KARO BIO

Press Release

October 14, 2005

QUARTERLY REPORT JULY - SEPTEMBER 2005

- **The Board of Directors has decided to modify the Company's strategy. In addition to the current partnership based model, Karo Bio will bring selected compounds to late stage clinical development**
- **To implement the strategy, Karo Bio's Board has decided to issue new shares with preferential rights. Assuming full subscription, the rights issue will generate MSEK 278.7 before transaction costs**
- **The collaboration with Wyeth Pharmaceuticals has been extended for an additional year until August 31, 2006**
- **Phase Ia clinical study with KB2115 successfully completed**
- **Net sales for the nine months period amounted to MSEK 49.9 (32.9)**
- **The loss for the nine months period amounted to MSEK 73.7 (83.5)**
- **Cash flows from operating activities for the nine months period amounted to MSEK -61.0 (-78.9)**
- **Cash and bank balances and short-term investments amounted to MSEK 114.0 (100.8) at the end of the period**
- **Loss per share for the nine months period amounted to SEK 2.38 (4.23)**

Operations

Karo Bio is an innovative drug discovery and development company specializing in the development of novel pharmaceuticals with focus on metabolic diseases.

The Company has expanded from being a drug discovery company by adding in-house preclinical development resources and competence for development of drugs to treat metabolic diseases. Karo Bio has a strong project portfolio primarily targeting diseases such as diabetes, obesity, atherosclerosis and dyslipidemia.

In addition, Karo Bio has two strategic collaborations with international pharmaceutical companies for development of innovative therapies for the treatment of common diseases.

Research and Development

Karo Bio has a portfolio of four prioritized internal projects and two ongoing partnerships with major pharmaceutical companies.

Thyroid Hormone Receptor - TR

KB2115

Through a number of animal studies Karo Bio has shown that KB2115 increases the body's energy consumption and reduces body weight and markedly reduces blood lipids and blood glucose. Karo Bio's extensive preclinical safety documentation shows that KB2115 shows efficacy over a broad dose range with excellent tolerability.

Karo Bio is currently running a randomized, double-blind and placebo-controlled phase I study in healthy but overweight males and females with dyslipidemia. The primary objective of the new phase I study is to determine the short-term safety and tolerability of single (phase Ia) and multiple oral doses of KB2115 administered daily over a 14-day period (phase Ib). In addition to safety and tolerability, effects of KB2115 on blood lipids and metabolic markers will be measured. The phase Ia single dose part of the study has been successfully completed in the period and no adverse events have been recorded. The phase Ib part of the study is ongoing and will be fully evaluated in the fourth quarter of 2005 and the results will guide the positioning of KB2115 in future clinical development.

TR STAD

Karo Bio has developed a new series of compounds intended for treatment of different forms of dyslipidemia. Significant progress have been made during the past year and potent compounds which lower LDL cholesterol and triglycerides with no effect on the heart have been discovered. These compounds also have the ability to lower independent risk factors for development of cardiovascular disease such as lipoprotein(a). The goal is now to select a candidate drug for further preclinical development.

Glucocorticoid receptor - GR

KB3305

KB3305, intended for treatment of type 2 diabetes, has a favorable pharmacological profile in animal diabetes models and acts by selectively antagonizing the action of specific hormones called glucocorticoids, so named because of their key role in glucose metabolism. By developing compounds that are liver selective the pharmacological effects in other organs can be minimized. KB3305 demonstrates significant anti-diabetic effects in three separate animal disease models. As a consequence KB3305 normalizes the hyperglycemia associated with type 2 diabetes. Preclinical safety and toxicity studies suggest that KB3305 is a safe and well-tolerated drug with a 100-fold safety margin over the expected clinical dose.

The preclinical development of KB3305 is progressing and is primarily directed towards improvement of bioavailability and pharmaceutical formulation for the clinical trials. It is Karo Bio's goal to initiate clinical trials in humans during the first half of 2006.

Estrogen Receptors – ER

ER beta/Depression

Karo Bio is concentrating its efforts on the ER beta receptor. ER beta selective compounds have potential for a number of important diseases such as depression. Proof of principle in animal models has been obtained. In addition, important progress has been made during the period regarding the degree of selectivity in new compounds. Karo Bio is now preparing new patent applications.

Karo Bio partner projects

Estrogen Receptors - Merck & Co., Inc.

Karo Bio and Merck initiated a collaboration in the field of estrogen receptors in 1997. The joint drug discovery phase was completed in 2002. Merck continues with evaluation of compounds for clinical study.

