializing, we have further limited the alternatives in investing and reduced yield expectations accordingly. In close cooperation with our banks, advisors, the Audit and Corporate Governance Committee of the Supervisory Board and internal functions we aim continuously at finding an appropriate balance between exposure to these risks, obtaining a sufficient interest yield and minimizing our U.S. dollar currency exposure whilst benefiting from opportunities within these confines.

**Other opportunities and risks.** Further, we continuously monitor all applicable environmental, health and safety, operational as well as other applicable statutory or industrial guidelines and have implemented functions to comply with all of these effectively at each of our business locations.

To minimize the manifold tax, corporate, employment, competition, IP and other legal frameworks, we base our decision-making and design of our policies and processes on the advice of external as well as internal experts in each of these areas. Wherever appropriate and indicated, we set aside provisions to cover any potential liability.

There are risks specifically associated with our stock: the large holdings of a small number of venture capital (VC) funds and institutional shareholders in Epigenomics shares; comparatively low levels of liquidity in the stock; high volatility based on all of the above-described factors, as well as

external influences and negative perception by others of any share sale either by management or VC investors. However, at the same time, the tight holdings in Epigenomics's stock provides the opportunity to have a very interactive dialog with key shareholders on a regular basis. Also, interested buyers of Epigenomics shares have repeatedly chosen the opportunity of blocks becoming available at reasonable prices from VC shareholders. One of the opportunities available to Epigenomics is to privately place shares from its authorized capital to a small number of interested buyers.

There could potentially be other risks as well as significant opportunities beyond the ones described here that we currently either deem insignificant or are not aware of at the time of this report.

## PROGNOSIS REPORT

**New Epigenomics IVD partnership(s) sought for early cancer detection tests; expand overall partnership base; initiate pivotal clinical trial in prostate tissue classification test; further leverage IP position.**

**Economic environment.** We anticipate continuing economic recovery in both Europe and the U.S.A. We foresee only moderate increases in costs for supplies and staff. Given that energy prices and interest rates seem to have peaked for the short term, inflation is not expected to have a very significant impact on 2007 operating costs neither in Germany nor in the United States.

In line with the consensus view of most major banks, we expect the U.S. dollar to remain relatively weak in the medium term, which will in turn have a positive effect on Epigenomics's cost of operations in Seattle vis-à-vis the costs in Berlin in euro terms. However, pharmaceutical companies usually purchase R&D collaborative programs in U.S. dollar so that continuing price pressure on these deals is anticipated.

Given the very strong performance of the overall stock markets during 2006, particularly in Germany, we anticipate a flurry of activities on equity capital markets in 2007. We expect 2007 and 2008 to be characterized by modest increases in stock market valuations and the capital markets to be open to biotech issuers due to a positive overall trend.

Regulatory pressure on pharmaceutical companies worldwide to integrate pharmacogenomics into their drug development in order to avoid future cases of serious safety or efficacy concerns are expected to slowly but steadily increase. This will raise the awareness and perceived need by these companies to integrate pharmacodiagnostic efforts into their programs. Also, given the recommendations for reimbursement of early detection, especially in cancer, by the U.S. government and other bodies as well as massive popular awareness campaigns, the overall perception of cancer screening for the bulk of the population will steadily improve. As pharmacoeconomic arguments continue to be built for saving significant costs by avoiding unnecessary or inappropriate treatments, the contribution of innovative diagnostics towards such end is expected to increase over the longer term. In the short term, however, especially in Germany but also in the U.S., the public debate on the healthcare reform and the need to reduce costs in the healthcare system overall could lead to a climate that is not ideal for introducing high-priced and innovative molecular diagnostics into the marketplace. Although few people would argue with the long-term cost saving potential of such tests, it is quite possible that short-term costs are additive. Therefore, Epigenomics today is already dealing with the health economic opportunities that are inherent in molecular diagnostics.

**Business strategy.** It is important to note that as of the date of the annual report, our new CEO Geert Walther Nygaard has only just joined the management team of Epigenomics. Therefore it is reasonable to expect a thorough review of Epigenomics's business strategy, partnering model, product portfolio, and organizational designs. Such a review could result in certain changes to current priorities and focus.

The overriding goal of our corporate and business strategy is to develop novel molecular diagnostic tests for the early detection (screening) and monitoring of cancer as well as tumor classification – e.g. aggressiveness or relapse probability – to improve treatment choices for patients. By addressing these unmet medical needs we intend to create and grow shareholder value. At the same time we want to build and maintain excellent employee and stakeholder relationships, be a reliable and valued partner to the diagnostics, pharmaceutical and biotechnology industries and assume an active and involved role in our local communities and our industry as good corporate citizen.

The highest priority of Epigenomics's business strategy continues to be the development of early cancer detection (screening) tests in colon, prostate, lung and breast cancer. In order to achieve this, Epigenomics intends to offer individual programs or its entire pipeline of blood-(or urine-) based cancer screening tests for licensing and partnering. An ideal partner will need to have a strong track record in molecular diagnostics and ideally also in oncology, have access to an approved IVD testing platform and have superior regulatory, reimbursement, manufacturing, marketing and selling capabilities in the most important geographic regions.

To expedite the introduction to the U.S. market and opinion leaders, the business strategy of Epigenomics aims at partnering some of its blood-based workflows and assay systems with a reference laboratory partner. Following the transfer of workflow and assays, we would expect our partnering laboratory to run clinical studies to demonstrate the usefulness of our DNA-methylation-based tests in e.g. colon cancer monitoring or early detection and then commercialize the tests in a homebrew fashion prior to these products being available as IVD test kits via our future diagnostics partner(s).

We assume that sufficient levels of funding will be available, either from capital-markets-based financing transaction(s) or via strategic partnerships. Epigenomics plans to progress its prostate cancer molecular classification test (PCMCT) into its pivotal clinical trial in 2007 and towards regulatory approval in 2008. At the same time, Epigenomics retains the flexibility to seek appropriate strategic partnerships (e.g. manufacturing and commercialization) for its tissue-based cancer classification test pipeline.

We expect to continue to deliver successful results in our Clinical Solutions business's partnered programs. Going forward, Epigenomics will focus on delivering clinical biomarker studies and on offering solutions to its partners and customers.

Overall, our strategy will remain focused on developing and commercializing innovative molecular diagnostic and pharmacodiagnostic products in oncology and over time also on other disease indications, leverage our leading intellectual property estate in DNA methylation, offering clinical biomarker solutions, while complementing the skills and expertise available today with those needed to enter as a potential leader the emerging molecular diagnostics space.

Epigenomics's strategy and business model offer significant opportunities for growth in shareholder value and future profitability.

Broadening the strategic partnership base offers a clear path to gain wide-spread acceptance of our DNA methylation solutions as gold standard throughout the diagnostics, pharmaceutical and biotechnology industries. Also, making available selective IP through an out-licensing effort provides us with a short-term cash inflow opportunity and also with attractive, long-term continuous income streams via royalties and license fees.

The biggest potential opportunity in the long run is expected to be accessed by way of a growing pipeline of our own Epigenomics products. Rather than solely relying on partners for critical steps of the value chain – as had been the case in the Roche Diagnostics alliance – and relinquishing control over marketing, pricing, positioning etc., management believes that having control over such aspects offers the option to become a more fully integrated molecular diagnostics company counting on product revenue and margins rather than just on R&D collaboration funding or royalties. This provides us with the opportunity for a long-term sustainable business based on growing revenue and heightened self-sufficiency. Therefore, management considers all strategic options for financing, partnering and corporate development opportunities.

**Financing strategy.** Our financing strategy is tailored towards ensuring sufficient liquidity for our operations based on the available funds at present. Virtually all operations that are not covered as part of our collaborative R&D agreements are funded solely through equity capital raised in several venture capital rounds as well as our IPO in July 2004. At the end of 2006, the balance sheet continued to be practically debt-free.

We closely monitor the capital markets and investor base to evaluate opportunities for further increasing the free float in Epigenomics's shares that allow our VC shareholders to reduce some of their holdings. As part of a concrete and well-defined project we have also been continuously assessing the equity capital markets environment towards the possibility of satisfying our medium- to long-term financing needs. To that end, Epigenomics AG has an authorized capital of currently up to 5.7 million shares, which can be issued as part of (a) possible financing transaction(s) or another strategic transaction.

Our treasury and investment policy is in line with these goals and ensures a diversified portfolio of cash, cash equivalents as well as marketable and held-to-maturity securities. We aim at avoiding any overexposure to one particular issuer, type of investment, maturity, or other investment risk. A key element in our treasury and investment policy is to maintain relationships with major banks assisting us with the investment portfolio management. Strategically, we strive for reducing the overall risk level in terms of exposure to price drops in available-for-sale securities by reducing our holdings and taking full advantage of the significantly higher U.S. dollar interest rates, which we see continuing to exceed European interest rates throughout the next several quarters.

**Goals for 2007 and beyond.** Our operating plans are based on a euro/U.S. dollar exchange rate in line with recent levels and a largely unchanged macroeconomic and political environment. Thereby, we believe to continue to be able to benefit from a revenue base in euro and a significant portion of our operational costs in U.S. dollar. Epigenomics expects to achieve its 2007 and 2008 goals with a reduced headcount and reduced operating cost base following the reorganization in October 2006.

We expect completing further important clinical testing and validation studies in our blood- and urine-based early cancer detection programs. We anticipate publishing further details and results from these studies in 2007 and beyond. Our body-fluid-based early detection products for colon cancer screening, possible further screening and monitoring tests, as well as our tissue-based tests in prostate and breast cancer indications are expected to play an important part in the future development of Epigenomics.

Four key strategic objectives have so far emerged for 2007:

1. Partnering with a U.S. reference laboratory for blood-based testing in colon cancer indication(s);
2. Entering into (a) new diagnostics partnership(s) for some or all of our body-fluid-based screening tests;
3. Securing the mid- to long-term financial basis for continued development of our products and businesses.
4. Reviewing all strategic financing alternatives and opportunities.

We expect to show revenue growth from partnerships year over year already in 2007 but more pronounced in 2008 and onwards. The overriding objective for the IVD business in cancer screening is to base any new partnership on clear commitments and diligence as well as economics that reflect the much reduced risk and time to market of some of the more advanced tests (e.g. CCS).

In our Clinical Solutions business we aim at adding new partnerships with leading pharmaceutical or biotechnology companies, delivering promising results to our current partners and expanding or extending ongoing relationships towards integrated clinical biomarker solutions.

Another key strategic goal for 2007 and 2008 remains to gain significantly more visibility and commercial clout by carefully crafted sales and distribution deals on our own product development programs by focusing our pipeline of tissue tests under development on opportunities that we can address on our own.

Given, that we expect to continue investing significant parts of our R&D budget into our own product development (both screening until partnered as well as blood-based monitoring and tissue tests) and facing the sizeable costs of being a public company, we expect net losses over the next two years to continue at high levels.

2008 offers the opportunity for first sales of home-brew tests by a future reference laboratory partner. Meaningful revenue from own product sales is expected from 2009 onwards.

We believe our Clinical Solutions revenue to grow independently from our IVD strategy and partnership(s) and, compared to 2006, total revenue should be growing at double-digit percentage figures in 2007 and 2008. Our out-licensing effort is expected to begin contributing significant amounts to 2007 revenue with further modest growth in 2008 and beyond.

While we expect a positive net contribution from our licensing effort even in its first few years, it will not be before 2008 that the Clinical Solutions business could begin to deliver significant positive contributions to the Epigenomics bottom line. For our Diagnostics business it will be a precondition that Epigenomics and its IVD partner(s) have successfully launched first products for a positive segment contribution. Hence, management expects a significant negative net contribution margin from its Diagnostics business for both 2007 and 2008.

Following the successful implementation of all reorganization measures, management anticipates some decreases in operating costs despite significant external costs for the pivotal clinical trial of our PCMCT test and its associated outsourced manufacturing. Net loss is likely to improve against 2006 levels but continue to be high for the next two years.

It is quite common for biotechnology companies in later stages of clinical development to have significant dips in earnings and increased cash requirements before obtaining regulatory approval for partnered or own products with corresponding surges in revenue and cash inflows. Management sees no reason for Epigenomics to not follow a similar pattern in 2007 and 2008 with high net cash required.

