Annual Report 2006

»Our vision is to become a profitable and sustainable pharmaceutical company with products on the market and with a competitive product portfolio containing a mix of partner projects and proprietary projects in development.«

KARO BIO

Contents

Legal disclaimer

This Annual 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.

Introducing Karo Bio

Karo Bio is a drug discovery and development company specializing in nuclear receptors for the development of novel pharmaceuticals with focus on metabolic diseases. Karo Bio has three clinical and four preclinical projects.

The company has expanded from being a drug discovery company by adding in-house preclinical and clinical development resources and competence for development of drugs to treat metabolic diseases. The company has a strong project portfolio with innovative molecules that primarily targets diseases such as diabetes, atherosclerosis and dislipidemia. In all of these areas there are significant market opportunities and a growing need for new pharmaceuticals with new mechanisms of action.

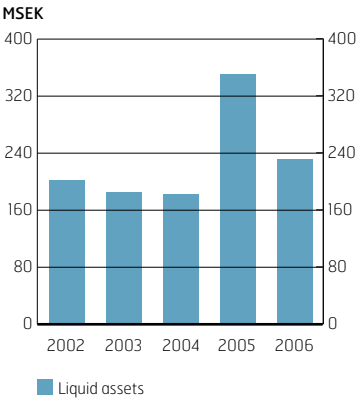
In addition to the proprietary projects Karo Bio has two strategic collaborations with international pharmaceutical companies and one biotech collaboration for development of innovative therapies for the treatment of common diseases.

Karo Bio has been listed on the Stockholm Stock Exchange since 1998.

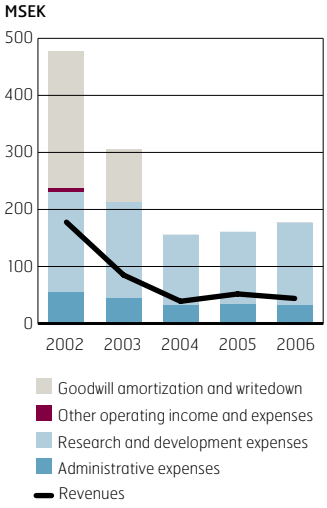
2006 in Brief

- Karo Bio completed phase I clinical trials with KB2115 and phase II is ongoing
- Karo Bio received a milestone payment from Wyeth for selection of a candidate drug and an additional milestone payment for initiation of phase I clinical studies. The collaboration was extended for an additional year until August 31, 2007
- KB5359 was selected as a candidate drug for treatment of dyslipidemia and preclinical development was initiated
- The clinical development of KB3305 is delayed due to technical issues with the pharmaceutical formulation
- Merck initiated phase I clinical studies in the field of estrogen receptors and women's health with a collaboration compound
- Karo Bio outlicensed a class of selective androgen receptor modulators (SARMs) for treatment of osteoporosis to Radius
- Net sales amounted to MSEK 44.0 (51.9)
- The loss for the year amounted to MSEK 126.1 (111.0)
- Cash flows from operating activities amounted to MSEK –110.4 (–90.0)
- Liquid assets and other short-term investments amounted to MSEK 231.0 (346.9) at the end of the year
- Loss per share amounted to SEK 1.63 (2.37)

Liquid assets



Revenues and expenses



Dear fellow shareholder,

It is with pride and anticipation that I sit down to reflect on the achievements in the past year for Karo Bio and the opportunities and challenges to come.

The year has been successful on many accounts, not only for Karo Bio, but also for the biotech industry as a whole with several companies making significant progress.

We financed the company in the fourth quarter of 2005, based on a new strategy and with the will and determination to drive our projects further into clinical phase. This has progressed well and the achievements in 2006 make us confident as we face 2007.

IN THE FALL OF 2005 WE FORMED THE FOLLOWING STRATEGY

- Drive four internal projects towards clinical stage.
- Support our pharma partners – Merck, Wyeth and, in 2006, Radius – to ensure our joint success;
- Pursue partnering discussions with focus on our thyromimetic projects to prepare for the best possible partnering agreements.

SUMMING UP THE YEAR

Our lead thyromimetic compound, KB2115, is in clinical phase II, a defining three month study in patients with hypercholesterolemia with a special focus on safety parameters. Data are expected late in the second quarter 2007.

The follow on compound from our TR platform is KB5359, now in advanced IND-enabling toxicology with the objective to enter phase I trials in man by the second half of 2007.

Our liver selective glucocorticoid antagonist, KB3305, with type 2 diabetes as target indication, is ready to enter phase I studies in man. A technical issue involving the quality of the pharmaceutical formulation will delay the study. We expect this to be settled by a new production lot and the studies to be carried out during 2007.