Atherosclerosis - Wyeth Pharmaceuticals

The collaboration targets the liver X receptor (LXR) with the aim to develop new treatments for atherosclerosis.

LXR is a regulator of cholesterol metabolism. It has been demonstrated that compounds that modulate the activity of LXR promote net cholesterol efflux from atherosclerotic blood vessels resulting in the potential for regression of vascular plaque formation. In addition, LXR modulators have anti-inflammatory properties and based on their profile and the need for new drugs, LXR modulators have the potential to become important agents in future treatment of atherosclerosis and other diseases. The collaboration has generated potent lead compounds that inhibit lipid accumulation in the aorta in animal models of atherosclerosis. The project continues to make good progress with lead compounds advancing in predevelopment.

In August the research term of the collaboration was extended for an additional year until August 31, 2006 with the intention of selecting candidate drugs for development.

Organization

Karo Bio has recruited Dr Jens Kristensen to be responsible for Karo Bio's clinical development activities. He will join the management team as Chief Medical Officer and Vice President Clinical Development as of November 2005.

By the end of the period, Karo Bio had 78 (79) employees, of which 69 (68) are engaged in research and development.

Nominating Committee

A nominating committee consisting of Thomas Ehlin, representing Nordea's funds, Björn Franzon, Fourth Swedish National Pension Fund, Ragnhild Wiborg, Pecunia, and Per-Olof Mårtensson, chairman of the Karo Bio board of directors, has been appointed. One additional representative will, in accordance with the decision at the shareholders'

meeting in April 2005, be appointed. Information on this will be available on Karo Bio's website.

New Share Issue

The Board of Directors of Karo Bio AB has on September 28, 2005 decided to make a modification of the Company's strategy. In addition to the current partnership-based model, Karo Bio will bring selected compounds to late stage clinical development. Such compounds will potentially be launched by the Company in selected markets. To implement the strategy, Karo Bio's Board has decided to issue new shares with preferential rights for existing shareholders. Assuming full subscription, the rights issue will generate MSEK 278.7 to the Company before transaction costs.

The decision by the Board is subject to approval by a special general meeting to be held on October 14, 2005. Guarantees and statements of intent to subscribe have been received corresponding to 94 percent of the rights issue.

The new share issue is expected to be completed in December 2005.

Result and Financial Position

Result

Net sales for the quarter decreased to MSEK 2.7 as compared to MSEK 8.8 for the same period last year. Revenues in the third quarter 2005 consist entirely of research funding from the research collaboration with Wyeth Pharmaceuticals, while the corresponding quarter in 2004 included the period's share of an upfront payment received at the initiation of the collaboration in September 2001, which was fully taken as income in August 31, 2004. Revenues also decreased due to fewer Karo Bio scientists engaged and paid for in the collaboration.

Expenses for the quarter decreased by MSEK 0.9 to MSEK 34.3 (35.2). In September 2004, the number of employees was reduced and a provision amounting to MSEK 5.2 for related expenses was recorded.

Operating loss for the quarter amounted to MSEK 31.6 (26.4). Financial net amounted to MSEK 0.3 (1.5), including a currency effect of MSEK 0.1 (0.7) relating to financial items. The reported loss for the quarter amounted to MSEK 31.3 (25.0).

Cash Flow

Cash flows from operating activities for the quarter amounted to MSEK -31.4 (-24.8).

Cash and bank balances and short-term investments with a duration less than 90 days amounted to MSEK 52.0 (56.4) at the end of the period. If including short-term investments with duration exceeding 90 days, the assets amounted to MSEK 114.0 (100.8).

Capital Investments

Capital investments in equipment amounted to MSEK 0.5 (0.1) during the quarter including equipment financed with capital leases.

Shareholders' Equity and Per Share Data

At period-end, warrants representing 710 370 shares were outstanding. The warrants were issued in conjunction with the implementation of the stock option programs 2001 and 2003 (warrants representing 428 400 and 281 970 shares, respectively, after adjustment for the effect of previous rights issues in accordance with the terms of the programs).

The share capital at the end of the period amounted to MSEK 61.9. The total number of shares amounted to 30 965 118 shares at a par value of SEK 2. Total consolidated shareholders' equity amounted to MSEK 109.8 after taking into account the loss for the period.

Loss per share for the period, based on the weighted average number of shares outstanding, amounted to SEK 1.01 (1.26). The Group's equity ratio as of period-end was 80.4 percent (70.8) and equity per share at period-end was SEK 3.55 (4.65).