«Radical prostatectomy is a common treatment for prostate cancer, being successful in most of the cases. However, there is a group of patients who will develop a PSA relapse, and eventually may develop metastasis. With the currently available parameters, this high-risk group of patients is hard to define. We clearly need better prognostic information at the time we have to decide together with the patient, whether additional treatment is required after surgery to prevent cancer recurrence.»

Prof. Dr. Chris Bangma
Chairman of the Department of Urology
Erasmus MC, University Medical Center,
Rotterdam, The Netherlands


Epigenomics has identified a biomarker that can accurately predict the clinical outcome in prostate cancer patients after surgical removal of the prostate gland. A prognostic molecular diagnostic test using this biomarker may help oncologists to better estimate the likelihood of a relapse in these patients. This biomarker will be made available as a testing service for patients through a centralized reference laboratory in 2008.


Design Model

# Consolidated Financial Statements and Notes for Fiscal Year 2006

**Consolidated Financial Statements and Notes for Fiscal Year 2006**

# Group Income Statement

| EUR thousand | Notes | 2006 | 2005 |
|---|---|---|---|
| **Revenue** | 1 | **3,504** | **9,594** |
| Cost of sales | 2 | –5,020 | –7,690 |
| **Gross profit** | 2 | **–1,516** | **1,904** |
| Other income | 3 | 1,938 | 1,527 |
| Research and development costs | 4 | –8,702 | –8,121 |
| Marketing and business development costs | 5 | –2,719 | –1,523 |
| General and administrative costs | 6 | –4,076 | –3,844 |
| Other expenses | 9 | –686 | –177 |
| **Operating result (EBIT)** | 10 | **–15,761** | **–10,234** |
| Financial result | 11 | 674 | 226 |
| **Net loss for the year before taxes on income** | | **–15,086** | **–10,008** |
| Taxes on income | 12 | –316 | 1,221 |
| **Net loss for the year** | | **–15,402** | **–8,788** |
| Earnings per share (basic and diluted) in EUR | 13 | –0.92 | –0.54 |

# Group Balance Sheet

**ASSETS**

| EUR thousand | Notes | Dec 31, 2006 | Dec 31, 2005 |
|---|---|---|---|
| **Non-current assets** | | | |
| Intangible assets | 15 | 6,524 | 5,183 |
| *thereof goodwill* | *16* | *2,625* | *2,625* |
| Tangible assets | 17 | 2,050 | 2,000 |
| Financial assets | 18 | 1,000 | 1,000 |
| Deferred taxes | 19 | 985 | 1,258 |
| Other non-current assets | | 0 | 30 |
| **Total non-current assets** | | **10,559** | **9,471** |
| | | | |
| **Current assets** | | | |
| Inventories | 20 | 199 | 208 |
| Trade and other receivables | 21 | 319 | 734 |
| Marketable securities | 22 | 4,775 | 9,173 |
| Cash and cash equivalents | 23 | 12,566 | 23,519 |
| Other current assets | 24 | 1,715 | 1,892 |
| **Total current assets** | | **19,575** | **35,526** |
| | | | |
| **Total assets** | | **30,134** | **44,997** |

**EQUITY AND LIABILITIES**

| EUR thousand | Notes | Dec 31, 2006 | Dec 31, 2005 |
|---|---|---|---|
| **Equity** | | | |
| Subscribed capital | 25 | 16,916 | 16,403 |
| Capital reserve | 26 | 25,294 | 32,072 |
| Net loss for the year | | –15,402 | –8,788 |
| Other comprehensive income | 27 | –610 | –312 |
| **Total equity** | | **26,198** | **39,375** |
| | | | |
| **Non-current liabilities** | | | |
| Liabilities from leasing contracts | | 0 | 4 |
| **Total non-current liabilities** | | **0** | **4** |
| | | | |
| **Current liabilities** | | | |
| Trade payables | | 1,255 | 1,060 |
| Liabilities from leasing contracts | | 4 | 40 |
| Deferred income | 28 | 912 | 2,168 |
| Other liabilities | 29 | 951 | 1,553 |
| Provisions | 30 | 813 | 797 |
| **Total current liabilities** | | **3,935** | **5,618** |
| | | | |
| **Total equity and liabilities** | | **30,134** | **44,997** |

# Group Cash Flow Statement

| EUR thousand | Notes | 2006 | 2005 |
|---|---|---|---|
| **Cash and cash equivalents at the beginning of the year** | | **23,519** | **32,166** |
| | | | |
| **Operating activities** | 31 | | |
| **Net loss for the year before taxes on income** | | **–15,086** | **–10,008** |
| Corrections for: | | | |
| Depreciation on tangible assets | | 1,107 | 1,118 |
| Amortization of intangible assets | | 461 | 556 |
| Gains (2005: losses) from the disposal of assets | | –1 | 13 |
| Stock option expenses | | 85 | 284 |
| Foreign currency exchange losses (2005: gains) | | 53 | –249 |
| Price losses of securities | | 128 | 889 |
| Other financing expenses | | 6 | 0 |
| Interest income | 11 | –897 | –1,155 |
| Interest expenses | 11 | 33 | 40 |
| Taxes | | –158 | –112 |
| Inflows not affecting net income | | 0 | 145 |
| **Operating result before changes in net current assets** | | **–14,269** | **–8,480** |
| Decrease in trade receivables and other current assets | | 453 | 51 |
| Decrease in inventories (2005: increase) | | 9 | –95 |
| Decrease in current liabilities (2005: increase) | | –1,517 | 264 |
| **Liquidity earned from operating activities** | | **–15,324** | **–8,260** |
| Interest received | | 946 | 759 |
| **Cash flow from operating activities** | 31 | **–14,378** | **–7,501** |
| | | | |
| **Investing activities** | | | |
| Payments for investments in tangible assets | | –1,211 | –1,004 |
| Proceeds from investment grants | 14 | 139 | 213 |
| Payments for investments in intangible assets | | –234 | –203 |
| Proceeds from divestments in financial assets | | 0 | 761 |
| Proceeds from the sale of marketable securities | | 4,913 | 7,778 |
| Payments for the purchase of marketable securities | | –997 | –9,234 |
| **Cash flow from investing activities** | 32 | **2,610** | **–1,689** |
| | | | |
| **Financing activities** | | | |
| Interest payments for silent partnerships | | 0 | –13 |
| Payments for lease financing | | –40 | –41 |
| Payments for the creation of new shares | | –85 | 0 |
| Proceeds from the exercise of stock options | 25/26 | 932 | 282 |
| **Cash flow from financing activities** | 33 | **807** | **228** |
| **Cash flow** | | **–10,961** | **–8,962** |
| | | | |
| Currency adjustments | | 8 | 314 |
| | | | |
| **Cash and cash equivalents at the end of the year** | | **12,566** | **23,519** |

# Statement of Changes in Group Equity

| EUR thousand | Notes | Subscribed capital | Capital reserve | Retained earnings | Net loss for the year | Other compreh. income | Group equity |
|---|---|---|---|---|---|---|---|
| **Dec 31, 2005** | | **16,403** | **32,072** | **–8,788** | **0** | **–312** | **39,375** |
| Net loss for the year 2006 | | 0 | 0 | 0 | –15,402 | 0 | –15,402 |
| Fair value adjustments of securities | 27 | 0 | 0 | 0 | 0 | –298 | –298 |
| **Total comprehensive income** | | **0** | **0** | **0** | **–15,402** | **–298** | **–15,700** |
| Capital increase from issue of shares | 25 | 305 | 0 | 0 | 0 | 0 | 305 |
| Premium from issue of shares | 26 | 0 | 1,286 | 0 | 0 | 0 | 1,286 |
| Financing costs | 26 | 0 | –85 | 0 | 0 | 0 | –85 |
| Exercise of stock options | 26 | 208 | 725 | 0 | 0 | 0 | 933 |
| Stock-based compensation | 26 | 0 | 85 | 0 | 0 | 0 | 85 |
| Deduction of net loss for the year 2005 | | 0 | –8,788 | 8,788 | 0 | 0 | 0 |
| **Dec 31, 2006** | | **16,916** | **25,294** | **0** | **–15,402** | **–610** | **26,198** |

| EUR thousand | Notes | Subscribed capital | Capital reserve | Retained earnings | Net loss for the year | Other compreh. income | Group equity |
|---|---|---|---|---|---|---|---|
| **Dec 31, 2004** | | **16,334** | **42,364** | **–11,009** | **0** | **50** | **47,739** |
| Net loss for the year 2005 | | 0 | 0 | 0 | –8,788 | 0 | –8,788 |
| Fair value adjustments of securities | 27 | 0 | 0 | 0 | 0 | –361 | –361 |
| **Total comprehensive income** | | **0** | **0** | **0** | **–8,788** | **–361** | **–9,149** |
| Exercise of stock options | | 69 | 213 | 0 | 0 | 0 | 282 |
| Stock-based compensation | | 0 | 284 | 0 | 0 | 0 | 284 |
| Financing costs | | 0 | 220 | 0 | 0 | 0 | 220 |
| Deduction of stock-based compensation 2005 | | 0 | –35 | 35 | 0 | 0 | 0 |
| Deduction of net loss for the year 2004 | | 0 | –10,974 | 10,974 | 0 | 0 | 0 |
| **Dec 31, 2005** | | **16,403** | **32,072** | **0** | **–8,788** | **–312** | **39,375** |

# Notes to the Consolidated Financial Statements

## BASIC INFORMATION, PRINCIPLES AND METHODS

**Description of business activity.** Epigenomics ("Epigenomics" or the "Company") was founded as a limited liability company (GmbH) in 1998 and has its headquarters in Berlin, Germany. In 2000, the Company was converted into a stock corporation (AG) and entered into the commercial register ("Handelsregister") Charlottenburg under HRB 75861. Since July 19, 2004, it is listed in the Prime Standard segment of the Frankfurt Stock Exchange (ticker symbol: ECX).

In accordance with its Articles of Incorporation, the object of the Company is the development and marketing of procedures and devices for the production of particularly epigenetic parameters such as DNA methylation patterns as well as the information technology bases necessary for their procurement and evaluation. The focus of the Company lies on the development of novel diagnostic products for cancer.

**General principles.** The consolidated financial statements of Epigenomics AG have been prepared according to Article 315a of the German Commercial Code ("HGB") and the International Financial Reporting Standards (IFRSs) of the International Accounting Standards Board (IASB), London, in effect at the closing date December 31, 2006 , as mandatorily applicable in the European Union. Further, these statements are in accordance with the German Accounting Standards (GAS).

The "going concern" principle according to IAS 1.23 has been considered.

The reporting period as defined in these consolidated financial statements is the period from January 1, 2006, to December 31, 2006. The reporting currency is the euro.

The income statement has been prepared using the cost of sales method.

**Adoption of new and revised International Financial Reporting Standards.** In the reporting year, the Group has not adopted new or revised standards and interpretations issued by the IASB. Further, the Group has not elected to adopt the new Standard IFRS 7 ("Financial Instruments: Disclosures") in advance of its effective date January 1, 2007.

**Management's judgment and expectations.** The management of the Company has made several judgments in the process of applying the entity's accounting policies that have a significant effect on the amounts recognized in the financial statements. Those judgments concern the valuation of goodwill, the capitalization of development costs and the recognition of deferred taxes. The judgments are described for each relevant position in the enumeration of accounting policies.

Management's expectations on the future are based on a scenario of moderate economic growth in the major countries (G-8 countries and Australia) over the next 3-5 years. The euro currency is expected to remain stable and strong vis-à-vis the U.S. dollar. Dramatic changes in the legislation of the major countries that could significantly affect the biotechnological industries are not assumed. Changes in the tax laws of Germany and the U.S.A. are also not anticipated. All future scenarios further assume an essentially unchanged access to relevant clinical and biological data and resources for the execution of the Company's commercial projects.

**Consolidation group.** The consolidated Group includes Epigenomics AG as the parent company (principal office: Kleine Präsidentenstrasse 1, 10178 Berlin, Germany), and Epigenomics, Inc. (principal office: Suite 300, 1000 Seneca Street, Seattle, WA 98101, U.S.A.), its wholly-owned subsidiary.

For the reporting year, the two companies have submitted individual, audited financial statements independent of their consolidation.