The ER beta project, aiming at highly selective compounds that affect the central nervous system, is progressing well and we expect to select a candidate drug and start the production of substance for the IND enabling toxicology during the second part of 2007.

Both our big partner companies – Merck and Wyeth – have entered phase I studies with our joint programs; Merck with an estrogen receptor agonist aimed for women's health and Wyeth with a LXR agonist aiming at atherosclerosis.

During the year, Karo Bio outlicenced technology and compounds in the field of SARM's (Selective Androgen Receptor Modulators) to the US company Radius Health, Inc. Radius will develop these compounds focusing on osteoporosis and muscle wasting.

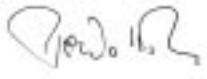
KARO BIO GOING FORWARD

Looking forward into 2007 and beyond, Karo Bio is in an excellent position to realize significant value through both internal as well as partnership programs. Our portfolio is maturing with clinical data to be generated in five projects, three of which are not partnered at this time. This gives Karo Bio the opportunity to choose how far the company wishes to develop these projects in clinical phase. As always, the balance between development cost, financial risk and potential revenue is a delicate calculation. Management and the Board are convinced that the present investment in the project portfolio is correct and that this should result in shareholder value during the coming year.

On a longer term basis, we continue to develop our vision how we can make Karo Bio a profitable and sustainable emerging pharmaceutical company. This requires careful planning and execution, and time will tell whether this can be achieved based on Karo Bio's own merits, or if a combination of assets is needed.

I wish to end this review by thanking all supporting shareholders, a challenging Board and a very loyal and competent Karo Bio organization for contributing to the progress in 2006.

Huddinge in February 2007



Per Olof Wallström

›› Looking forward into 2007 and beyond, Karo Bio is in an excellent position to realize significant value through both internal as well as partnership programs. ‹‹

2006 Key Accomplishments

- ✔ KB2115 phase I studies sucessfully completed
- ✔ KB2115 phase II program initiated
- ✔ KB5359 selected as Candidate Drug and preclinical development initiated
- ✔ Approval received from the Swedish Medical Products Agency for KB3305 phase I studies.
  Study delayed until 2007.
- ✔ Wyeth in phase I studies
- ✔ Merck in phase I studies
- ✔ SARM licensing agreement with Radius

›› The pharmaceutical market is undergoing dramatic changes with new distribution channels, increasing pricing pressures and generic competition as major products go off patent. ‹‹

The Pharmaceutical Market

The pharmaceutical market is undergoing structural changes and growing needs in the metabolic disease area create new opportunities for nuclear receptor drugs.

TRENDS IN THE GLOBAL PHARMACEUTICAL MARKET

The pharmaceutical market is undergoing dramatic changes with new distribution channels, increasing pricing pressures and generic competition as major products go off patent. R&D productivity in terms of launch of new products is also below expectations and the willingness to license in products from biotechnology companies is therefore increasing. In spite of the lack of productivity in drug discovery for the pharmaceutical companies, the global pharmaceutical market continues to grow by approximately seven percent[1] per year and it is estimated that the global sales will increase from today's level of USD 600 billion to USD 900 billion in 2010[1]. The metabolic diseases market share is around 10 percent[1] of the global market and it is expected to grow significantly in the coming years since metabolic diseases are spreading like an epidemic and burdens society with enormous costs.

NEW OPPORTUNITIES FOR NUCLEAR RECEPTOR DRUGS

Nuclear receptors are key regulators of metabolism, glucose control, and lipid regulation. They also regulate many genes simultaneously which make them suitable targets for multifactorial diseases. For these reasons, drugs that mediate their effects via nuclear receptors have great potential for treatment of metabolic diseases. In this area Karo Bio is focusing on the thyroid hormone receptor (TR) and the glucocorticoid receptor (GR), which have a potential as targets for hypercholesterolemia, diabetes and other diseases. Karo Bio has developed a leading position with these receptors as targets for metabolic diseases, and believes that the Karo Bio projects have a competitive edge in relation to other competing concepts.

New opportunities are opening up in the field of the central nervous system (CNS) and depression. The medical need is significant and current drugs are going off patent and are associated with side effects. New knowledge about the function and distribution of estrogen receptor beta has been generated. In the CNS field, estrogen receptor (ER) beta appears to have important functions for mood and cognition, which makes it an attractive target for treatment of depression. ER beta is also emerging as a target for treatment of cancer and inflammatory disorders. Karo Bio's knowledge about this receptor and access to competitive drug discovery technologies creates a strong competitive position.

In addition to the classical receptors like TR, GR and ER the newly discovered receptors in the family, like the liver X receptor (LXR), provide new opportunities for pharmaceutical development. In this area Karo Bio collaborates with Wyeth pharmaceuticals and the parties are the first to take an LXR compound into clinical studies for treatment of atherosclerosis.