Parent Company

The Parent Company recorded revenues for the nine months period amounting to MSEK 49.9 (32.9) and is reporting a loss after financial items of MSEK 74.5 (89.2).

Capital investments in equipment for the nine months period amounted to MSEK 1.2 (1.4), excluding capital investments financed with capital leases.

Cash and bank balances and short-term investments amounted to MSEK 114.0 (100.7) at the end of the period.

CONDENSED CONSOLIDATED INCOME STATEMENTS (kSEK)

	July-September		January- September		Jan-Dec
	2005	**2004**	**2005**	**2004**	**2004**
Net sales	2 696	8 779	49 943	32 938	38 953
Operating expenses					
Administrative expenses	-5 433	-6 178	-28 056	-26 699	-31 980
Research and development expenses	-28 772	-29 125	-92 528	-94 637	-123 456
Other operating income and expenses	-57	83	-907	2 272	2 140
	-34 262	-35 220	-121 491	-119 064	-153 296
Operating loss	**-31 566**	**-26 441**	**-71 548**	**-86 126**	**-114 343**
Financial net	303	1 474	-2 107	2 669	7 045
Loss after financial items	**-31 263**	**-24 967**	**-73 655**	**-83 457**	**-107 298**
Tax	-	-	-	-	-
LOSS FOR THE PERIOD	**-31 263**	**-24 967**	**-73 655**	**-83 457**	**-107 298**
Depreciation included in operating expenses	*-1 626*	*-2 162*	*-5 609*	*-10 238*	*-12 369*
Loss per share (SEK) [*)]					
- weighted average number of shares outstanding	-1.01	-1.26	-2.38	-4.23	-4.83
Number of shares outstanding (000)					
- weighted average during period	30 965	19 739	30 965	19 737	22 217
- weighted average during period, incl warrants	31 675	20 453	31 677	20 453	22 932
- at end of period	30 965	19 739	30 965	19 739	30 965
- at end of period, including warrants	31 675	20 453	31 675	20 453	31 679

[*)] The outstanding warrants lead to no dilution of earnings per share, as a conversion to shares would lead to an improvement of earnings per share.

CONDENSED CONSOLIDATED BALANCE SHEETS (kSEK)

	September 30		Dec 31
	2005	**2004**	**2004**
Assets			
Licenses and similar rights	0	104	78
Equipment	14 189	20 427	18 531
Other current assets	8 369	8 227	14 533
Short-term investments	74 366	85 885	166 507
Cash and bank balances	39 670	14 950	14 482
TOTAL ASSETS	**136 594**	**129 593**	**214 131**
Shareholders' equity and liabilities			
Shareholders' equity	109 839	91 808	178 952
Non-current liabilities	1 880	2 798	2 573
Deferred revenue	1 297	6 015	2 681
Other current liabilities	23 578	28 972	29 925
TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES	**136 594**	**129 593**	**214 131**

CONDENSED CONSOLIDATED CASH FLOW STATEMENTS (kSEK)

	July-September		January-September		Jan-Dec
	2005	**2004**	**2005**	**2004**	**2004**
Operating activities					
Operating loss before financial items	-31 566	-26 441	-71 548	-86 126	-114 343
Depreciation	1 626	2 162	5 609	10 238	12 369
Other items not affecting cash flows	59	71	199	-148	-76
	-29 881	24 208	-65 740	-76 036	-102 050
Financial items received and paid	1 508	789	4 319	3 802	3 531
Cash flow from operating activities before changes in working capital	**-28 373**	**-23 419**	**-61 421**	**-72 234**	**-98 519**
Changes in working capital	-3 087	-1 361	430	-6 622	-13 171
Cash flow from operating activities	**-31 460**	**-24 780**	**-60 991**	**-78 856**	**-111 690**
Investing activities					
Investment in licenses and similar rights	-	-	-3 700	-3 775	-3 775
Net investment in equipment	-763	-341	-1 902	-641	-1 075
Net investment in short-term investments	43 997	8 208	53 016	13 647	-57 292
Cash flow from investing activities	**43 234**	**7 867**	**47 414**	**9 231**	**-62 142**
Cash flow from operating and investing activities	**11 774**	**-16 913**	**-13 577**	**-69 625**	**-173 832**
Financing activities					
Proceeds from new share issues	-	-	-	60	113 482
Cash flow from financing activities	**-**	**-**	**-**	**60**	**113 482**
Cash flow for the period	**11 774**	**-16 913**	**-13 577**	**-69 565**	**-60 350**
Cash and cash equivalents at the end of the period	**52 013**	**56 375**	**52 013**	**56 375**	**65 590**
Cash and cash equivalents consist of					
Short-term investments with duration less than 90 days	12 343	41 425	12 343	41 425	51 108
Cash and bank balances	39 670	14 950	39 670	14 950	14 482
	52 013	**56 375**	**52 013**	**56 375**	**65 590**