**Principles of consolidation.** In the consolidation of capital, the acquisition values of the investment are balanced with the share of equity capital applicable to them on the date of acquisition. A resulting difference is added to the assets and liabilities in the amount in which their current market value deviates from their carrying value. An amount in excess is capitalized as goodwill.

Intercompany results, revenue, expenses, profits, receivables and payables between the Group companies are eliminated.

**Accounting and valuation principles.** Capitalized **goodwill** has to undergo an impairment test at least once a year according to IFRS 3 ("Business Combinations") and in connection with IAS 36 ("Impairment of Assets"). The regular application of this impairment test is scheduled by the end of each calendar year, subsequent to the annual budgeting process of the Company. The recorded goodwill has been allocated to the SBU Diagnostics as cash-generating unit (CGU). The impairment test compared the net carrying value of the assets of the SBU Diagnostics to their value in use. The value in use has been defined as the discounted future cash flows of the business unit.

Management's expectations regarding the future cash flows of the screening business were based on the most recent business plans and are, however, subject to risks and uncertainty. In previous years, expectations were based on the Company's collaboration with its former key customer Roche and on the assumption that new product developments would be started within this cooperation. After the termination of that collaboration in December 2006, the business plan for the Company's screening division has been amended. Product development programs are expected to be continued over the next planning periods. However, there will be (a) new partner(s) to collaborate with and an amended time schedule. (For the generally underlying assumptions to the aforementioned business plan see also "Management's judgments and expectations"). All of those assumptions are key sources of estimation uncertainty and bear a significant risk of causing a material adjustment to the carrying amounts of the capitalized goodwill. However, no impairment of the capitalized goodwill has been determined in 2006.

Other **intangible assets** than goodwill are valued at acquisition cost less scheduled amortization on a straight-line basis. Depending on the investment, useful life will be defined between three years (software) and twenty years (patents). For patents, the useful life in individual cases depends on the term of the patent protection. Amortization of intangible assets is allocated to the functional area in which they are used. IAS 38 ("Intangible Assets") is applied. In accordance with this standard, an intangible asset is reported if it is likely that a future financial advantage is associated with the use of such asset and that its cost can be reliably determined.

**Tangible assets** are measured at acquisition or production cost, less scheduled depreciation caused by usage. Apart from directly attributable costs, pro rata overhead cost and depreciation are also included in the production costs of internally produced equipment. Public and governmental investment grants lower acquisition or production cost. Interest on third-party capital is not included in production cost. Repair costs are immediately calculated as an expense. Depreciation for leasehold improvements is applied on a straight-line basis over the remaining term of the underlying leases. Mobile fixed assets are depreciated in principle on a straight-line basis. The useful life is 3–8 years for technical and electronic equipment and 5–10 years for operational and office equipment.

In the table "Non-current assets", fully depreciated tangible assets are shown under acquisition/production cost and accumulated depreciation until the assets in question are decommissioned. In the case of disposal, assets and related depreciation are eliminated from the accounts. Income resulting from the disposal of assets (proceeds less residual carrying value) is shown in the income statement under other income/other expenses.

Investment grants and subsidies are offset directly against the subsidized assets, i.e. the asset value is reduced. The grants are thus liquidated by depreciation of the reduced investment over the remaining term.

If the value of the tangible capital assets calculated according to the above principles exceeds the fair value of these assets on the closing date, it will be taken into account by means of an extraordinary depreciation. The amount to be adjusted is determined by the net realisable value or – if higher – the net present value of future cash flows estimated from value in use of the asset. An impairment test will be done annually for assets or groups of assets for which an unplanned decrease in value is assumed. If there is no longer any reason for extraordinary depreciation, an appreciation will take place.

Securities held to maturity are shown under **financial assets**, recognized at their amortized cost and accounted for at trade date. If such securities are disposed of or are determined to be impaired, the realized differentials are recognized through profit or loss. Impairment is determined when the fair value of a financial asset falls significantly below its amortized acquisition cost and the resulting differential is expected to be permanent.

**Deferred taxes** are calculated according to the rules of IAS 12 (“Income Taxes”) and are recognized for temporary differences between the carrying amount of assets and liabilities in the financial statements and the tax balance sheets of the companies involved. Further, deferred tax assets are recognized from tax loss carryforwards if a realization in the future is probable. If the realization is not probable, a valuation allowance is recognized against the tax loss carryforwards.

The recognition of deferred taxes is based on the local tax rates enacted or the rates, which are expected to apply at the time of realization. Deferred tax assets and liabilities are offset only if they are subject to compensation with regard to the same tax authority.

Because of the current organization of procedures and the limited storage capacity of the Company, no appreciable amount of **inventories** was held. Exceptions to this are oligonucleotides (samples of synthetically produced DNA) and natural (cell) tissue samples. These are assessed at acquisition or recovery cost. Sample tubes that have been opened are fully expensed in the income statement in the month of their first use. All basic low-value consumables are valued at acquisition cost. A standardized consumption pattern is assumed. For the balance sheet date, a physical inventory of all materials and consumables was taken.

The reported **primary financial instruments** comprise of cash and cash equivalents, marketable securities, trade receivables, trade payables and other financial liabilities. Those instruments are recognized initially at acquisition costs and then at amortized acquisition costs or at their fair value.

**Trade receivables** are recognized at amortized acquisition costs, net of allowances for doubtful accounts.

According to the definitions of IAS 39.9 (“Financial Instruments: Recognition and Measurement”), the Company’s **marketable securities** are classified either as “financial assets at fair value through profit or loss” or as “available-for-sale financial assets”. Independent of this classification they are recognized at fair value and accounted for at trade date. Changes in fair value are recognized through profit or loss or – if the securities classify for available-for-sale financial assets – in other comprehensive income until the securities are disposed of or are determined to be permanently impaired. Impairment losses recognized in profit or loss are subsequently reversed if an increase in the fair value of the instrument can be objectively determined.

**Derivative financial instruments** are carried at fair value and accounted for at trade date. As a matter of principle, the fair values of derivative financial instruments correspond to the market values. For unlisted derivatives the fair values are determined by individual settlement quotes from the Company’s house banks. Changes in the fair value of derivative financial instruments are recognized through profit or loss.

A **cash equivalent** is defined as being readily convertible on a short-term basis to a known amount of cash and carrying a low risk of changes in value (IAS 7.6 “Cash Flow Statements”). Instruments generally qualify as cash equivalents when they are more closely related to the money markets than to the bond markets (for example: money market funds) and are issued by a debtor rated “investment grade”. All such cash equivalents must be convertible into primary cash at any time.

Paid premiums on fund shares are expensed immediately through profit or loss.

Payments before the balance sheet date, which will be expenses for a specific period after that day, are deferred and reported as **prepaid expenses** in other current assets.

**Liabilities** are classified as **current** liabilities in accordance with IAS 1.60. Basically, the Company’s normal operating cycle according to this definition is twelve months.

**Trade payables** are derecognized if the obligation on which this liability is based is fulfilled or cancelled. Foreign currency liabilities are recognized at exchange rates at the reporting date.

**Deferred income** is recognized for grants and research and development payments ("R&D payments") received in advance. Grants received in advance that were provided by the government or by comparable central, regional or local authorities, are recognized through profit or loss over the subsidized terms of each project according to its progress of fulfillment. R&D payments received in advance from customers are capitalized and recognized through profit or loss over the term of the contract according to the progress of fulfillment. No advance payments were received in the reporting year, which would have to be recognized through profit or loss within a time frame of more than twelve months.

**Provisions** are recognized in accordance with IAS 37 ("Provisions, Contingent Liabilities and Contingent Assets") if it is likely that a debt exists and a reliable estimate of the amount is possible.

**Revenue** from research and development collaboration agreements is recorded and recognized in accordance with the applicable performance requirements and terms of the respective contracts as contract research costs are incurred, using the percentage of completion method. Milestone payments are recognized as revenue according to the milestone payment method. Revenue under the milestone payment method is recorded and recognized when acknowledgement of having achieved applicable performance requirements is received from the partner. Nonrefundable upfront payments are deferred and recognized on a straight-line basis over the maximum research term (i.e. including optional prolongation terms). Revenue from the sale of products and other services is recognized when delivery has taken place, transfer of risk has been completed, the amount of future returns can be reasonably estimated and collection of the receivable is probable.

**Research costs** cannot be capitalized according to IAS 38 ("Intangible Assets"). **Development costs** have to be capitalized if they can be clearly identified as such in accordance with IAS 38.57 and it is equally clear that later cash flows have a high likelihood of being directly associated to them. To date, the Company has not capitalized any internal development costs, because management assumes that, due to the risks in the development phase, the conditions, which would require the capitalization of development costs, are not satisfied.

The fair value of **granted stock options** is calculated using the Black-Scholes option pricing model and is **expensed** over the expected option term of 2–4 years against the capital reserve. The valuation date is the grant date according to IFRS 2.11.

## Management judgments in the application of accounting policies/assumptions and estimates.

The preparation of the consolidated financial statements in compliance with International Financial Reporting Standards requires, in the case of several items, that assumptions or estimates be made that affect the valuation in the Group's balance sheet and/or the income statement. This also applies to the listing of contingent assets and liabilities. The actual amounts may vary from these assumptions and estimates.

In particular, assumptions and estimates are required for:

- determining, if the criteria for the capitalization of development costs are met,
- testing a potential impairment of assets (especially regarding intangible assets like goodwill and licenses),
- determining the terms of inlicensed intellectual property rights,
- determining, if deferred taxes are realizable,
- determining, if securities classify as "held to maturity", "available for sale" or "at fair value through profit or loss",
- setting the parameters regarding the valuation of stock option grants,
- accounting for provisions.

**Currency translation.** In the individual financial statements, receivables and liabilities in foreign currencies are valued using the corresponding euro reference rate issued by the European Central Bank on the last business day prior to the closing date. Items that are hedged by forward transactions are valued at the forward price.

For consolidation purposes, the reporting currency of the U.S.-based Epigenomics, Inc. is the euro as well. Therefore, the translation risk from Epigenomics, Inc.'s functional currency (U.S. dollar) to the Group's presentation currency (euro) lies completely in the separate financial statements of this subsidiary and not in its consolidation.

Exchange rate differences are recognized through profit or loss.

The exchange rate of the U.S. dollar, the only major foreign currency in the consolidated financial statements, changed during the reporting year as follows:

**REPORTING DATE RATES**

| | Dec 31, 2006 | Dec 31, 2005 |
|---|---|---|
| EUR/USD | 1.3170 | 1.1797 |

**AVERAGE RATES**

| | 2006 | 2005 |
|---|---|---|
| EUR/USD | 1.2630 | 1.2380 |

## NOTES TO THE GROUP INCOME STATEMENT

**1 Revenue.** Total revenue in 2006 decreased to EUR 3,504 thousand from EUR 9,594 thousand in the previous year. A notable bigger one-off effect (milestone revenue) had been recognized in 2005 according to the progress in the Roche collaboration with no comparable impact included in the reporting year's number. The decrease of 64 % in revenue is attributable to both business units.

The revenue of 2006 is composed of R&D payments (62 %), reimbursements including handling charges (22 %), scientific processing services (14 %) and royalty income (2 %).

**2 Cost of sales/gross profit.** Cost of sales include the material and personnel expenses, IP costs and depreciation that can be directly allocated to the sales revenue, as well as pro rata overheads.

The gross profit decreased to EUR –1,516 thousand (2005: EUR 1,904 thousand), i.e. to a gross margin of –43 % (2005: 20 %).

### 3 Other income

| EUR thousand | 2006 | 2005 |
|---|---|---|
| Third-party research grants | 1,250 | 699 |
| Exchange gains from currency conversion | 292 | 369 |
| Income from liquidation of provisions | 235 | 95 |
| Insurance recoveries | 55 | 0 |
| Income from option exercises | 45 | 334 |
| Various refunds | 45 | 0 |
| Income from the sale of assets | 2 | 0 |
| Other | 14 | 30 |
| **Total** | **1,938** | **1,527** |

The income from option exercises was recognized as premium on the exercise of conversion rights to shares of Orca Biosciences. This company was the predecessor of today's Epigenomics, Inc.

**4 Research and development costs (R&D costs).** The following are recorded as research and development costs:

- the direct personnel and material expenses of the R&D divisions;
- the depreciation of the R&D divisions;
- the other direct expenses of the R&D divisions;
- the pro rata overheads of the R&D divisions.