1) Piribo: Pharmaceutical Market Trends 2006–2010

Needs for New Lipid Lowering Medicines

Karo Bio is a pharmaceutical company that devotes much of its research efforts to developing drugs for the treatment of high cholesterol levels. Professor Bo Angelin of the Karolinska University Hospital, Huddinge, believes that there is a clear medical need for new therapies in addition to the current statins.

”We certainly do have relatively effective cholesterol and blood lipid-lowering medications today, but as therapeutic goals shift toward lower and lower levels, the need for new and more effective drugs will continue to grow. The new therapeutic goals are based on research findings that point to additional health benefits and preventive effects from lowering cholesterol and blood lipid values beyond the earlier target levels,” says Professor Angelin

Bo Angelin is chief physician at the Endocrinology, Metabolism and Diabetes Clinic at Karolinska University Hospital in Huddinge. He is also the Research Director of the Center for Nutrition and Toxicology, Karolinska Institute, Novum, and one of the world’s leading authorities in this field.

’Statins’ have become very important in the treatment of high levels of the ’dangerous’ LDL (low density lipoprotein) cholesterol, and it is now well known that the pharmacological treatment of elevated LDL levels significantly reduces cardiovascular disease and mortality. However, despite statins and other cholesterol-lowering drugs many of the patients being treated still fail to reach their therapeutic goals. There are also many patients who do not tolerate statins.

”There is a need for drugs that use new methods to lower lipid levels, and that can be added to today’s statins as supplemental therapies, so that we can, so to speak, attack the bad cholesterol on multiple fronts,” says Angelin.
The ’normal’ values for LDL cholesterol are substantially higher than they should be with respect to the risk of cardiovascular disease.

”At the same time, you need to have a certain amount of cholesterol circulating to maintain normal cell functions. That level is probably around one-fifth of the values that we currently consider normal, i.e. average” says Angelin.

According to Angelin, there are a number of exciting innovative approaches that have major potential to lead to effective new drugs. Some of these approaches involve stimulating the body’s ability to get rid of cholesterol and perhaps even ’vacuum’ fats already deposited in the blood vessels.

This can be done, for instance, by raising the level of high density lipoprotein (HDL) cholesterol in various ways, and thereby hopefully transporting cholesterol from the vascular walls to the liver, where it is eliminated into the intestinal tract via the bile. The intravenous administration of proteins that are constituents of HDL has been shown to have a positive effect on the arterial calcification process.

”In the future, combinations of blood lipid-modulating drugs having different mechanisms of action will probably dominate, but very extensive studies will be needed to conclusively establish these routines,” says Angelin.

According to Angelin, an ideal drug should both lower the ’dangerous’ fractions of LDL and VLDL and simultaneously raise the protective HDL fraction.

Professor Bo Angelin of the Karolinska University Hospital, Huddinge

Facts: Blood lipids

Blood lipids are fat particles such as various forms of cholesterol and triglycerides. High levels of cholesterol in particular is associated with development of cardiovascular disease.

Vision

To become a profitable and sustainable pharmaceutical company with products on the market and with a competitive product portfolio containing a mix of partner projects and proprietary projects in development.

Goals 2007

- Finalize the first phase II study with KB2115 and follow up with new studies in selected patient groups
- Sign a partnership for KB5359
- Complete the preclinical development of KB5359 and initiate phase I studies
- Initiate the phase I study with KB3305
- Select a candidate drug in the ER beta program for treatment of depression
- Support existing partnerships in their continued clinical and preclinical development

Business Model and Strategy

Karo Bio's business is based on a model in which projects targeting major patient populations in competitive market segments are outlicensed to partners in preclinical or early clinical stages of development. In addition to the partnership-based model, Karo Bio will bring selected compounds aimed at targeted patient populations to late stage clinical development and regulatory approval. The company will potentially launch such compounds in selected markets.

The strategy will create opportunities for flexibility in deal making, while providing better control of the business and improved prospects for revenue and earnings-generation over time. Thus, the risks in this strategy are better balanced.

Karo Bio's Strategy and Business Model

Karo Bio's strategy for developing the company and building shareholder value is to:

Generate new innovative projects through drug discovery targeting nuclear receptors

Reduce risk by maintaining a focused project portfolio and building a clinical pipeline

Bring selected projects in niche areas to the market or late stage out licensing

License out compounds intended for the treatment of broad patient populations

An Integrated Approach to Drug Development

Karo Bio has an integrated drug discovery process with departments for Discovery Research, Preclinical Development and Clinical Development. The departments are divided into different sections with specialist competences for discovery and development. In addition to internal resources Karo Bio also collaborates with internationally leading scientists in the field of nuclear receptor research and clinical medicine.

