

July 12, 2001

QUARTERLY REPORT APRIL-JUNE 2001

- **Björn Nilsson took office as President on July 1.**
- **New technology for lead compound characterization and selection in-licensed from Duke University, North Carolina.**
- **US patent on Estrogen Receptor Beta crystal structures received.**
- **US patent on Thyroid Hormone Receptor crystal structures and drug design principles received.**
- **Group net sales in the second quarter increased to MSEK 27.2 (22.8), and cash flows from operating activities amounted to MSEK -26.3 (1.4).**
- **The loss after financial items increased to MSEK 92.5 (55.6), primarily due to goodwill depreciation regarding Karo Bio USA and increased activities. Operating loss excluding goodwill depreciation amounted to MSEK 33.0 (17.3).**
- **Cash and cash equivalents and short-term investments amounted to MSEK 263.2 (366.0) at the end of the period.**

OPERATIONS

Karo Bio is a leading drug discovery company in the field of nuclear receptor biology and medicinal chemistry. The Company develops receptor-selective and tissue-selective pharmaceuticals for treatment of major disorders. Karo Bio has operations in Sweden and in North Carolina and California in the United States. The Company maintains collaborations with leading academic groups and leading international pharmaceutical companies.

COLLABORATIVE PROJECTS

Abbott Laboratories

The project aims at development of a novel therapy for treatment of type 2 diabetes. Identification and optimization of lead compounds for clinical trials continue.

Bristol-Myers Squibb

This project focuses on novel therapies for treatment of metabolic disorders by targeting thyroid hormone receptors. The primary indication is obesity and preparation for clinical trials are ongoing.

Merck & Co

The Merck project targets estrogen receptors and development of novel therapies in the field of women's health care. Karo Bio's discovery of the new estrogen receptor beta is an important cornerstone in the project. Selection of clinical development candidates is underway.

BioKey® Assays Collaborations

Karo Bio continues to collaborate with several pharmaceutical and biotechnology companies – Aventis Pharma, Bayer AG, Boehringer Ingelheim Pharmaceuticals, Inc., GPC Biotech, NovImmune S.A. and Serono International S.A. – to establish high throughput screening assays for novel drug targets.

INTERNAL PROJECTS***Skin Disorders***

Phase II clinical data for the treatment of steroid induced skin atrophy with KB-261 are currently being analyzed.

Cardiac Arrhythmia

Karo Bio's lead compound KB130015 and second-generation products for the treatment of cardiac arrhythmia are currently the subjects of discussions with pharmaceutical companies.

Glaucoma

In this project, the thyroid hormone receptor is a novel target for the treatment of glaucoma where the objective is to treat this disorder by lowering intra-ocular pressure.

Exploratory Program

Karo Bio's exploratory research activities are focused on the mineralocorticoid receptor, the androgen receptor and the orphan receptor LXR. Drugs that act through these receptors may be utilized to treat high blood pressure, prostate cancer and cardiovascular disease.

BioKey® Assay for Genomics-based Antimicrobials

Karo Bio utilizes its proprietary BioKey® Assay to discover drugs to treat infectious diseases based on novel bacterial drug targets. Lead compounds for the novel essential gene products DXR and IspB are currently being tested.

TECHNOLOGY DEVELOPMENT

Karo Bio is focused on the discovery and development of novel therapeutics for which access to leading technology is very important. In May, Karo Bio reached an Agreement with Duke University, Durham, North Carolina, granting Karo Bio the exclusive rights to technologies, including Cellular Braille™, developed at Duke University Medical Center. The Cellular Braille™ technology further expands the capabilities of the Karo Bio Molecular Braille® technology that was previously developed by Karo Bio USA in collaboration with scientists at Duke University Medical Center. See below for further information regarding financial effects and accounting treatment.

Karo Bio has also received four US patents in the second quarter. The subject of one of these is a novel method to treat certain skin disorders. It provides broad coverage including method of treatment claims as well as claims for skin treatment compositions with thyroid hormones and thyroid hormone analogs. US patents have also been granted that cover structural information related to the estrogen and thyroid hormone receptors.

ORGANIZATION

Björn Nilsson took office as President on July 1.

By the end of the period, Karo Bio had 124 employees (115). Of these, 36 are based in the United States and 102 are engaged in research.

RESULTS AND FINANCING

Group net sales for the second quarter increased to MSEK 27.2 compared to the same period last year (22.8 after restatement following the change in accounting principle regarding revenues, see Accounting and Valuation Principles below). Group expenses increased by MSEK 39.7 to MSEK 120.6 (80.9), which was primarily due to the acquisition of Karo Bio USA, increased activities and costs in relation to the change of president. Goodwill depreciation increased by MSEK 19.7 and operating expenses increased from the activities in Karo Bio USA, which were not included in prior period figures for all three months.