**5 Marketing and business development costs (M&BD costs).** The following are recorded as marketing and business development costs:

- the direct personnel and material expenses of the M&BD divisions;
- the depreciation of the M&BD divisions;
- the other direct expenses of the M&BD divisions;
- the pro rata overheads of the M&BD divisions.

**6 General and administrative costs.** The following are recorded as general and administrative costs:

- the direct personnel and material expenses of the administrative divisions;
- the depreciation of the administrative divisions;
- the other direct expenses of the administrative divisions;
- the pro rata overheads of the administrative divisions;
- the Company's statutory costs,

if the costs listed are not carried forward as internal services. The administrative divisions comprise the business departments and systems administration.

## 7 Cost analysis

| | 2006 | | | | | 2005 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **EUR thousand** | **Cost of sales** | **R&D costs** | **M&BD costs** | **G&A costs** | **Total** | **Cost of sales** | **R&D costs** | **M&BD costs** | **G&A costs** | **Total** |
| Materials/ consumables | 1,142 | 1,393 | 0 | 1 | 2,536 | 2,142 | 903 | 0 | 1 | 3,046 |
| Depreciation and amortization | 275 | 918 | 159 | 216 | 1,568 | 546 | 954 | 9 | 165 | 1,674 |
| Staff costs | 1,803 | 4,605 | 915 | 1,619 | 8,942 | 2,668 | 4,258 | 850 | 1,707 | 9,483 |
| Other costs | 1,800 | 1,786 | 1,645 | 2,240 | 7,471 | 2,334 | 2,006 | 664 | 1,971 | 6,975 |
| **Total** | **5,020** | **8,702** | **2,719** | **4,076** | **20,517** | **7,690** | **8,121** | **1,523** | **3,844** | **21,178** |

Compared to the indicated numbers for the previous year in the table above, due to an editorial error, the Company's consolidated financial statements for 2005 showed slightly different partial amounts for staff costs as well as depreciation and amortization. These editorial errors can be classified as nonsubstantial and had no further impact on the consolidated financial statements for 2005.

The amount of EUR 1,568 thousand for depreciation and amortization in 2006 comprises extraordinary depreciation on tangible assets of EUR 144 thousand due to the restructuring of the Company in October 2006. In addition, another extraordinary depreciation charge of EUR 71 thousand was recognized in the reporting year due to a technology change. Extraordinary amortization of EUR 156 thousand was recognized as a consequence of terminated license agreements.

## 8 Personnel costs

| EUR thousand | 2006 | 2005 |
|---|---|---|
| Personnel remuneration | 7,611 | 7,960 |
| Stock option expenses | 85 | 284 |
| Social security expenses | 1,246 | 1,239 |
| **Total personnel costs** | **8,942** | **9,483** |
| Employees (average) | 145 | 141 |
| Personnel costs/employee | 61.7 | 67.3 |

Social security expenses include the employer's contribution to the German statutory pension insurance fund (EUR 420 thousand) and voluntary employer's contributions to a 401(k) savings plan in the U.S.A. (EUR 69 thousand).

## 9 Other expenses

| EUR thousand | 2006 | 2005 |
|---|---|---|
| Exchange losses from currency conversion | 595 | 42 |
| Expenses related to former periods | 90 | 0 |
| Banking fees | 0 | 125 |
| Losses from disposal of non-current assets | 0 | 7 |
| Other | 1 | 3 |
| **Total** | **686** | **177** |

**10 Operating result (EBIT).** In the reporting year, the recorded operating loss before interest and taxes (EBIT) of EUR 15,761 thousand is significantly higher than the EBIT in 2005 (EUR –10,234 thousand). The operating loss before interest, taxes, depreciation and amortization (EBITDA) increased in 2006 by EUR 5,632 thousand to EUR 14,193 thousand.

## 11 Financial result

| EUR thousand | 2006 | 2005 |
|---|---|---|
| Interest and related income | 897 | 1,155 |
| Interest and related expenses | –33 | –40 |
| Other financial income | 42 | 90 |
| Other financial expenses | –232 | –979 |
| **Total financial results** | **674** | **226** |

**12 Taxes on income.** The taxes on income in the amount of EUR 316 thousand (2005: benefit of EUR 1,221 thousand) comprise taxes recorded by the Company's U.S. subsidiary in Seattle.

| EUR thousand | 2006 | 2005 |
|---|---|---|
| Current tax expenses | 43 | 37 |
| Deferred tax expenses/income | 273 | –1,258 |
| **Total taxes on income** | **316** | **–1,221** |

Deferred tax expenses in the amount of EUR 57 thousand were calculated for the reporting period for Epigenomics, Inc. resulting from temporary valuation differences between IFRSs and U.S. tax law. Simultaneously, deferred tax income in the amount of EUR 7 thousand resulting from temporary valuation differences between IFRS balance sheet and the U.S. tax balance was calculated. For already capitalized deferred taxes on tax loss carryforwards, deferred tax expenses in the amount of EUR 223 thousand were recognized in the reporting year.

Starting with the reporting year, Epigenomics, Inc. utilizes the deferred tax assets capitalized in 2005. Deferred tax income was calculated on its tax loss carryforwards as a consequence of the existing transfer price agreement between Epigenomics AG and its U.S. subsidiary. The usage of a cost plus method according to this agreement leads to a guaranteed annual profit for Epigenomics, Inc., so that a utilization of its tax loss carryforwards in the foreseeable future is sufficiently probable. A tax rate of 34 % was applied.

Deferred tax expenses in the amount of EUR 363 thousand were calculated for the reporting period for Epigenomics AG resulting from temporary valuation differences between IFRSs and German tax law. In this connection, a tax rate of 39 % was applied.

Deferred tax income in the reporting period was calculated for Epigenomics AG resulting from temporary valuation differences between German trade law and German tax law. It amounts to EUR 78 thousand.

There are also tax loss carryforwards to record for Epigenomics AG in Germany (approximately more than EUR 47 million at balance sheet date), with potential high net deferred tax income.

Since all the aforementioned matters must be settled with the same fiscal authority, in accordance with IAS 12.71 et seq, a balancing of the respective income and expenses has been performed. The deferred tax income resulting from this balancing amounts to EUR 18,441 thousand. As the current forecasts of the Company with regard to achieving the breakeven point are still subject to significant uncertainty, valuation allowances have been recognized for all of the net deferred tax assets.

**13 Earnings per share.** The earnings per share (basic) are calculated by dividing the Group's net loss for the year by the weighted-average number of shares issued.

| | 2006 | 2005 |
|---|---|---|
| Net loss for the year in EUR thousand | –15,402 | –8,788 |
| Weighted-average number of shares issued | 16,686,707 | 16,373,948 |
| **Earnings per share in EUR (basic)** | **–0.92** | **–0.54** |

The outstanding stock options granted by the Company are antidilutive according to IAS 33.41 and IAS 33.43. Therefore, the earnings per share (diluted) equal the earnings per share (basic). The number of shares issued as of the balance sheet date amounts to 16,916,125.

# NOTES TO THE GROUP BALANCE SHEET

## NON-CURRENT ASSETS

### NON-CURRENT ASSETS SCHEDULE

| EUR thousand | Acquisition costs Jan 1, 2006 | Additions 2006 | Disposals 2006 | Acquisition costs Dec 31, 2006 |
|---|---|---|---|---|
| **Intangible assets** | | | | |
| Software | 483 | 174 | –5 | 652 |
| Licences and patents | 3,609 | 1,627 | 0 | 5,236 |
| Goodwill | 3,351 | 0 | 0 | 3,351 |
| **Total intangible assets** | **7,443** | **1,801** | **–5** | **9,239** |
| | | | | |
| **Tangible assets** | | | | |
| Fixtures and leasehold improvements | 860 | –39 | 0 | 821 |
| Technical equipment | 5,584 | 1,155 | –139 | 6,600 |
| Other fixed assets | 76 | 3 | –2 | 76 |
| **Total tangible assets** | **6,520** | **1,119** | **–142** | **7,497** |
| | | | | |
| **Financial assets** | | | | |
| Securities held to maturity | 1,000 | 0 | 0 | 1,000 |
| **Total financial assets** | **1,000** | **0** | **0** | **1,000** |
| | | | | |
| **Total assets** | **14,962** | **2,920** | **–147** | **17,736** |

| | Accumulated depreciation Jan 1, 2006 | Additions 2006 | Disposals 2006 | Accumulated depreciation Dec 31, 2006 | Carrying values Dec 31, 2006 | Carrying values Dec 31, 2005 |
|---|---|---|---|---|---|---|
| | | | | | | |
| | 308 | 107 | –5 | 410 | 243 | 175 |
| | 1,226 | 354 | 0 | 1,580 | 3,657 | 2,383 |
| | 726 | 0 | 0 | 726 | 2,625 | 2,625 |
| | **2,260** | **460** | **–5** | **2,715** | **6,524** | **5,183** |
| | | | | | | |
| | | | | | | |
| | 635 | 40 | 0 | 675 | 146 | 225 |
| | 3,839 | 1,021 | –138 | 4,722 | 1,878 | 1,745 |
| | 46 | 7 | –2 | 51 | 26 | 30 |
| | **4,520** | **1,067** | **–139** | **5,447** | **2,050** | **2,000** |
| | | | | | | |
| | | | | | | |
| | 0 | 0 | 0 | 0 | 1,000 | 1,000 |
| | **0** | **0** | **0** | **0** | **1,000** | **1,000** |
| | | | | | | |
| | **6,779** | **1,527** | **–144** | **8,162** | **9,574** | **8,183** |

**14 Investment subsidies.** In the reporting period, investment subsidies affecting the carrying values were received by Epigenomics AG in Germany in the amount of EUR 139 thousand (2005: EUR 213 thousand). This relates to a government investment grant for investments in tangible assets ("Investitionszulage").

**15 Intangible assets.** The licenses and patents listed in the amount of EUR 3,899 thousand represent mainly acquisition costs for acquired patents and exclusive rights of use to property rights of third parties. Those acquisition costs were caused usually by upfront payments. The majority of the licenses require the Company to pay additional annual minimum fees that are expensed immediately. The license contracts may usually be cancelled at short notice. However, some of those licenses are vital for the Company's business model.

In the reporting year, the net value of the capitalized intangible assets increased by EUR 1,341 thousand. This increase was mainly due to the purchase of a developing license for a testing platform. This license was contributed in kind by U.S.-based Affymetrix, Inc. in the framework of a capital increase.

**16 Goodwill.** The capitalized goodwill was tested for impairment in December 2006/ January 2007 in order to comply with IFRS 3 and IAS 36. It had originated in the acquisition of Orca Biosciences (now: Epigenomics, Inc.) in 2001 and is assigned in content to the SBU Diagnostics and its screening business as the relevant cash generating unit. The Company's current business plan projections for the screening business were used for the test. According to this plan, future cash inflows will be generated in a partnering model from milestone payments, R&D payments and royalty income. All future cash flows are measured by the net present value method. Following the termination of the Roche collaboration, the appropriate discount rate, which has been applied, was raised from 20 % in 2005 to 25 % in the reporting year. No impairment had to be recognized.

**17 Tangible assets.** The increase in net tangible fixed assets was partly compensated by investment subsidies ("Investitionszulage") – amounting to EUR 113 thousand – for capital expenditures in 2005, which have been claimed in the reporting period.

**18 Financial assets.** The financial assets in the amount of EUR 1,000 thousand (Dec 31, 2005: EUR 1,000 thousand) represent exclusively a promissory note issued by a German special branch bank. Due date of this note is March 2011. At the balance sheet date, the price of this note was quoted at 97.61 %. Using the effective interest method no impairment loss could be recognized.

**19 Deferred tax assets.** Deferred tax assets of EUR 1,258 thousand have been capitalized in 2005 due to tax loss carryforwards of Epigenomics, Inc. (see under "Taxes on income"). Due to taxable profits of the U.S. subsidiary in the reporting year, a utilization of EUR 273 thousand has been recognized.

## CURRENT ASSETS

**20 Inventories.** The stock in trade mainly consists of chemical and biological materials and consumables, mainly tissue samples and oligonucleotides.

**21 Trade and other receivables.** Trade and other receivables listed in the amount of EUR 319 thousand (Dec 31, 2005: EUR 734 thousand) are comprised nearly exclusively of trade receivables towards domestic and international customers. There were no reasons for value adjustments of individual receivables at balance sheet date.