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (kSEK)

	July-September		January-September		Jan-Dec
	2005	**2004**	**2005**	**2004**	**2004**
Amount at beginning of period	**141 210**	**117 348**	**178 952**	**174 850**	**174 850**
Effect from changes in accounting principles	-	-	249	-	-
Currency translation difference	-139	-617	4 199	281	-2 200
Employee stock option program - value of employee services	31	44	94	74	118
New issues of shares	-	-	-	60	113 482
Loss for the period	-31 263	-24 967	-73 655	-83 457	-107 298
Amount at end of period	**109 839**	**91 808**	**109 839**	**91 808**	**178 952**

EQUITY DATA

	September 30		Dec 31
	2005	**2004**	**2004**
Equity ratio	80.4%	70,8%	83.6%
Equity per share at the end of period, SEK	3.55	4.65	5.78
Equity per share at the of period, including warrants, SEK	3.47	4.49	5.65

Accounting and Valuation Principles

Effective January 1, 2005, companies listed on a stock exchange within the European Union are required to present consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) issued by International Accounting Standards Board (IASB).

This quarterly report has been prepared in accordance with International Accounting Standards 34 for interim reports and other effective IFRS standards and IFRIC interpretations enacted by the EU commission at the end of September 2005. The accounting and valuation principles applied are unchanged compared to what was applied in the Annual Report for 2004 with the exception for implementation of IFRS as described in the annual report for 2004 and as described below.

Other than presentational changes and increased disclosure requirements in the annual report, the transition to IFRS leads to changes in the following areas for the Company:

- IFRS 2 Share-based Payments – accounting for stock option programs
- IAS 39 Financial Instruments: Recognition and Measurement
    - Accounting for currency forward contract intended for hedging exposure to currency fluctuations
    - Valuation of short-term investments
- IAS 7 Cash Flow Statements – definition of cash and cash equivalents in the cash flow statement

IAS 39 became effective January 1, 2005. In accordance with the provisions of IFRS 1, Karo Bio has elected not to restate the periods prior to 2005 in regards to financial instruments in accordance with IAS 39. Financial instruments are, consequently, accounted for in accordance with previously adopted principles in restated financial statements for 2004.

Comparative figures for 2004 have been adjusted for changes in accounting principles except for changes from IAS 39 as described above.

Stock Option Programs

Karo Bio has issued stock options to employees under two stock option programs, Program 2001 and Program 2003. Accounting for such stock options is regulated by IFRS 2 Share-based Payments. IFRS 2 applies to Program 2003, while Program 2001 is not covered by IFRS 2 under the transition rules since the options under this program

were issued before November 7, 2002. Program 2003 is considered an equity-settled payment transaction under IFRS 2, where the fair value of the options granted are recognized in the income statement as a payroll expense over the vesting period. The fair value of the options granted under Program 2003, determined as of the grant date, amounted to MSEK 0.4 based on a valuation performed by Ernst & Young. The Black-Scholes model for option pricing was used for the valuation. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioral considerations. Vesting conditions are included in assumptions about the number of options that are expected to become exercisable. These estimates are revised regularly. Karo Bio recognizes the impact of the revision of original estimate, if any, in the income statement, and a corresponding entry to equity over the remaining vesting period. The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium reserve when options are exercised.

The previously used accounting principle for stock-based compensation was to, upon exercise of stock option, credited nominal value to share capital and exercise price less nominal value to the share premium reserve. No charge was taken to the income statement for stock options granted as compensation for employees. This principle will continue to apply for the Program 2001.

Financial instruments

The difference between the measurement according to IAS 39 and previously adopted principles are in the balance sheet as at January 1, 2005, reported in the shareholders' equity in accordance with the transition rules in IFRS 1. The effect amounts to kSEK 249 and consists of kSEK 171 regarding currency forward contracts and kSEK 78 regarding short-term investments. The amounts have as of January 1, 2005 increased other current assets and short-term investments, respectively.