DISCOVERY RESEARCH

Drug discovery at Karo Bio starts with target validation which means that a specific nuclear receptor is mechanistically linked to a disease. The target validation process is guided by Karo Bio's unique competence in the field of nuclear receptor structure and function and is conducted in close collaboration with clinical experts. The search for a molecule that binds to the receptor and modulates the function of the receptor is very much driven by structural biology and medicinal chemistry. In this process, Karo Bio determines the three-dimensional structures of receptors and designs molecules that bind to the receptors in a way which modifies the disease process. Our leading position in nuclear receptor structure biology has enabled the design of innovative molecules and unique compound libraries.

PRECLINICAL DEVELOPMENT

In recent years, Karo Bio has built up resources for preclinical development to enable selection of high quality drug candidates. In-house resources include animal models for ADME (absorption, distribution, metabolism and excretion) as well as resources for pharmacokinetics, bioanalysis and *in vivo* pharmacology. In-house competences for safety pharmacology and toxicology are also available. In addition to these resources Karo Bio utilize contract organizations to characterize compounds. When a compound fulfills preset criteria for efficacy and safety in these models a candidate drug is selected. A documentation package for regulatory approval, before starting clinical trials, is prepared after additional external toxicology studies.

CLINICAL DEVELOPMENT

The department for clinical development is responsible for planning and execution of clinical studies. During the clinical trials the compound is evaluated for its safety and efficacy in treating or preventing a specific disease or condition. The results of these studies will comprise the most important factors in the approval process. The different steps in clinical development are described below.

Phase I

In phase I the compound is administered to humans for the first time. The focus is initial safety and tolerability, as well as uptake, distribution, elimination and metabolism of the drug (PK/PD data) to define a dose range and dose regimen for the phase II studies and to determine the nature of adverse reactions, if any. These studies are performed in healthy volunteers but also in special populations of patients.

Phase II

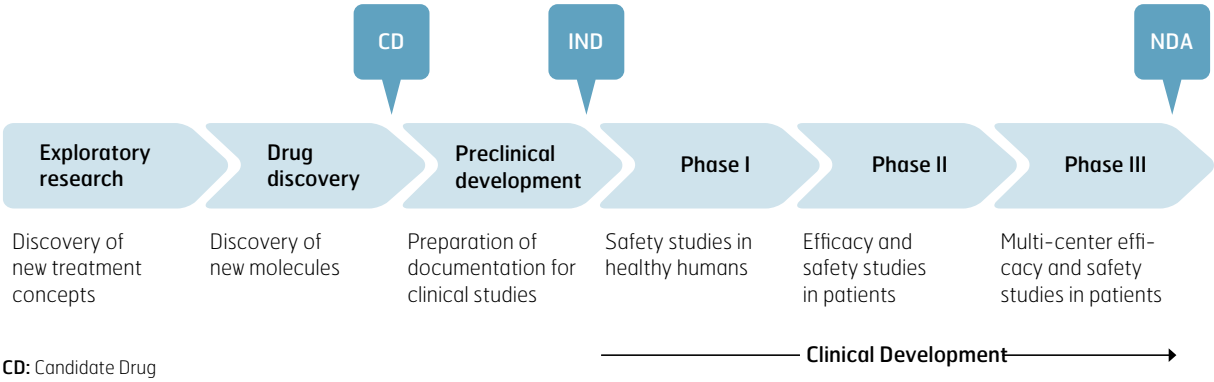
Phase II is usually the first time patients are exposed to the compound. Phase II is a therapeutic exploratory phase, often divided into phase IIa and IIb. Phase IIa is aimed at proof of principle, showing that the compound has beneficial effects by proving efficacy in a small group of patients with a well defined diagnosis. In phase IIb, the scope is to prepare for the pivotal phase III studies by confirming the dose selection, administration regimen, endpoints, and other information in a wider patient population and for longer duration proof of concept. The study duration can be extended to several months to look at possible tolerance or rebound effects.