**22 Marketable securities.** The marketable securities listed in the amount of EUR 4,775 thousand (Dec 31, 2005: EUR 9,173 thousand) include mainly marketable corporate bonds, mortgage bonds, bond fund shares and debt certificates of various maturities. Under the investment policy of the Company, each investment in securities underlies certain strict criteria. These include amongst others the limitation to securities nominated in euro currency only and an official capital market rating of the issuer or the securities not below "investment grade". All reported securities are underlying the usual market and interest risks. The interest rate risks are mostly price risks but for some securities there is also an interest rate cash flow risk. Currency risks are minimized by avoiding investments in securities nominated in currencies other than the euro. However, some of the investments are indirectly subject to currency risks as they might be linked or refer partially to non-euro nominations.

The fair value of all marketable securities is identified by their stock exchange quotations at each relevant balance sheet date.

| EUR thousand | Dec 31, 2006 | Dec 31, 2005 |
|---|---|---|
| Corporate bonds | 2,542 | 4,201 |
| Bond fund shares | 1,052 | 2,071 |
| Mortgage bonds | 612 | 623 |
| Debt certificates | 569 | 599 |
| Bearer bonds | 0 | 835 |
| Index-linked bonds | 0 | 510 |
| Participation rights | 0 | 270 |
| Currency call options | 0 | 64 |
| **Total** | **4,775** | **9,173** |

The investment strategy of the Company provides for an allocation of the various securities to different remaining maturities.

| EUR thousand | Fair value Dec 31, 2006 | in % | Fair value Dec 31, 2005 | in % |
|---|---|---|---|---|
| Time to maturity of marketable securities | | | | |
| < 1 year | 0 | 0 | 1,196 | 13.0 |
| 1 – 2 years | 612 | 12.8 | 0 | 0 |
| 2 – 5 years | 494 | 10.4 | 1,825 | 19.9 |
| > 5 years | 2,048 | 42.9 | 4,084 | 44.5 |
| Unlimited | 1,621 | 33.9 | 2,068 | 22.6 |
| **Total** | **4,775** | **100.0** | **9,173** | **100.0** |

**23 Cash and cash equivalents.** Cash and cash equivalents decreased to EUR 12,566 thousand at balance sheet date (Dec 31, 2005: EUR 23,519 thousand). More than 85 % of those funds were denominated in euro currency at balance sheet date. The remainder is denominated in U.S. dollar currency. The total amount is allocated to three different banks.

| EUR thousand | Dec 31, 2006 | Dec 31, 2005 |
|---|---|---|
| Time deposits | 7,324 | 5,620 |
| Asset-backed securities fund shares | 4,657 | 6,145 |
| Bank accounts, petty cash, cheques | 585 | 282 |
| Open real estate fund shares | 0 | 11,472 |
| **Total** | **12,566** | **23,519** |

The reported fund shares have very limited underlying credit risks as well as low market and interest rate risks. The remaining maturities of the time deposits were shorter than three months as of balance sheet date.

## 24 Other current assets

| EUR thousand | Dec 31, 2006 | Dec 31, 2005 |
|---|---|---|
| Receivables from tax authorities | 848 | 911 |
| Claims based on granted projects | 379 | 305 |
| Accrued expenses | 282 | 365 |
| Interest receivables | 125 | 232 |
| Claims based on external research cooperations | 0 | 3 |
| Other | 81 | 76 |
| *thereof with a prospective maturity > 1 year* | *38* | *38* |
| Total | 1,715 | 1,892 |

## EQUITY

**25 Notes to share categories and capital structure.** The share capital of Epigenomics AG comprises exclusively common shares with equal rights and a par value of EUR 1 each as of December 31, 2006. During the reporting year, the number of shares increased from 16,403,178 to 16,916,125 shares. A total of 208,156 new shares were created by the exercise of employee stock options. An additional 304,791 novel no-par value bearer shares – issued to Affymetrix, Inc. – were created by a capital increase from authorized capital against contribution in kind. For the computation of the numbers of the issued new shares, the value of a single Epigenomics share in the Affymetrix capital increase has been determined at a price of EUR 5.22. This capital increase has been recorded by the commercial register Charlottenburg on July 31, 2006.

Capital structure of Epigenomics AG as of December 31:

| EUR | Dec 31, 2006 | Dec 31, 2005 | Change |
|---|---|---|---|
| **Share capital** | **16,916,125** | **16,403,178** | **512,947** |
| | | | |
| Conditional Capital | 1,432,161 | 992,638 | 439,523 |
| Conditional Capital I | 27,431 | 47,219 | –19,788 |
| Conditional Capital III | 139,625 | 187,043 | –47,418 |
| Conditional Capital IV | 617,426 | 758,376 | –140,950 |
| Conditional Capital V | 647,679 | 0 | 647,679 |
| | | | |
| Authorized Capital III | 5,695,209 | 6,000,000 | –304,791 |

Conditional Capital V can be used to create new shares upon the exercise of stock options granted under the new stock option program (06–10) of the Company. Conditional Capital I and III can not be used anymore to grant stock options as the underlying granting timeframe has been expired. However, new shares can still be created upon exercise of options from these older programs.

The decrease in the Conditional Capitals I, III and IV in the reporting year was due to stock option exercises out of the underlying stock option programs. None of those decreases has been recorded yet by the commercial register Charlottenburg as of December 31, 2006, but all were already filed for registration at this point in time.

Conditional Capital V has been created in 2006 and allows the creation of new shares upon the exercise of stock options granted under this new stock option program of the Company. It has been approved by the Annual General Shareholders' Meeting (AGM) on July 10, 2006. In October 2006, Epigenomics was informed of a lawsuit against certain decisions approved by the majority of the shareholders at this AGM filed by an individual shareholder who at the time of the AGM held two shares of Epigenomics AG. The issues are of a formal nature and relate to the new stock option program. Epigenomics's

management views this lawsuit as unfounded, frivolous, and clearly not in the best interest of the Company's shareholders and has retained legal counsel to safeguard the Company's interests. The Company filed a counter motion for expedited registration of the new stock option program given overriding interests of the Company. Due to this lawsuit, Conditional Capital V had not been recorded yet by the trade register Charlottenburg as of December 31, 2006, but was already filed for registration at this point in time.

Authorized Capital III can be used by the Executive Board to increase, with the consent of the Supervisory Board, the Company's share capital at any time or from time to time on or before June 22, 2009, by up to EUR 5.7 million by issuing up to 5,695,209 new no-par value bearer shares in return for cash contributions or contributions in kind. In July 2006, the original amount of EUR 6.0 million has been partly utilized (EUR 304,791) for a capital increase by contribution in kind in connection with Affymetrix, Inc.

**26 Capital reserve.** In the reporting year, the capital reserve decreased from EUR 32,072 thousand (Dec 31, 2005) to EUR 25,294 thousand mainly due to the deduction of the net loss for the year 2005. Offsetting effects came from the aforementioned (note 25) capital increase by contribution in kind (EUR 1,286 thousand), from the paid-in surplus of exercised employee stock options (EUR 725 thousand) and from the current stock option expense accounting according to IFRS 2 (EUR 85 thousand).

**27 Other comprehensive income.** Other comprehensive income comprises changes in fair values of marketable securities. The decrease in the reporting year from EUR –312 thousand (Dec 31, 2005) to EUR –610 thousand (Dec 31, 2006) was mainly due to continued price losses in various bonds as a consequence of increased interest rates especially in the euro currency zone.

## CURRENT LIABILITIES

**28 Deferred income.** Payments received in advance for services to be rendered by Epigenomics AG in the future are recorded as deferred income. The payments received for commercial collaborations are recognized as revenue over the respective contractual terms. The payments received for granted projects are recognized as other income according to the percentage of completion method. There is no repayment obligation for Epigenomics.

| EUR thousand | Dec 31, 2006 | Dec 31, 2005 |
|---|---|---|
| Payments in advance for commercial collaborations | 696 | 1,895 |
| Payments in advance for granted projects | 216 | 273 |
| **Total** | **912** | **2,168** |

## 29 Other liabilities

| EUR thousand | Dec 31, 2006 | Dec 31, 2005 |
|---|---|---|
| Payables due to staff | 398 | 424 |
| Payables due to tax authorities | 177 | 114 |
| Supervisory Board fees | 138 | 119 |
| Audit fees | 113 | 115 |
| Liabilities from derivative instruments | 98 | 91 |
| Payables due to social security institutions | 11 | 136 |
| Liabilities from external research collaborations | 0 | 533 |
| Other | 16 | 21 |
| **Total** | **951** | **1,553** |

Liabilities from derivative instruments reflect the net present value of an interest swap at balance sheet date with a remaining term until April 2010.

## 30 Provisions

| EUR thousand | Dec 31, 2006 | Dec 31, 2005 |
|---|---|---|
| Payroll provisions | 466 | 405 |
| Royalty provisions | 177 | 64 |
| Annual General Shareholders' Meeting | 55 | 72 |
| Provision for milestone payments | 55 | 0 |
| Provision for granted projects | 30 | 83 |
| Provision for onerous lease contract | 11 | 148 |
| Other | 19 | 25 |
| **Total** | **813** | **797** |

At the reporting date, payroll provisions increased mainly due to expected bonus payments, for payments according to the German "Arbeitnehmererfindergesetz" (employees invention act) and for outstanding salaries. The increase in royalty provisions was mainly due to licencing agreements with contractual obligations for the Company to pay royalties to the licensor in the future according to a defined progress in development projects. The provision for an onerous lease contract could be released to a large extent as a new sub-tenant for leased but no longer used office space was found in the reporting year.

## NOTES TO THE GROUP CASH FLOW STATEMENT

**31 Operating activities.** Cash flow from operations is derived indirectly on the basis of the net loss for the year before taxes on income. Cash comprises bank deposits and cash in hand. Cash equivalents are defined as instruments being convertible on a short-term basis to a known amount of cash and carrying a very low risk of changes in value.

**32 Investing activities.** Cash flow from investing activities is ascertained in respect of payment. For information on the reported proceeds from investment grants please refer to "Investment Subsidies".

**33 Financing activities.** Cash flow from financing activities is ascertained in respect of payment.

## SEGMENT REPORTING

The Company's business model in the past had been set up on two strategic business units (SBUs): Diagnostics and Clinical Solutions. The SBU Diagnostics develops diagnostic tests for the early detection (screening), classification and monitoring of cancer and commercializes these through in vitro diagnostic partnerships such as the Roche Diagnostics alliance (2002–2006) as well as own product development. The SBU Clinical Solutions had focused on programs that were geared towards analyzing biomarkers for specific cancer drugs and assisting partnering pharmaceutical and biotech companies in their respective drug development programs.

In the course of time, the boundaries between the two segments have started to become less clear-cut. On the one hand, in our Diagnostics business we have been providing R&D-collaboration-based work and had licensed certain rights to the use of biomarkers for IVD kits. On the other hand, in our Clinical Solutions business we have been able to use diagnostics rights to develop IVD kits, e.g. as companion diagnostics for certain oncology drugs of our partners. In addition, our licensing business has started to make available certain IP to partners such as Qiagen and Affymetrix to develop methylation-based products for the research market.

With the termination of the R&D and licensing collaboration with Roche Diagnostics and the search for a new type of partnership in the diagnostics business (e.g. reference laboratories as well as (a) new IVD kit partner(s)), the main reason for separating our segments by business model and type of partner has become less important. Also, with our reorganization in fall of 2006 we ended the notion of the past several years of two separate business units by integrating the SBU Clinical

Solutions into a single department that is part of our overall Diagnostics business. Whilst in the past certain central costs were shared and allocated based on usage criteria to each of the SBUs that matrix organization has effectively been dismantled. With no more than six employees, the Clinical Solutions department no longer fulfils the criteria to be a separate strategic business unit (SBU) by itself.

In addition, at the level of business development and licensing we have built an integrated team reporting to the CSO that takes overall responsibility for all our partnership-based businesses – be it diagnostics, clinical solutions or licensing business.