Currency forward contracts

Karo Bio's policy is to hedge forecasted cash flows in foreign currencies from large currency rate fluctuations as provided in the Company's financial policy. In this respect, a certain level of assurance must exist in order to consider possible transactions and related cash flows. Currency hedging is accomplished primarily through currency forward contracts. These instruments were previously not required to be measured at fair value in the balance sheet. In accordance with IAS 39, all derivatives are to be measured at fair value. The derivatives which are currently used by the Company do not qualify for hedge accounting in accordance with IAS 39. As a result, changes in fair value of cash flow hedges in foreign currencies are included in other operating income and expenses.

The previous accounting principle for forward currency contracts entered into for hedging purposes was to apply hedge accounting. This meant that unrealized gains and losses on forward currency contracts were deferred and reported when realized.

Short-term investments

Short-term investments consist of investments in money market instruments, highly liquid bonds with maturities of less than five years and investments in highly liquid fixed income mutual funds. Short-term investments are classified as financial assets held for trading purposes. This entails that the assets are stated at fair value in the

balance sheet, defined as market value. Changes in fair value are included in financial items in the income statement.

Previously, short-term investments in debt instruments were stated at the lower of cost or market value. Any premium or discount on investments intended to be held to maturity was amortized over the life of the instrument.

Cash flow statements

Karo Bio has used the term liquid assets, defined as bank holdings and short-term investments, as the ending component of the cash flow statement. In accordance with IAS 7 Cash Flow Statements only investments with maturities of less than 90 days at the time of acquisition are to be included in the term cash and cash equivalents used by IAS 7. As a consequence, changes such as investments in and redemptions or sales of short-term investments with maturities exceeding 90 days are reported as cash flows from investing activities. As a result, cash and cash equivalents in the cash flow statements as of September 30, 2004 and December 31, 2004 is lower than liquid assets previously reported.

Reconciliation of reported loss and shareholders equity for comparative periods according to IFRS

The Company's financial statements have been affected by the transition to IFRS in reporting periods relevant to this quarterly report in the following way:

Equity as at January 1, March 31, June 30, September 30 and December 31, 2004, was not affected.

The reported loss for the period January - September, July - September and for the full year 2004 and increased by kSEK 74, 44 and 118, respectively, relating to cost for share-based payments regarding the stock option program 2003. The value of the options was credited to equity, leading to a neutral net effect in equity.

Other IFRS standards

A review of all other IFRS standards not described in the previous sections was performed. The adoption of those standards did not have a material effect on Karo Bio's financial position or result.

The Parent Company

Beginning January 1, 2005 the parent company implemented RR 32 Reporting for legal entities, which has lead to the same effects in the financial statements as for the Group from IAS 39 and IFRS 2.

Other

Amounts are expressed in kSEK (thousands of Swedish Kronor) unless otherwise indicated. MSEK is an abbreviation for millions of SEK. Amounts or figures in parentheses indicate comparative figures for the corresponding period last year, updated for changes in accounting principles as appropriate.

Scheduled Releases of Financial Information

Karo Bio intends to distribute financial reports as follows:

- Quarterly Report October - December and Earnings Report 2005 — February 8, 2006
- Annual General Meeting — May 3, 2006

Financial reports, press releases and other information are available on Karo Bio's web site www.karobio.com Karo Bio's financial reports and press releases may be downloaded and subscribed to on the web site at www.karobio.com/finance Financial reports are available on the web site upon release.

Huddinge October 14, 2005

Per Olof Wallström
President

For further information, please contact

Per Olof Wallström, President, tel. +46 8 608 60 20,
Per Otteskog, Senior Vice President Corporate Development, tel. +46 8 608 60 18,
Bertil Jungmar, Chief Financial Officer, tel. +46 8 608 60 52.

Legal disclaimer

This financial report includes statements that are forward looking and actual results may differ materially from those stated. In addition to the factors discussed, among other factors that may affect results are developments within research programs, including development in preclinical and clinical trials, the impact of competing research programs, the effect of economic conditions, the effectiveness of the Company's intellectual property rights and preclusions of potential third party's intellectual property rights, technological development, exchange rate and interest rate fluctuations, and political risks.

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

Karo Bio AB (publ.), Novum, SE-141 57 Huddinge, Sweden.
Telephone: +46 8 608 60 00.
Fax: +46 8 774 82 61
Corporate identity number: 556309-3359
Website: www.karobio.com