Phase III

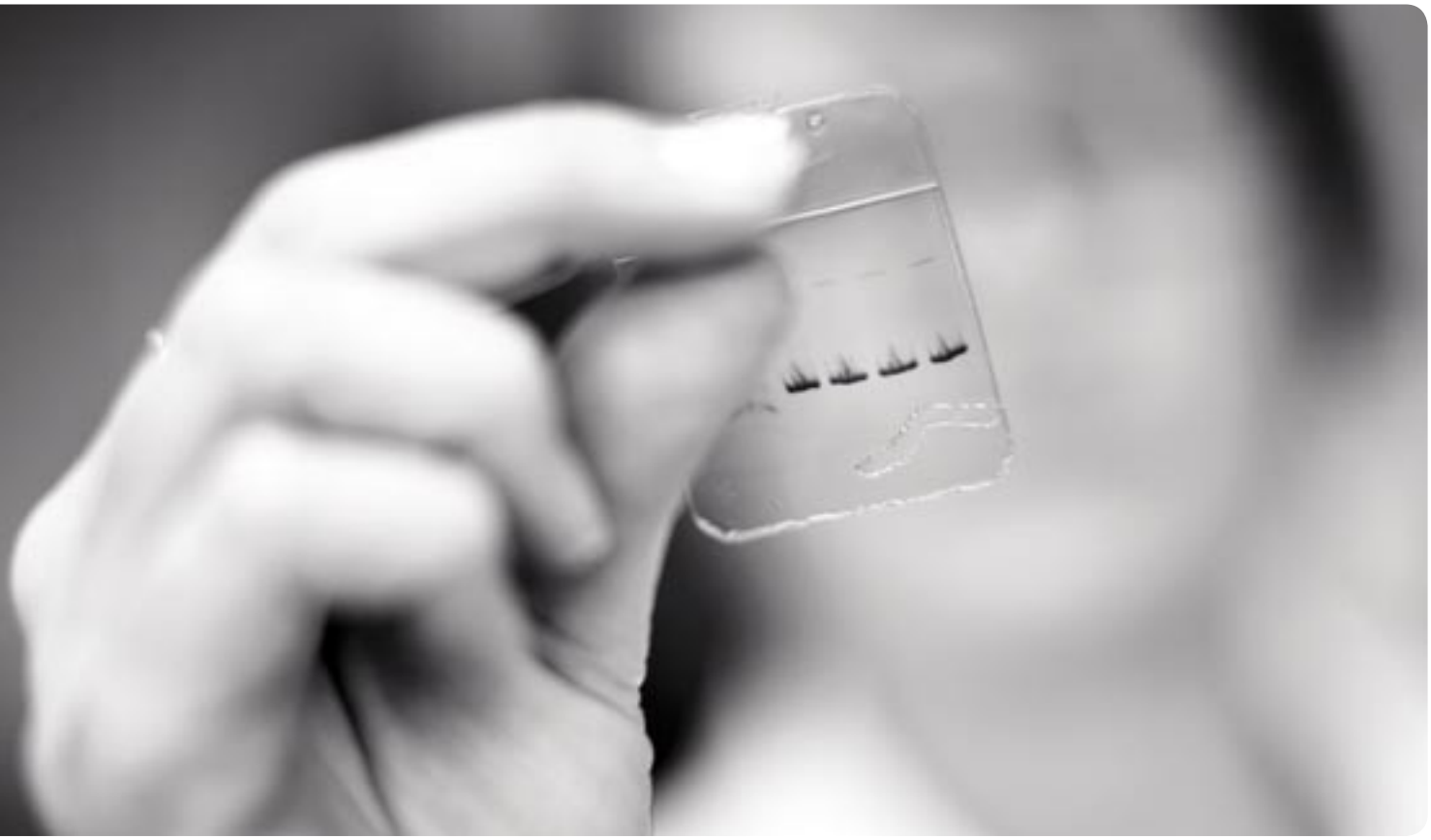
In the pivotal phase III, studies a large number of patients are studied to confirm therapeutic benefit and to provide documentation needed for approval of the targeted claims and regulatory purpose. To a large extent, study designs are determined by the level of efficacy seen in phase II studies. Indication or compound-specific issues may need to be addressed, such as head-to-head comparison, combined treatment and efficacy in different disease states. For safety and tolerability, general regulatory demands define the number of patients and the exposure time needed for approval.

Once all clinical documentation has been compiled and evaluated, a new drug application (NDA) is submitted to the regulatory authorities.

Major Steps in Discovery and Drug Development



CD: Candidate Drug
IND: Investigational New Drug Application
NDA: New Drug Application



The Project Portfolio

Karo Bio has a pipeline of projects which contains both proprietary projects and partner projects. All projects target major markets where there are significant unmet medical needs. In the fields of dyslipidemia, diabetes and CNS there is also a great need for new potent drugs with new mechanisms of action that can be used either as a single therapy or in combination with existing drugs. Karo Bio's compounds fulfil these criteria and are all generated from Karo Bio's discovery research and are all first in class molecules.

Karo Bio invests in the further development of its proprietary compounds in the pipeline and also in discovery research with the intention of generating new projects. The responsibility for further development of the partner projects lies with the partner which also covers the entire development costs. Karo Bio however retain rights to future milestone payments and royalties on future sales.