These considerations have led us to the conclusion that Epigenomics is really running a global diagnostics business with a multitude of different channels and outlets to the market, none of which warrants separation into a strategic business unit (SBU) by itself in terms of critical mass or business model. Therefore we have decided to end the distinction into separate SBUs and accordingly the segment reporting with the annual report 2006. We strive to continue providing transparent and detailed information on the source of revenue by type of business transaction (R&D collaboration versus service and licensing), but will not allocate direct or indirect costs to particular business segments. This is also in line with the reporting by other molecular diagnostics companies who run a single diagnostics business including all types and sources of commercial projects and revenue.

**34 Segment result.** The income statement for the SBUs do not contain any intersegment charges.

**SEGMENT RESULT**

| | Diagnostics | | Clinical Solutions | | Other | | Epigenomics Total | |
|---|---|---|---|---|---|---|---|---|
| **EUR thousand** | **2006** | **2005** | **2006** | **2005** | **2006** | **2005** | **2006** | **2005** |
| **Revenue** | **2,302** | **6,903** | **573** | **2,675** | **629** | **16** | **3,504** | **9,594** |
| Cost of sales | –4,495 | –6,370 | –556 | –1,244 | 31 | –76 | –5,020 | –7,690 |
| **Gross profit** | **–2,193** | **533** | **17** | **1,431** | **660** | **–60** | **–1,516** | **1,904** |
| *Gross margin* | *–95%* | *8%* | *3%* | *53%* | | | *–43%* | *20%* |
| Other income | 787 | 140 | 211 | 1 | 941 | 1,386 | 1,938 | 1,527 |
| Research and development costs | –6,136 | –3,083 | –1,376 | –1,212 | –1,190 | –3,826 | –8,702 | –8,121 |
| Marketing and business development costs | –610 | –601 | –562 | –598 | –1,547 | –324 | –2,719 | –1,523 |
| General and administrative costs | 0 | 0 | 0 | 0 | –4,076 | –3,844 | –4,076 | –3,844 |
| Other expenses | –17 | –1 | –3 | –1 | –666 | –175 | –686 | –177 |
| **Segment result** | **–8,169** | **–3,012** | **–1,713** | **–379** | **–5,878** | **–6,843** | **–15,761** | **–10,234** |

### SEGMENT BALANCE SHEET DATA

| EUR thousand | Diagnostics | | Clinical Solutions | | Other | | Epigenomics Total | |
|---|---|---|---|---|---|---|---|---|
| | Dec 31, 2006 | Dec 31, 2005 | Dec 31, 2006 | Dec 31, 2005 | Dec 31, 2006 | Dec 31, 2005 | Dec 31, 2006 | Dec 31, 2005 |
| Segment assets | 5,900 | 4,899 | 853 | 1,162 | 23,381 | 38,936 | 30,134 | 44,997 |
| Segment liabilities | 773 | 404 | 186 | 180 | 2,976 | 5,038 | 3,935 | 5,622 |
| **Net segment assets** | **5,127** | **4,495** | **667** | **982** | **20,405** | **33,898** | **26,199** | **39,375** |
| Investments in non-current assets | 1,463 | 466 | 370 | 122 | 1,088 | 419 | 2,920 | 1,007 |
| Depreciation and amortization | 834 | 788 | 179 | 241 | 555 | 645 | 1,568 | 1,674 |

The segment result for the SBU Diagnostics was influenced by significant non-cash expenses. Those expenses were mainly related to allocations of the SBU's payroll and royalty provisions.

### SEGMENT RESULT BY REGION

| EUR thousand | 2006 | 2005 |
|---|---|---|
| **Total revenue** | **3,504** | **9,594** |
| thereof Europe | 3,356 | 8,949 |
| in % | 96 | 93 |
| thereof North America | 148 | 645 |
| in % | 4 | 7 |

### NET SEGMENT ASSETS BY REGION

| EUR thousand | Dec 31, 2006 | Dec 31, 2005 |
|---|---|---|
| **Net segment assets** | **26,199** | **39,375** |
| thereof Europe | 24,564 | 37,877 |
| in % | 94 | 96 |
| thereof North America | 1,635 | 1,498 |
| in % | 6 | 4 |
| | | |
| **Investments** | **2,920** | **1,007** |
| thereof Europe | 2,645 | 709 |
| in % | 91 | 70 |
| thereof North America | 275 | 298 |
| in % | 9 | 30 |

## OTHER INFORMATION

**35 Stock option plans established in previous years.** As of the balance sheet date, the Epigenomics Group (via Epigenomics AG) had four stock option plans in place. Details of the option plans 2000, 01-05 and 03-07 can be found in the Company's IPO prospectus and the consolidated financial statements 2003, respectively. Both documents are available on the Company's website. In general, the rights under all three programs are such that option holders can obtain shares in the Company by exercising their option rights once certain exercise hurdles have been fulfilled. In order for options to be exercisable the stock price must have appreciated by at least 10 % versus the stock price at grant date and the statutory waiting period of two years as well as vesting must have been completed. If employees leave the company before the options are vested these are forfeited without compensation.

**36 Stock option plan 06–10.** A fourth stock option plan ("06-10") was introduced during the reporting year and approved by the Annual General Shareholders' Meeting on July 10, 2006. The Company's share capital was therefore conditionally increased by up to 3.95 % of the share capital registered before the capital increase, i.e. by up to EUR 647,679.00 by issuance of up to 647,679 bearer shares of common stock with an accounting par value of EUR 1.00 each (Conditional Capital V). The Executive Board of the Company is authorized until the expiration (December 31, 2010) to issue subscription rights with respect to shares out of the stock option plan 06–10 in one or more annual tranches in favor of beneficiaries according to the conditions of this plan, once the Conditional Capital V becomes effective by registration in the commercial register. In case of Executive Board members being beneficiaries, only the Supervisory Board can grant such options. Each individual subscription right entitles the beneficiary to subscribe to one bearer share of common stock of the Company with a par value of EUR 1.00 each against payment of the exercise price. Beneficiaries of the plan are the Company's Executive Board members ("group 1"; 69.5 % of the total volume) and its employees ("group 2"; 30.5 % of the total volume).

The subscription rights in every tranche shall vest for the group 2 beneficiaries as follows: one-third of the subscription rights issued in one tranche shall vest one year after the issuance of the subscription rights of such tranche; a further one-third of the subscription rights issued in one tranche shall vest two years after the issuance of the subscription rights of such tranche; the final one-third of the subscription rights issued in one tranche shall vest three years after the issuance of the subscription rights of such tranche.

The subscription rights of every tranche shall vest completely or partially for group 1 beneficiaries, if and to the extent that the Supervisory Board of the Company declares such vesting of subscription rights vis-à-vis a group 1 beneficiary in compliance with the rules set out hereafter. The declaration of vesting of subscription rights vis-à-vis a group 1 beneficiary by the Company's Supervisory Board requires a corresponding prior resolution by the Supervisory Board. The Supervisory Board adopts its decision regarding the "if" and the extent of the vesting of subscription rights of a group 1 beneficiary at its free discretion taking into account the individual services of the individual beneficiary and the development of the Company. The Supervisory Board can declare the complete or partial vesting of subscription rights issued in one tranche in favor of group 1 beneficiaries at any time after the issuance of these subscription rights. In case that the Supervisory Board does not decide on the vesting vis-à-vis one or more of the group 1 beneficiaries, the subscription rights of every tranche shall vest for group 1 beneficiaries in the same way as for group 2 beneficiaries (see above).

Subscription rights of each tranche can be exercised for the first time after their vesting as described before and after expiration of the statutory waiting period. The statutory waiting period starts with the issuance of the subscription rights of a tranche and ends two years after the issuance of the subscription rights of such tranche. The restriction of the exercise of the subscription rights to certain exercise periods and the subscription rights being subject to the compliance with all exercise conditions remain unaffected by the expiration of the waiting period.

The term of the subscription rights of every tranche begins with the issuance of the subscription rights of such tranche and ends with the expiration of seven years after the issuance of the subscription rights of such tranche.

The subscription rights can only be exercised against payment of the exercise price to the Company. The exercise price corresponds to the average stock exchange closing price, increased by 10 %, of the 20 stock exchange trading days preceding the issuance of the subscription rights in the Exchange Electronic Trading (XETRA) system. In no case, however, less than the final stock exchange price of the share on the day the subscription rights were issued ("market value" or "fair market value"). Furthermore, the subscription rights regarding a tranche can only be exercised in case the price of the Company's share has reached or surpassed the payable exercise price at least once within the period between the issuance of the subscription rights of this tranche and the exercise of these subscription rights (performance target).

Any subscription rights of a beneficiary that have not yet vested expire without compensation in any case upon termination of the employment or work contract with the beneficiary, irrespective of the reason for such termination. The expiration date is the day on which the employment or work contract ends.

The subscription rights granted to the beneficiaries under the stock option plan 06–10 are non-transferable. In case that subscription rights are not or cannot be exercised until the end of their term, they expire without compensation. The same applies for vested subscription rights.

The new shares shall participate in the profit from the beginning of the fiscal year in which they are issued.

**37 Development of stock options in the reporting year.** In 2006, a total number of 173,880 stock options were granted under the Company's stock option plan 03–07, which has been adopted by the resolution of our Annual General Shareholders' Meeting on August 1, 2003. Each option right entitles the holder to subscribe to one bearer share of common stock with a par value of EUR 1.00 each in return for payment of the exercise price. The exercise price for each of the new rights was fixed at the average closing price of the 20 trading days before the grant date. The aggregate proceeds to the Company if these options were exercised and shares were issued would amount to EUR 1,027 thousand. No stock options were granted to members of the Executive Board in the reporting year. A total number of 148,921 stock options can still be issued under the stock option plan 03–07.

**DETAILS OF STOCK OPTIONS GRANTED IN 2006**

| Expiry date | Jan 1, 2013 | Jul 1, 2013 | Oct 1, 2013 | Total/Average |
|---|---|---|---|---|
| Number | 104,000 | 18,940 | 50,940 | 173,880 |
| Share price at grant date (in EUR) | 6.30 | 4.82 | 3.68 | 5.37 |
| Exercise price (in EUR) | 6.93 | 5.30 | 4.05 | 5.91 |
| Historical volatility at grant date (in %) | 52.37 | 50.96 | 50.63 | 51.71 |
| Risk-free interest rate (in %) | 3.00 | 3.80 | 3.56 | 3.25 |
| Aggregate proceeds if shares are issued (in EUR) | 720,720 | 100,382 | 206,307 | 1,027,409 |

The option rights of all new holders will vest as follows: 25 % of the options will vest on the first anniversary of the grant date, another 25 % on the second anniversary of the grant date, another 25 % on the third anniversary of the grant date and the remaining 25 % on the fourth anniversary of the grant date. All vested options may be exercised no earlier than the second anniversary of the grant date.

In the reporting year, 208,156 stock options with a weighted-average exercise price of EUR 4.50 have been exercised. The weighted-average share price upon exercise was EUR 6.07. A total number of 132,412 options with a weighted-average exercise price of EUR 4.76 forfeited during the reporting period. The number of all outstanding options as of December 31, 2006, decreased to 579,381 with an average exercise price of EUR 5.00 (Dec 31, 2005: EUR 4.60).

| Option holder | Options issued as of Dec 31, 2005 | Options issued in 2006 | Options forfeited in 2006 | Options exercised in 2006 | Options issued as of Dec 31, 2006 |
|---|---|---|---|---|---|
| Dr. Kurt Berlin | 56,613 | 0 | 0 | 0 | 56,613 |
| Christian Piepenbrock | 56,613 | 0 | 0 | 0 | 56,613 |
| Oliver Schacht, Ph.D. | 69,363 | 0 | 0 | 0 | 69,363 |
| **Total Executive Board** | **182,589** | **0** | **0** | **0** | **182,589** |
| Other option holders | 563,480 | 173,880 | 132,412 | 208,156 | 396,792 |
| **Total options** | **746,069** | **173,880** | **132,412** | **208,156** | **579,381** |
| *thereof exercisable* | | | | | *383,481* |

Terms of options outstanding at December 31:

| Expiry date | Exercise price in EUR | Dec 31, 2006 number | Dec 31, 2005 number |
|---|---|---|---|
| 2008 | 1.76 | 12,750 | 12,750 |
| | 1.94 | 2,703 | 6,791 |
| | 4.53 | 17,179 | 35,920 |
| 2009 | 4.53 | 30,910 | 32,929 |
| 2010 | 4.53 | 47,334 | 97,264 |
| 2011 | 4.53 | 268,105 | 521,895 |
| | 7.15 | 4,500 | 9,500 |
| 2012 | 7.29 | 22,340 | 25,340 |
| | 8.13 | 3,680 | 3,680 |
| 2013 | 4.05 | 50,940 | 0 |
| | 5.30 | 18,940 | 0 |
| | 6.93 | 100,000 | 0 |
| **Total** | | **579,381** | **746,069** |

## 38 Information on the Executive Board and the Supervisory Board of the Company and their remuneration

Members of the Executive Board of the Company during the reporting year were:

- Alexander Olek, Ph.D., Berlin (D), Chief Executive Officer
- Dr. Kurt Berlin, Stahnsdorf (D), Chief Scientific Officer
- Christian Piepenbrock, Berlin (D), Chief Operating Officer
- Oliver Schacht, Ph.D., Seattle (U.S.A.), Chief Financial Officer and Chief Executive Officer of Epigenomics, Inc.

