

## **Report of the Executive Board on agenda item 7 pursuant to Section 221 Paragraph 4 Sentence 2 in connection with Section 186 Paragraph 4 Sentence 2 AktG**

The Executive Board and the Supervisory Board propose to the Annual General Shareholders' Meeting under item 7 of the agenda to authorize the Executive Board to issue, subject to Supervisory Board approval, until June 2, 2019, once or several times bearer or registered bonds with warrants, convertible bonds, participation rights or a combination of these instruments in an aggregate nominal amount of up to EUR 20,000,000.00 and to exclude the shareholders' subscription right. For the purpose of delivering the shares in respect of the bonds with warrants, convertible bonds and participation rights a new Conditional Capital X shall be created and a new Section 5 Paragraph 11 of the Articles of Association shall be inserted.

The Executive Board issues, pursuant to Section 221 Paragraph 4 Sentence 2 in connection with Section 186 Paragraph 4 Sentence 2 AktG, a written report on the authorization to exclude the subscription right in connection with the new authorization to issue bonds with warrants, convertible bonds, participation rights or a combination of these instruments, which is released in full below:

The proposed authorization to issue bonds, participation rights or a combination of these instruments in an aggregate nominal amount of up to EUR 20,000,000.00 as well as the creation of the new Conditional Capital X in an amount of up to EUR 1,586,206.00 are intended to broaden the Company's options to finance its activities (as further described below) and to give the Executive Board access, subject to Supervisory Board approval, to quick and flexible financing in the interest of the Company, in particular in case of propitious capital market conditions.

The shareholders are, in principle, entitled to a statutory subscription right for bonds with warrants or conversion rights or obligations or with a right of the Company to, entirely or partially, grant to the holders or creditors of the bonds non-par value shares of the company instead of payment of a due cash amount ("share delivery right"), Sections 221 Paragraph 4, 186 Paragraph 1 AktG. In principle, shareholders are entitled to a statutory subscription right for participation rights, regardless of whether the participation rights carry option or conversion rights or obligations or a share delivery right. To the extent that shareholders are not granted the possibility to directly subscribe for the bonds or participation rights, the Executive Board may make use of the possibility to issue bonds or participation rights to a credit institution, to a company which is deemed equivalent to a credit institution by statute and by the proposed resolution, or to several, also to a syndicate of, credit institutions and/or such equivalent companies, with the obligation for offer the bonds or participation rights to the shareholders in accordance with their subscription right (indirect subscription right within the meaning of Section 221 Paragraph 4 Sentence 2 in connection with Section 186 Paragraph 5 AktG).

The authorization provides for the possibility to exclude the subscription right for fractional amounts resulting from the conversion ratio. This enables the utilization of the requested authorization by round amounts and thereby facilitates the implementation of the shareholders' subscription right. Furthermore, the proposed resolution includes the authorization to exclude the subscription right in favor of the holders or creditors of previously issued option or conversion rights or obligations and/or bonds or participation rights with respect to which the Company has a share delivery right. The advantage of this is that the option and/or conversion price for previously issued option or conversion rights or obligations or share delivery rights does not need to be reduced which allows for increased aggregate proceeds for the Company. Both exclusions of the subscription right are therefore in the interest of the Company and its shareholders.

The issue price of the new shares, in case of an exclusion of the subscription right, must in each case at least be equal to 80% of the stock exchange price of the shares, determined at a time which is close to the issuance of the bonds and/or participation rights. The possibility of an extra amount (which may increase in accordance with the term of the bonds or participation rights) allows for the terms and conditions of the bonds or participation rights to take into account the respective conditions on the capital markets at the time of issuance. If option or conversion obligations or a share delivery right for the Company are foreseen, the option or conversion price may also be aligned to the average stock market price of the shares of the Company prior to the issuance of the shares, even if it is below the aforementioned minimum price. These structuring options enable the Company to successfully place the bonds or participation rights in the market at favorable conditions for the Company and taking into account the prevailing market conditions at the time when the bonds or participation rights are issued.

The Executive Board is further authorized, subject to Supervisory Board approval, to entirely exclude the shareholders' participation right, if the bonds or the participation rights with warrants or conversion rights and/or participation rights with share delivery right are issued against cash payment at a price that is not significantly below the market value of these bonds and/or participation rights. This enables the Company to make use of propitious market conditions very quickly and to obtain better conditions with respect to the interest rate, option and/or conversion price and the issue price of the bonds and/or participation rights by determining the terms and conditions in accordance with current market conditions. If subscription rights were granted, a smooth placement at market conditions would not be possible. Section 186 Paragraph 2 AktG allows for a publication of the subscription price (and therefore the conditions of these bonds and/or participation rights) until the third to last day of the subscription period. However, taking into account the often volatile stock markets, even then a market risk exists over several days which leads to precautionary discounts when the terms and conditions of the bonds and/or participation rights are fixed, and therefore to terms and conditions which do not correspond to the market conditions. Also, if a subscription right is granted, there is uncertainty with respect to its exercise (subscription behavior) which constitutes a risk for a successful placement with third parties or causes additional expenses in connection therewith. Finally, the Company cannot react quickly to propitious or adverse market conditions if a subscription right is granted due to the length of the subscription period; the Company would rather bear the risk of falling share prices during the subscription period which might lead to raising equity at unfavorable conditions.