Karo Bio Pipeline

PROJECT	Target validation	Drug discovery	Preclinical development	Phase I	Phase II	Phase III	NDA
KB2115 Severe Dyslipidemia							
KB5359 Dyslipidemia							
KB3305 Type 2 diabetes							
ER beta Depression							
Wyeth / Karo Bio LXR / Atherosclerosis							
Merck / Karo Bio ER / Women's Health							
Radius / Karo Bio SARMs / Osteoporosis							

NDA: New Drug Application

Project Descriptions

PROPRIETARY PROJECTS

KB2115, Severe Dyslipidemia

MARKET AND MEDICAL NEED

Statins have become very important for the treatment of hypercholesterolemia which affects more than 250 million people in the seven major markets (Datamonitor), and it is now well established that pharmacological treatment of elevated serum cholesterol levels significantly reduces cardiovascular events and mortality. However, there is still a significant portion of the patients who do not reach the targeted levels of cholesterol lowering and there are many patients that do not respond to or are intolerant to statins. For these reasons there is a great need for new drugs in this field. KB2115 is primarily aimed for severe dyslipidemia but the clinical data will guide positioning of the drug .

PRODUCT PROFILE

KB2115 targets the thyroid hormone receptor, but unlike thyroid hormone, KB2115 is pharmacologically selective. This means that the compound lowers cholesterol and blood lipids without harmful effects on the heart and other tissues when the compound is given at therapeutic doses. Through a number of animal studies, Karo Bio has shown that KB2115 increases the body's energy consumption, reduces body weight, and markedly reduces blood lipids and blood glucose. Karo Bio's extensive preclinical safety documentation shows that KB2115 is cardiac-sparing.

DEVELOPMENT STATUS

Karo Bio has successfully completed a phase I study with KB2115 in healthy but overweight individuals with dyslipidemia. The primary objective of the phase I study was to determine the short-term safety and tolerability of single (phase Ia) and multiple oral doses administered daily over a 14-day period (phase Ib). No serious adverse events were recorded and KB2115 was well tolerated. Also, excellent bioavailability and pharmacokinetic properties were documented. No adverse effects on the heart were reported. In addition to the beneficial safety profile of KB2115, a significant lowering of total and LDL cholesterol of up to 40 percent was documented. Thus, the compound has the potential to become an important agent for the treatment of severe dyslipidemia. Phase II clinical development was initiated in November 2006.

KB5359, Second Generation Selective Thyroid Hormone Receptor Modulator for Dyslipidemia

MARKET AND MEDICAL NEED

The dyslipidemia market is described in the KB2115 project description section. As for KB5359, the profile of the compound indicates that it can be used broadly for common forms of dyslipidemia.

PRODUCT PROFILE

From its extensive library of pharmacologically selective thyroid hormone receptor modulators, Karo Bio has selected KB5359 for further development. In preclinical models, KB5359 has an efficacy and safety profile that is beneficial for the treatment of common forms of dyslipidemia. KB5359 significantly lowers LDL cholesterol in several animal models, with no observed negative effects on the heart. KB5359 also has the potential to lower independent risk factors for the development of cardiovascular disease such as body weight, triglycerides, blood glucose and lipoprotein(a). Synergistic or additive effects with statins have also been documented. KB5359 also appears, based on preclinical findings, to have an improved safety profile in relation to KB2115. For example, the compound is likely more liver selective than KB2115. It will thus have reduced systemic effects and will be easier to handle for general practitioners. It is Karo Bio's goal to seek a partner for further development of KB5359 since its potential will require a large development and marketing organization.

DEVELOPMENT STATUS

In June 2006, KB5359 was selected as a candidate drug. The non-clinical safety program has been initiated with the intention of generating documentation to allow clinical studies during 2007.

KB3305, Liver Selective GR Antagonist for Type 2 Diabetes in Phase I Development

MARKET AND MEDICAL NEED

Approximately 170 million (Datamonitor) people in the world suffer from type 2 diabetes and the disease is rapidly spreading also in developing countries. By 2025 the number of diabetics is estimated at 300 million (Datamonitor). In US alone every sixth death is related to type 2 diabetes (Datamonitor).

There are several forms of oral medicines on the market for diabetes treatment, but in spite of this 60 percent of the patients do not reach the target level for glucose reduction. The total market for anti-diabetics was USD 15 billion (Datamonitor) in 2005 and it is estimated to increase significantly when new and more efficient medicines reach the market (Datamonitor).

PRODUCT PROFILE

Therapy for type 2 diabetes remains inadequate in spite of a number of available treatments. None of the existing treatments directly targets the increased glucose production in the liver that occurs in type 2 diabetics and which is driven by glucocorticoid hormones. However, Karo Bio has targeted the increased glucose production in the liver. The drug discovery efforts have led to the development of KB3305, a liver selective glucocorticoid antagonist. By developing compounds that are liver selective the pharmacological effects in other organs can be minimized. The compound KB3305 is the first known example of such a liver selective GR antagonist. It demonstrates significant anti-diabetic effects in three separate animal disease models.