The operating loss amounted to MSEK 93.4 (58.1). Operating loss excluding goodwill depreciation amounted to MSEK 33.0 (17.3). Financial income amounted to MSEK 0.9 (2.4).

Cash flows from operating activities amounted to MSEK -26.3 (1.4). Investment in technology resulted in cash flow of -10.7 (-0.0). Capital investments in equipment amounted to MSEK 5.7 (1.0). Capital investments were mainly new laboratory equipment to enhance capacity and capabilities.

As a consequence, cash and cash equivalents and short-term investments amounted to MSEK 263.2 (366.0) at period-end.

Loss per share for the period amounted to SEK 7.70 (5.28), based on the weighted average number of shares outstanding. Corresponding fully diluted figures are SEK 7.52 (5.24). The Group's equity/assets ratio as of period-end was 89.2% (93.4%) and equity per share at period-end was SEK 58.97 (86.03).

INVESTMENT IN TECHNOLOGY

The investment in exclusive rights to technologies from Duke University as per the Agreement described above was capitalized in May 2001. The amount capitalized represents the net present value of the determinable payments according to the Agreement. Payments will be made over a four-year payment schedule.

Additional payments contingent on patents being received and milestone payments are provided for in the Agreement. These future payments will be substantially less than the amount capitalized.

Depreciation will be taken over a three-year period, beginning in May 2001. Due to the rapid development in the biotech area, a longer depreciation period was not considered appropriate. The milestone payments will be expensed as incurred in order to match expected milestone payments received from partners.

SHAREHOLDERS' EQUITY

Shareholders' equity increased by MSEK 0.1 from the exercise of warrants, leading to 10,688 new shares.

The Incentive Program 2001 was introduced in May 2001, following the decision made at the Shareholders' Meeting on April 26, 2001. Warrants representing 340,000 shares were issued. In addition, the 85,000 warrants relating to the Incentive Program 2000 were canceled in May 2001, also following a decision made at the Shareholders' Meeting.

Consequently, the Company's share capital of SEK 60,107,455 at the end of the period was divided among 12,021,491 shares at par value of SEK 5. In addition, warrants representing 389,943 shares were outstanding.

Total shareholder's equity amounted to MSEK 708.9 after taking into account effect of the change in accounting principle and the loss for the period

ACCOUNTING AND VALUATION PRINCIPLES

This quarterly report has been prepared in accordance with the Swedish Financial Accounting Standards Council's (the Council) standard RR 20 for interim reports. The accounting and valuation principles applied are consistent with provisions of the Swedish Annual Accounts Act and standards issued by the Council. With exception from the change in accounting policy described below, the principles are unchanged compared to what was applied in the Annual Report for 2000.

Karo Bio has decided to change the accounting for down payments from collaborative research projects. Such down payments are received at the initiation of collaborations and are non-refundable. In previous periods, non-refundable down payments were reported as revenue when received. Beginning January 1, 2001, non-refundable down payments are reported as revenue over the term of the collaborative research agreement, which usually is three years. The change is compliant with the new accounting standard regarding Revenue Recognition RR 11 issued by the Council, which is effective January 1, 2001. Comparative figures for prior periods have been restated accordingly.

Amounts or figures in parentheses indicate comparative figures for the corresponding period last year.

SCHEDULED RELEASES OF FINANCIAL INFORMATION

Karo Bio intends to distribute financial reports as follows:

- Quarterly Report: October 17.
- Full Year Report: February 8, 2002.

CONDENSED CONSOLIDATED INCOME STATEMENT (kSEK)