Alexander Olek resigned from the Company's Executive Board as of August 17, 2006 (see "Other financial obligations" for further information).

Effective February 1, 2007, Geert Walther Nygaard has been appointed as new CEO of Epigenomics AG by the Supervisory Board.

In 2006, the total remuneration of the members of the Executive Board amounted to EUR 795 thousand (2005: EUR 1,167 thousand), comprising EUR 609 thousand in fixed compensation (2005: EUR 909 thousand), EUR 176 thousand in bonus payments (2005: EUR 225 thousand) and EUR 10 thousand in other compensation payments in lieu of vacation (2005: EUR 33 thousand).

Members of the Supervisory Board of the Company during the reporting year were:

- Prof. Dr. Dr. h.c. Rolf Krebs, Mainz (D), Chairman
- Bruce Carter, Ph.D., Seattle (U.S.A.), Deputy Chairman
- John Berriman, Reading (GB) – until July 10, 2006
- Prof. Dr. Dr. Uwe Bicker, Bensheim-Auerbach (D)
- Dr. Ann Clare Kessler, San Diego (U.S.A.)
- Prof. Dr. Günther Reiter, Pfullingen (D)
- Günter Frankenne, Berg/Neumarkt (D) – since July 10, 2006.

In 2006, total remuneration of the members of the Supervisory Board amounted to EUR 158 thousand (2005: EUR 116 thousand) plus out-of-pocket expenses amounting to EUR 31 thousand.

Further details to the composition of the Executive Board and the Supervisory Board and their compensation in the reporting year can be found in the "Corporate Governance" section of the consolidated management report.

**39 Other financial obligations.** For the Epigenomics Group, other financial obligations arise from a total of two leases at the Berlin and Seattle locations:

a) For the Berlin location at Kleine Präsidentenstrasse 1, there is a fixed-term lease with term expiring on February 28, 2010. Until this date, a total rent of EUR 1,263 thousand (undiscounted) has to be paid.

b) For the Seattle location, there is a fixed-term lease with term expiring on November 30, 2007. Until this date, a total rent of USD 407 thousand has to be paid.

In the reporting period and in previous years, Epigenomics acquired numerous exclusive licenses to third-party intellectual property. This means that there are certain obligations to pay minimum license fees in years to come. Additionally, Epigenomics has the obligation to reimburse most of those third parties for costs incurred in connection with the maintenance and the prosecution of the licensed rights. Those costs are mainly charges for patent attorneys or office actions and are difficult to forecast regarding their amounts and timing. The expected amount due to various licensors (including reimbursements for patent prosecution) stands at approximately EUR 750–800 thousand for the years 2007 and 2008. Most of these agreements can be terminated by Epigenomics at short notice. There is only one case in which Epigenomics is under a fairly long-term binding obligation. However, this payment obligation will not exceed EUR 20 thousand per year.

Once Epigenomics starts to generate product revenue with third parties, which is generated with the help of this licensed intellectual property, then in some cases license fees that are above and beyond the normal license fees and which correspond to a percentage of such revenue must be paid to the licensors. Consequently, the potential amount of these obligations is difficult to quantify, since a significant share of the variable license fees is dependent on the type and composition of future revenue.

After his retirement as Epigenomics's CEO in August 2006, Alexander Olek entered into a consulting agreement with the Company for the calendar years 2007 and 2008. Under the terms of this agreement, Mr. Olek will provide his expertise and services to the Company in strategic matters. Epigenomics has committed to request at least eight consulting days per month from Mr. Olek at a net rate of EUR 2,083 per day plus out-of-pocket expenses. Therefore, the total value of this contract adds up to at least EUR 200 thousand per year.

Due to contracts with third parties, Epigenomics had payment obligations at the balance sheet date of EUR 110 thousand for services and goods to be received in 2007.

**40 Information on the auditors of the Company.** As in the previous years, UHY Deutschland AG had been chosen as the Company's auditing firm for the financial year 2006. A total amount of EUR 156 thousand has been expensed during the reporting year for miscellaneous services of this auditing firm for Epigenomics AG. Details are shown in the following table:

| EUR thousand | 2006 | 2005 |
|---|---|---|
| Expected costs for audit of the annual financial statements 2006 | 93 | 0 |
| Critical review of quarterly financial statements in the reporting year | 30 | 33 |
| Audit of the annual financial statements 2005 | 0 | 90 |
| Audit of the annual financial statements 2004 | 0 | 4 |
| Other confirmation services | 33 | 5 |
| **Total** | **156** | **132** |

The costs disclosed for the audits of the annual financial statements are related to the audits of the individual financial statements of Epigenomics AG according to German GAAP, of the individual financial statements of Epigenomics, Inc. according to IFRS and of the consolidated financial statements for the Epigenomics Group. Other confirmation services occurred partially in connection with granted projects and have in these cases been reimbursed by the sponsor.

**41 Statement of the Executive Board and the Supervisory Board of Epigenomics AG pursuant to Section 161 of the German Stock Corporation Act (AktG) with respect to the German Corporate Governance Code.** In December 2006, the Executive Board and the Supervisory Board of the Company issued the declaration of conformity in accordance with Section 161 of the German Stock Corporation Act (Aktiengesetz). The declaration has been published on the Company's website (www.epigenomics.com) and can also be taken from the management report 2006.

**42 Information on other transactions with related parties.** After his retirement as Chief Operating Officer of the Company effective October 31, 2005, Aron Braun has still received his previous monthly remuneration until October 2006. The amount of EUR 113 thousand that the Company has paid to Mr. Braun in the reporting year had already been expensed in 2005.

After his retirement as Chief Executive Officer of Epigenomics, Inc. effective December 31, 2005, R. Gary Schweikhardt has still received his previous monthly remuneration including social security payments until December 2006. The amount of EUR 188 thousand that the Company has paid to Mr. Schweikhardt in the reporting year had already been completely expensed in 2005.

During the reporting year, the Company recognized revenue from outlicensing and services for Epiontis GmbH, Berlin, in a total value of EUR 57 thousand. At balance sheet date, the Company held a minority stake in Epiontis. The managing director of Epiontis GmbH is Sven Olek, a brother of Epigenomics' former CEO Alexander Olek.

**43 Information on material events after the end of the reporting period.** For material nonadjusting events after the balance sheet date reference is made to the supplementary report of the consolidated management report 2006.

# Auditors' Report

We have audited the consolidated financial statements prepared by the Epigenomics AG, Berlin, comprising the balance sheet, the income statement, statement of changes in equity, cash flow statement and the notes to the consolidated financial statements, together with the group management report for the business year from January 1 to December 31, 2006. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315a Abs. (paragraph) 1 HGB and supplementary provisions of the articles of incorporation are the responsibility of the parent company's management. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report based on our audit.

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

Our audit has not led to any reservations.

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

Furthermore, not intended to qualify our opinion, we point out that the financial statements are prepared on a going concern basis of the group. The Executive Board derives the positive prognosis for the group's continued existence from a detailed financial and earnings plan for the business years 2007 and 2008 with the result that the group will most probably be able to continue its business activity during the present and coming business year, with adherence to the payment obligations.

The continued existence prognosis is tainted with uncertainties due to the maintenance of the ability to pay. In regard to this, we refer to the indications in the consolidated management report, especially to the section "Financial Opportunities and Risks" as well as the explanations in the notes under section "General principles" The group will be reliant on the allocation of financial resources in the future, since the resulting annual deficits in 2007 and 2008 will, according to plan, exceed the liquid resources on December 31, 2006.

Berlin, February 16, 2007
UHY Deutschland AG
Wirtschaftsprüfungsgesellschaft

(Stoeber)
Wirtschaftsprüfer
[German Public Auditor]

(Dr. Peters)
Wirtschaftsprüferin
[German Public Auditor]

# Income Statement 2006 of Epigenomics AG

**according to HGB**

| | 2006<br>EUR | 2005<br>EUR thousand |
|---|---|---|
| **Total revenue** | **5,201,453.68** | **11,515** |
| | | |
| Revenue | 3,018,079.25 | 9,848 |
| Changes in inventories | 0.00 | –106 |
| Own services capitalized | 0.00 | 14 |
| Other operating income | 2,183,374.43 | 1,759 |
| | | |
| Cost of materials | –4,101,656.18 | –4,854 |
| Expenses for raw materials and supplies | –1,511,206.34 | –1,930 |
| Expenses for external services | –2,590,449.84 | –2,924 |
| Payroll costs | –6,962,795.80 | –6,554 |
| Wages and salaries | –6,082,879.25 | –5,670 |
| Social security contributions | –879,916.55 | –884 |
| Depreciation and amortization | –1,283,102.76 | –1,312 |
| on tangible and intangible assets | –1,283,102.76 | –1,312 |
| Other operating expenses | –10,678,328.40 | –9,936 |
| Other interest and similar income | 1,269,483.15 | 1,454 |
| *of which from affiliated companies* | *139,230.05* | *252* |
| Amortization on securities | –394,487.50 | –1,063 |
| Interest and similar expenses | –38,286.14 | –147 |
| | | |
| **Result from ordinary business activities** | **–16,987,719.95** | **–10,897** |
| | | |
| Extraordinary expenses | 0.00 | –1,300 |
| | | |
| **Net loss for the year before taxes** | **–16,987,719.95** | **–12,197** |
| | | |
| Income taxes | 0.00 | 0 |
| Other taxes | 0.00 | 0 |
| | | |
| **Net loss for the year** | **–16,987,719.95** | **–12,197** |

# Balance Sheet of Epigenomics AG

**(according to HGB) as of December 31, 2006**

**ASSETS**

| | Dec 31, 2006 EUR | Dec 31, 2005 EUR thousand |
|---|---|---|
| **Non-current assets** | **13,586,586.72** | **12,047** |
| Intangible Assets | 3,887,406.92 | 2,540 |
| Licences, trademarks & other property rights | 3,887,406.92 | 2,540 |
| Tangible Assets | 1,572,902.26 | 1,520 |
| Leasehold improvements | 150,351.48 | 222 |
| Technical equipment and machines | 1,401,672.37 | 1,273 |
| Other equipment, furniture and fixtures | 20,878.41 | 25 |
| Financial Assets | 8,126,277.54 | 7,987 |
| Interests in affiliated companies | 3,487,047.49 | 3,487 |
| Loans to affiliated companies | 3,639,230.05 | 3,500 |
| Non-current securities | 1,000,000.00 | 1,000 |
| | | |
| **Current assets** | **18,769,196.58** | **34,675** |
| Inventories | 154,369.48 | 192 |
| Raw materials and supplies | 154,369.48 | 192 |
| Receivables and other assets | 1,699,217.22 | 2,315 |
| Trade accounts receivable | 271,179.01 | 734 |
| Other current assets | 1,428,038.21 | 1,580 |
| Securities | 9,342,883.12 | 26,487 |
| Other securities | 9,342,883.12 | 26,487 |
| Cash and cash equivalents | 7,572,726.76 | 5,682 |
| | | |
| **Prepaid expenses** | **210,190.50** | **239** |
| | | |
| **Total assets** | **32,565,973.80** | **46,961** |