In addition to this beneficial effect of KB3305 and its potential use as an anti-diabetic agent, KB3305 significantly improves several measures of blood lipid levels in these animal models. This is important since elevated triglycerides in patients with type 2 diabetes severely increase the risk for serious cardiovascular events such as myocardial infarction and stroke.

Preclinical safety and toxicity studies suggest that KB3305 is a safe and well-tolerated drug.

DEVELOPMENT STATUS

In November 2006 Karo Bio received approval for initiation of phase I clinical studies. The initiation of these studies will occur during 2007, following completion of a technical issue involving the capsule formulation.

ER beta Agonists for Depression

MARKET AND MEDICAL NEED

With the discovery of the new estrogen beta receptor, new treatment opportunities in the field of women's health have evolved. Potential indications are cancer, inflammatory disorders and depression which are major and disabling disorders that cause suffering in patients and burden the community with very high costs. Although new treatments have been developed, these are associated with side effects that create a need for new medicines.

»In November 2006 Karo Bio received approval for initiation of phase I clinical studies. The initiation of these studies will occur in 2007, following completion of a technical issue involving the capsule formulation.«

It is well known that estrogens have beneficial effects on mood, but the side effects of estrogens limit their use in a broader context. The discovery of the new estrogen receptor beta has opened possibilities for development of new selective compounds with fewer side effects. Depression is an area where ER beta selective agonists may be useful since the ER beta receptor co-localizes in areas in the brain that control mood and feelings of anxiety. The need for new drugs to treat depression is also great since current drugs have a late onset of action and are associated with several adverse effects.

PRODUCT PROFILE

The candidate drug to be selected shall be orally bioavailable and with a high affinity for ER beta in order to avoid ER alpha mediated side effects like uterine stimulation. The compound should also be CNS permissive and exhibit anti-depressive effects.

DEVELOPMENT STATUS

Proof of principle in animal depression models with ER beta agonists has been obtained. Karo Bio has also generated data that suggest that additive effects can be obtained when ER beta agonists are combined with compounds belonging to the common SSRI (Selective Serotonin Reuptake Inhibitors) class of anti-depressant agents. Optimization of lead compounds is ongoing with the aim to select a candidate drug for further development.

PARTNER PROJECTS

Merck Collaboration

Merck and Karo Bio collaborate in the field of estrogen receptors. Estrogen receptors are important targets for several diseases in the field of women's health. The joint drug discovery phase has been concluded and Merck is responsible for the development phase. Merck entered phase I clinical development in August 2006.

Wyeth Collaboration

The collaboration with Wyeth Pharmaceuticals is aimed at new treatments of atherosclerosis with the liver X receptor (LXR) as target. Preclinical studies have shown that compounds which stimulate LXR have anti-atherogenic effects. In August 2006, Wyeth initiated phase I clinical studies which triggered a milestone payment to Karo Bio. The collaboration was also extended in August 2006 for another year until August 31, 2007 with the intention to develop back-up compounds and explore new clinical indications.

Radius Licensing Agreement

Karo Bio announced a licensing agreement with Radius, a private US company, in August 2006. Under the terms of the agreement Radius acquires the exclusive worldwide rights, excluding the Nordic and Baltic countries, to a new class of selective androgen receptor modulators (SARMs) discovered by Karo Bio. Radius is advancing these SARM compounds in preclinical studies for the treatment of osteoporosis and frailty associated with loss of muscle mass.

Teamwork and Flexibility

The development of KB2115 is the result of Karo Bio's leading research in the area of pharmacologically selective thyroid hormone mimetics in collaboration with world leading international scientists.

Dr. Karin Mellström, Project leader, KB2115

Dr. Karin Mellström joined Karo Bio in 1995 as head of Cell Biology and then became project leader for the TR project. She has led and followed this project since the collaboration with Bristol-Myers Squibb was initiated in the fall of 1997.

"In the collaboration with Bristol-Myers Squibb we aimed to development a compound to treat obesity", she says. "Together we discovered a great number of compounds that, unlike the natural thyroid hormone, were pharmacologically selective and cardiac sparing. KB2115 was one of these promising lead compounds and Bristol-Myers Squibb performed a phase I clinical trial in healthy volunteers. However, Bristol-Myers Squibb discovered that the compound could undergo an unwanted chemical modification; the clinical development of KB2115 was put on hold. When Bristol-Myers Squibb later terminated its drug discovery efforts for obesity around TR, the jointly discovered compounds were returned to Karo Bio".

Associate Professor Anders Berkenstam, Vice President Discovery Research at Karo Bio remembers: "The KB2115 compound had a wonderful profile and was very potent. We were determined to continue the program on our own and we also developed ideas about a new way forward for KB2115, which originally was intended for treatment of obesity. The powerful LDL lowering effects of the compound and the increasing need for new dyslipidemia drugs provided new opportunities in the dyslipidemia market. In addition, in preclinical studies, KB2115 also showed beneficial effects on other factors of importance for development of cardiovascular disease. We therefore decided to take the compound into clinical development for treatment of dyslipidemia."