	<u>Apr-Jun 2001</u>	<u>Apr-Jun 2000</u>	<u>Jan-Jun 2001</u>	<u>Jan-Jun 2000</u>
Net sales	27 183	22 819	50 964	48 562
Operating expenses				
Marketing expenses	-3 488	-2 632	-7 093	-4 203
Administrative expenses	-17 993	-4 865	-27 276	-9 160
Research and development expenses	-99 034	-73 188	-193 813	-101 699
Other operating expenses	<u>-102</u>	<u>-207</u>	<u>-203</u>	<u>-1 524</u>
	-120 618	-80 892	-228 386	-116 586
Operating loss	-93 435	-58 073	-177 422	-68 024
Income from financial investments	944	2 425	4 330	4 414
Loss after financial items	-92 491	-55 648	-173 092	-63 610
Tax	-	-	-	-
LOSS FOR THE PERIOD	-92 491	-55 648	-173 092	-63 610
<i>Depreciation of goodwill included in R&D expenses</i>	<i>-60 449</i>	<i>-40 722</i>	<i>-120 898</i>	<i>-42 011</i>
<i>Other depreciation included in operating expenses</i>	<u><i>-3 737</i></u>	<u><i>-2 066</i></u>	<u><i>-6 302</i></u>	<u><i>-3 829</i></u>
	-64 186	-42 788	-127 200	-45 840
Loss per share (SEK)				
- weighted average number of shares outstanding	-7,70	-5,28	-14,41	-6,46
- ditto, fully diluted	-7,52	-5,24	-14,15	-6,43
- shares outstanding at end of period	-7,69	-4,64	-14,40	-5,31
- ditto, fully diluted	-7,45	-4,58	-13,95	-5,23
Number of shares outstanding (000)				
- weighted average during period	12 013	10 538	12 010	9 854
- ditto, fully diluted	12 306	10 625	12 231	9 896
- at end of period	12 021	11 983	12 021	11 983
- ditto, fully diluted	12 411	12 156	12 411	12 156

CONDENSED CONSOLIDATED BALANCE SHEET (kSEK)

	<u>June 30 2001</u>	<u>June 30 2000</u>	<u>Dec 31 2000</u>
Assets			
Licences and similar rights	28 645	564	510
Goodwill	457 043	698 726	577 943
Equipment	28 907	23 724	24 667
Other current assets	16 486	15 021	13 612
Short-term investments, cash and cash equivalents	263 208	366 017	328 967
TOTAL ASSETS	794 288	1 104 052	945 699
Shareholders' equity and liabilities			
Shareholders' equity	708 883	1 030 893	881 597
Loans and leasing obligation	-	4 301	-
Liabilities	85 405	68 858	64 102
TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES	794 288	1 104 052	945 699

CONDENSED CONSOLIDATED CASH FLOW STATEMENT (kSEK)

	<i>Apr-Jun</i> <i>2001</i>	<i>Apr-Jun</i> <i>2000</i>	<i>Jan-Jun</i> <i>2001</i>	<i>Jan-Jun</i> <i>2000</i>
Operating activities				
Operating loss before financial items	-93 435	-58 073	-177 422	-68 024
Depreciation	64 186	42 788	127 200	45 840
Other items not affecting liquid assets	-101	38 293	-	38 293
	-29 350	23 008	-50 222	16 109
Financial income received and expenses paid	95	1 080	1 646	2 383
Cash flow from operating activities before changes in working capital	-29 255	24 088	-48 576	18 492
Changes in working capital	2 962	-22 725	1 832	-11 774
Cash flow from operating activities	-26 293	1 363	-46 744	6 718
Investing activities				
Investment in group companies	-	-18 230	-	-18 230
Investment in licences and similar rights	-10 700	-	-10 700	-
Investment in equipment	-5 683	-1 033	-8 428	-3 747
Sale of equipment	-	50	-	50
Cash flow from investing activities	-16 383	-19 213	-19 128	-21 927
Cash flow from operations	-42 676	-17 850	-65 872	-15 209
Financing activities				
Proceeds from new share issues	53	196 868	112	196 868
Repayment of loans	-	-3 488	-	-3 488
Cash flow from financing activities	53	193 380	112	193 380
Cash flow for the period	-42 623	175 530	-65 760	178 171
Liquid assets at the end of the period	263 208	366 017	263 208	366 017

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (kSEK)

	<i>Apr-Jun</i> <i>2001</i>	<i>Apr-Jun</i> <i>2000</i>	<i>Jan-Jun</i> <i>2001</i>	<i>Jan-Jun</i> <i>2000</i>
Amount at beginning of period	801 338	189 966	881 597	209 175
Effect from change in accounting principle	-	-	-	-11 251
New issues of shares				
- in kind	-	699 751	-	699 751
- directed placement	-	196 868	-	196 868
- warrants exercise	53	-	112	-
Translation difference	-17	-44	266	-40
Loss for the period	-92 491	-55 648	-173 092	-63 610
Amount at end of period	708 883	1 030 893	708 883	1 030 893

EQUITY DATA

	<i>Apr-Jun</i> <i>2001</i>	<i>Apr-Jun</i> <i>2000</i>	<i>Jan-Jun</i> <i>2001</i>	<i>Jan-Jun</i> <i>2000</i>
Equity ratio	89,2%	93,4%	89,2%	93,4%
Equity per share at end of period, SEK	58,97	86,03	58,97	86,03
Ditto, fully diluted, SEK	57,12	84,81	57,12	84,81

Huddinge, July 12, 2001

Björn Nilsson, President

For further information, please contact

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This report has not been subject to review by the Company's independent auditor.