In this case of an entire exclusion of the subscription right, the provision of Section 186 Paragraph 3 Sentence 4 AktG applies accordingly pursuant to Section 221 Paragraph 4 Sentence 2 AktG. The limit of 10% of the share capital for exclusions of subscription rights provided for in this provision is to be complied with according to the content of the resolution. The maximum amount of the conditional capital that may be used to secure option or conversion rights or obligations or a share delivery right may not exceed 10% of the share capital when the authorization to exclude the subscription right pursuant to Section 186 Paragraph 3 Sentence 4 enters into effect. By way of a corresponding requirement in the authorization resolution it is also ensured that the 10% limit will not be exceeded in case of a capital decrease either, as the authorization to exclude the subscription right must explicitly not exceed 10% of the share capital, neither when the authorization enters into effect nor – if this is the lesser amount – when the authorization is exercised. Treasury shares which are disposed of according to Section 186 Paragraph 3 Sentence 4 AktG as well as shares that are issued in case of capital increases against cash contributions under an exclusion of the subscription right pursuant to Section 186 Paragraph 3 Sentence 4 AktG or pursuant to Sections 203, 186 Paragraph 3 Sentence 4 AktG will count towards this limit, if their disposal and/or issuance occurs during the term of this authorization and prior to an issuance of bonds or participation rights without subscription right pursuant to Sections 221 Paragraph 4 Sentence 2, 186 Paragraph 3 Sentence 4 AktG; thereby they reduce the number of shares that may be issued based on the authorization by making use of an exclusion of subscription rights pursuant to Sections 221 Paragraph 4 Sentence 2, 186 Paragraph 3 Sentence 4 AktG. The same applies to shares for which option or conversion rights or obligations or, to the benefit of the Company, share delivery rights exist which arise from bonds or participation rights with warrants or convertible bonds or participation rights which have been issued, by the Company or a subsidiary, during the term of this authorization on the basis of other authorizations with exclusion of the subscription right pursuant to Section 221 Paragraph 4 Sentence 2 in conjunction with Section 186 Paragraph 3 Sentence 4 AktG. Such shares too will count towards the 10% limit. In addition to the foregoing limit of 10%, the exclusion of the subscription right pursuant to Sections 221 Paragraph 4 Sentence 2, 186 Paragraph 3 Sentence 4 AktG is further restricted to the volume of this authorization, i.e., to 1,586,206 new shares.

It further results from Section 186 Paragraph 3 Sentence 4 AktG that the issue price must not be significantly below the stock market price. This shall prevent a significant economic dilution of the value of the shares. Whether such a dilution effect occurs in case of the issuance of bonds or participation rights without subscription right can be determined by calculating the hypothetical market value of the bond and/or participation right based on recognized, particularly financial mathematical, methods and comparing this value with the issue price of the bond and/or participation right. If this issue price – after due examination – is not more than insignificantly lower than the hypothetical stock market price at the time when the bonds and/or participation rights are issued, the exclusion of the subscription right is not prohibited based on the rationale of Section 186 Paragraph 3 Sentence 4 AktG due to the merely insignificant discount. The proposed resolution therefore provides that the Executive Board – prior to the

issuance of the bonds and/or participation rights and after due examination in accordance with its legal duties – must have come to the conclusion that the envisaged issue price of the bonds and/or participation rights does not lead to a significant dilution of the value of the shares, as the issue price of the bonds and/or participation price does not significantly fall short of hypothetical market value calculated pursuant to recognized, in particular financial mathematical methods. Thereby, the arithmetical market value of a subscription right would be reduced to nearly zero such that no significant economic disadvantage may arise for the shareholders due to the exclusion of the subscription right. All this ensures that no significant dilution of the value of the shares will result from the exclusion of the subscription right.

In addition, the shareholders have the opportunity to maintain their *pro rata* share of the share capital of the Company also subsequent to the exercise of option or conversion rights, the performance of option or conversion obligations or the exercise of a share delivery right through stock market purchases of shares at any time. On the contrary, the authorization to exclude the subscription right offers the Company market-adequate determination of the terms and conditions, maximum security with respect to the possibility to place the bonds and/or participation rights with third parties and the quick utilization of propitious market situations.

To the extent that participation rights without option or conversion rights or obligations and without share delivery right are to be issued, the Executive Board is authorized, subject to Supervisory Board approval, to entirely exclude the shareholders' subscription right, if these participation rights have bond-like characteristics, i.e. do not confer membership rights in the Company, do not provide for a participation in the liquidation proceeds or the amount of interest is not calculated based on the annual surplus, the balance sheet profit or the dividend. In addition, interest and issue price of the participation rights must, in this case, correspond to current market terms at the time of issuance. If these conditions are fulfilled, the exclusion of the subscription right does not result in disadvantages to the shareholders, as the participation rights do not confer membership rights and no share in the liquidation proceeds or in the profit of the Company.

Berlin, April 2014

Epigenomics AG

The Executive Report