**EQUITY AND LIABILITIES**

| | Dec 31, 2006<br>EUR | Dec 31, 2005<br>EUR thousand |
|---|---|---|
| **Shareholders' equity** | **25,361,269.11** | **39,826** |
| Subscribed capital | 16,916,125.00 | 16,403 |
| Conditional Capital: EUR 1,432,131 | | |
| Capital reserve | 17,150,709.76 | 27,337 |
| Other profit reserves | 8,282,154.30 | 8,282 |
| Net loss for the year | –16,987,719.95 | –12,196 |
| | | |
| **Accruals and provisions** | **2,237,159.63** | **1,751** |
| Accruals for claims of employees | 1,037,527.52 | 413 |
| Other accruals and provisions | 1,199,632.11 | 1,338 |
| | | |
| **Payables** | **4,055,051.72** | **3,216** |
| Trade accounts payable | 560,028.12 | 321 |
| Payables due to affiliated companies | 3,304,706.00 | 2,653 |
| Other payables | 190,317.60 | 242 |
| | | |
| **Deferred income** | **912,493.34** | **2,168** |
| | | |
| **Total equity and liabilities** | **32,565,973.80** | **46,961** |

# Scientific Advisory Board

**Dr. Stefan Beck**
The Wellcome Trust Sanger Institute
Cambridge, U.K.

**Associate Prof. Susan Clark**
Sydney Cancer Centre
Sydney, Australia

**Prof. Dr. Manfred Dietel**
Charité
Berlin, Germany

**Dr. Jörg Hoheisel**
German Cancer Research Center
Heidelberg, Germany

**Dr. Rudolf Jaenisch**
Massachusetts Institute of Technology
Cambridge, Massachusetts, U.S.A.

**Dr. Peter Jones**
USC Norris Cancer Center
Los Angeles, California, U.S.A.

**Dr. Peter Laird**
USC Norris Cancer Center
Los Angeles, California, U.S.A.

**Dr. Christoph Plass**
The Ohio State University
Athens, Ohio, U.S.A.

**Dr. Wolf Reik**
The Babraham Institute
Cambridge, U.K.

## SCIENTIFIC CONSULTANTS AND CO-FOUNDERS

**Dr. Ivo Gut**
Head of Technology Development
Centre National de Génotypage, Paris, France
Expertise: mass spectometry

**Prof. Dr. Jörn Walter**
Head of Genetics Department
Universität des Saarlandes, Saarbrücken, Germany
Expertise: DNA methylation

# Corporate Calendar

## March 30, 2007
Report on Business 2006
Press conference and Analyst meeting

## May 3, 2007
3-Month Report, January 1 – March 31, 2007

## May 29, 2007
Annual General Shareholders' Meeting

## August 2, 2007
6-Month Report, January 1 – June 30, 2007

## October 31, 2007
9-Month Report, January 1 – September 30, 2007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The annual report is also available in German.


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# Newsflow Overview

## 2006

**January 4, 2006.** Successful completion of biomarker validation study for prostate cancer classification test

**January 30, 2006.** Pursuing development of Tamoxifen response test

**March 10, 2006.** Lead marker for prediction of breast cancer relapse confirmed

**March 22, 2006.** Extension of blood screening product collaboration with Roche Diagnostics

**April 3, 2006.** Data presentation confirming screening for methylated DNA in blood as key to early colorectal cancer detection

**April 5, 2006.** Clinical study proves prognostic power of Epigenomics's biomarker in prostate cancer

**April 25, 2006.** Release of EpiTect® Bisulfite Kit – elimination of key bottleneck in epigenetic research

**May 16, 2006.** Continuation of biomarker research collaboration with AstraZeneca

**June 27, 2006.** Start of strategic diagnostics platform agreement with Affymetrix

**July 5, 2006.** Presentation of new clinical data on colorectal cancer screening markers

**August 7, 2006.** Start of research collaboration with Johnson & Johnson Pharmaceutical Research & Development, LLC

**August 18, 2006.** Change in the Executive Board – Alexander Olek, Ph.D., leaves Epigenomics

**October 10, 2006.** Successful completion of first steps towards lung cancer screening test development

**October 26, 2006.** New focus on late-stage product development – Restructuring process at Berlin site

**December 12, 2006.** PITX2 prostate cancer molecular classification test successfully transferred to Affymetrix diagnostic platform

**December 15, 2006.** Successful completion of clinical studies in colorectal cancer and prostate cancer screening test programs. Review of all options for the commercialization of cancer screening test products after Roche Diagnostics terminates collaboration

## 2007 / 2008

**January 4, 2007.** Start of Centocor Inc. R&D collaboration to discover biomarkers

**January 16, 2007.** Geert Walther Nygaard, former Managing Director of Abbott Germany, appointed as new CEO

**March 5, 2007.** Heino von Prondzynski, former CEO of Roche Diagnostics, to stand for election into Epigenomics's Supervisory Board

**March 20, 2007.** Data from Epigenomics's colorectal cancer screening test program presented by Prof. Dr. Matthias Ebert (Gastroenterologist, Technical University of Munich) at Cambridge Healthtech Institute's Conference on Epigenomics in San Diego, CA, U.S.A.

**H1 2007.** Present 2006 clinical data of colorectal cancer screening test development program on leading scientific conferences (e.g. AACR, DDW)

**H1-H2 2007.** Adapt assay procedure to routine use for blood-based screening tests; compare previous and improved assay procedure in concordance study with colorectal cancer screening biomarker(s)

**H2 2007.** Enter into reference laboratory partnership for specialty, and potentially screening applications, of colorectal cancer biomarkers

Enter into first non-exclusive IVD partnership with diagnostics industry partner for co-development, marketing, distribution and commercialization of cancer screening test(s)

Deliver additional clinical data for prostate cancer screening test with marker panel aimed at improving discrimination between prostate cancer and benign prostate conditions in urine

Deliver first data demonstrating the utility of lung cancer screening marker for body-fluid testing in clinical samples

Sign new biomarker R&D collaboration agreements with pharma and biotech partners

**2008.** Conduct clinical studies in colorectal cancer screening test program using improved assay procedure

Start of IVD development by first diagnostics industry partner

Launch of colorectal cancer testing service through reference laboratory partner

Launch of prostate cancer molecular classification testing service through reference laboratory partner

# GLOSSARY

**Adjuvant treatment.** Supportive treatment applied together with or right after surgical removal of a tumor to prevent recurrence (Oncology).

**Assay.** Chemical reactions that allow detection or quantification of substances or biomarkers in samples.

**Aurora kinases.** Class of proteins involved in cell division control. When overexpressed, they can be involved in tumor development. Target of a class of oncology drugs called aurora kinase inhibitors.

**Bases.** Chemical components of DNA: adenine (A), cytosine (C), guanine (G), thymine (T). Bound to the sugar-phosphate-backbone of DNA, they encode the genetic information (also see DNA).

**Biochip.** Microarray.

**Biomarker.** A characteristic that is objectively measured and evaluated as an indicator of normal biologic or pathogenic processes or pharmacological responses to a therapeutic intervention.

**Biopsy.** Sample of tissue from a living body extracted for diagnostic purposes.

**Bisulfite.** Chemical substance used to make DNA methylation visible.

**CE marking.** The CE marking is a mandatory safety mark on many products placed on the market in the European Economic Area (EEA). By affixing the CE mark, the manufacturer assures that the item meets all the essential requirements of all applicable EU directives.

**Classification.** The division of a disease into medically relevant subtypes, such as aggressive and non-aggressive subclasses of tumors in oncology.

**Colonoscopy.** Invasive endoscopic examination of the large colon and the end section of the small bowel with a CCD camera or a fiber optic camera on a flexible tube passed through the anus. Frequently used to diagnose colorectal cancer and other colon diseases.

**Cytosine.** One of the four bases of the DNA. Can occur in an unmethylated and methylated version.

**DNA.** Desoxyribonucleic acid. The carrier of genetic information for all complex organisms. DNA consists of four different bases bound to a sugar-phosphate backbone: adenine (A), cytosine (C), guanine (G), thymine (T). The genetic information is encoded in the sequence of the four bases on the sugar-phosphate-backbone.

**DNA methylation.** Natural biological process by which a chemical methyl group is added stably to cytosine, one of the four bases of the DNA. DNA methylation serves the regulation of genes and the stability of the genetic information.

**EGFR.** Epidermal Growth Factor Receptor. Protein that when overexpressed is involved in abnormal cell division and tumor development. Target of the oncology drug class of EGFR inhibitors.

**Epigenetics.** Study of reversible, heritable changes in gene regulation that occur without a change in DNA sequence.

**Epigenomics.** Study of an organism's or a cell's entire epigenetic information.

**FDA.** Food and Drug Administration. U.S. Government agency responsible for the approval of drugs and medical devices (e. g. IVD tests).

**FOBT.** Fecal Occult Blood Test. Test that detects blood in stool, a possible indicator of colorectal cancer.

**Gene regulation.** Cellular control of the amount and timing of appearance of the functional product of a gene.

**Genome.** Entire hereditary information that is encoded in the DNA of an organism.

**Gleason score.** Given to prostate cancer based upon its microscopic appearance. A pathologist examines a biopsy and gives a score to the two most prominent patterns. These scores are then added to obtain the final Gleason score. Gleason scores are used for prostate cancer prognosis.

**GP.** General Practitioner.

**HEP.** Human Epigenome Project Project to decipher the entire DNA methylation pattern of the different tissues of the human body

**In vitro.** In a test tube.

**Indication.** A valid reason to use a certain test, medication, procedure, or surgery.

**Installed base.** A measure of the number of units of a particular type of system (e.g. a diagnostic instrument) actually in use.

**IVD.** In vitro diagnostic.

**IVD platform.** One or more instruments or devices by means of which an in vitro diagnostic test can be performed and the results be analyzed.

**Microarray.** A chip on which multiple biological molecules such as DNA, RNA or proteins can be detected and quantified in parallel. Epigenomics uses microarrays to measure, detect, and quantify DNA methylation.

**Molecular diagnostics.** Diagnostics based on genetic and epigenetic information.

**Monitoring.** The tracing of recurrence or assessment of progression of a disease.

**Morbidity.** Adverse effects caused by a disease or a treatment.

**Mortality.** Death caused by a disease or a treatment.

**OEM.** Original Equipment Manufacturer.

**Oligonucleotides.** Artificially generated piece of single stranded DNA composed of a defined sequence of bases.

**Oncology.** The branch of medicine that studies tumors (cancer) and seeks to understand their development, diagnosis, treatment, and prevention.

**Paraffin sections.** Sections of tissue embedded in a wax. The sections are routinely stained and examined by the pathologist under the microscope to diagnose a disease and make a prognosis.

**Pathology.** The study and diagnosis of disease through examination of molecules, cells, tissues, and organs.

**PCR.** Polymerase chain reaction. Method to multiply a section of the DNA in a test tube.

**Pharmacodiagnostic.** Study of the influence of genetic and epigenetic variation on drug response and toxicity in patients.

**Preanalytics.** Preparation of diagnostic samples necessary to perform the actual test (e. g. extraction of DNA from a blood or tissue sample).

**Prognosis.** Prediction of how a patient's disease will progress, and the chance of recovery.

**PSA.** Prostate Specific Antigen. A biomarker currently used to screen for prostate cancer.

**Reference laboratory.** Centralized diagnostic laboratory that provides testing services for routine and specialty applications.

**Research market.** Market for laboratory equipment and supplies not intended for therapeutic or diagnostic use in humans or animals.

**Screening.** The systematic and preventive examination of an asymptomatic population for early detection of disease.

**Sensitivity.** The measure of a test's ability to accurately detect the presence of a disease. For example, a sensitivity of 90 % means that out of 100 patients which actually have the disease , on average 90 are correctly diagnosed.

**Specificity.** The measure for a test's ability to exclude a disease if it is truly not present. For example, a specificity of 90 % means that out of 100 healthy people ten are falsely identified as having the disease.

**Surveillance.** Close watching of patients at high risk of developing a disease using a diagnostic procedure.

**Taxanes.** Class of oncology drugs.

**Test kit.** A set of reagents, consumables and processing instructions necessary to perform a diagnostic laboratory test.

**Topoisomerases.** Class of proteins involved in DNA replication. When overexpressed, they can be involved in tumor development. Target of a class of oncology drugs called topoisomerase inhibitors.

**Tumor.** A mass of excess tissue that results from abnormal cell division.

**Validation.** Establishing documented evidence that a process or system, when operated within established parameters, can perform effectively and reproducibly and meet its pre-determined specifications and quality attributes.

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