"However, at that time we were inexperienced in clinical development since this had previously been the responsibility of our pharmaceutical partners" Anders Berkenstam says. "Through good collaborative efforts and a lot of hard work we managed to design and perform a phase I study that successfully gave us a proof of concept that KB2115 is pharmacologically selective also in man as observed in our animal models. This means that the compound is very potent in lowering of LDL cholesterol without having effects on heart rate or rhythm. This was the first time that this was shown - a truly groundbreaking finding. Looking forward however, we knew that a prerequisite for effective progression of the clinical development, Karo Bio required internal expertise in clinical development."

In the fall of 2005 Karo Bio recruited Dr. Jens Kristensen as Vice President Clinical Development.

"I was intrigued about the possibility of taking KB2115 through clinical studies", he says. "The compound is very efficacious and the target is well validated. Although no serious adverse findings were detected in the phase I study we realized that there was a great need to focus on safety in the phase II program which was launched in November 2006. Phase II data, which will determine the future positioning of KB2115, will be available by mid 2007."

KB2115

KB2115 was discovered as an obesity drug in collaboration with Bristol-Myers Squibb and later repositioned by Karo Bio for treatment of dyslipidemia. The compound is a pharmacologically selective thyromimetic that lowers LDL without effects on heart rate.

Creativity and Competence

One of the effects of the maturation of Karo Bio's research and development portfolio in recent years has been a strategic change within the company itself. We have chosen to build up an integrated organization to conduct our preclinical and clinical development projects in an efficient and goal-oriented way.

In 2006 we continued to build our new organization. In recruiting Dr. Anneli Hällgren to head our preclinical development, we have laid a solid foundation for the selection of high quality clinical candidates.

Interaction is in fact a key element in our philosophy. Each projectgroup will of course have its own specific focus, but it must also have good insight into the other links in the research and development chain.

DEVELOPING COMPETENCE

We also believe that all our employees must feel that they are participants in the company's growth and development. We strongly emphasize internal training, and engaged in various leadership and management development programs in 2006. These programs involved project managers, section managers and department managers.

We have clearly defined processes for competence and individual development. Goals are defined and plans for competence enhancement are formulated in our individual employee goal and development interviews. Based on these goals we identify needs in terms of competence development, which are then addressed during the year.

HEALTH AND WORK ENVIRONMENT

The health and well-being of both the group and each individual are important competitive factors. Our employees are invited to undergo personal health profiles and we promote active rehabilitation early on in the course of an illness.

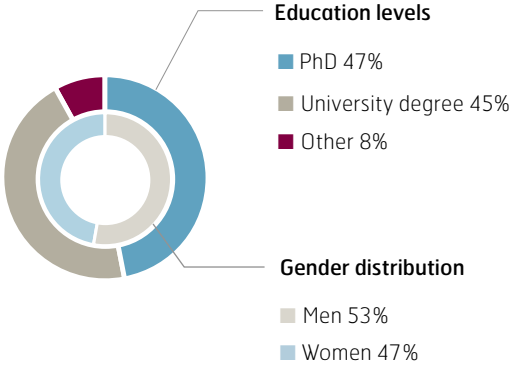
Karo Bios' gender equality plan includes goals that must be reached and requirements that must be met within specific times, as set forth in the Swedish Equal Opportunities Act. Men and women must have the same opportunities within the organisation without discrimination.

SOCIAL RESPONSIBILITY

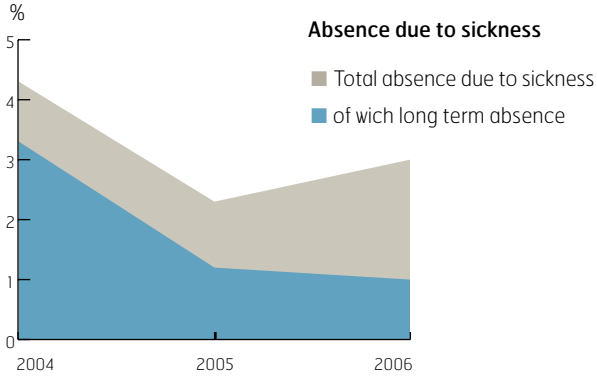
As an industrial company, Karo Bio has an impact on the environment. Because we are a research and development company with no in-house production, our consumption of energy and other natural resources and our air and water emissions are relatively limited.

Karo Bio's daily activities involving chemical substances and genetically modified cells and microorganisms entail strict requirements in terms of comprehensive environmental and safety efforts to minimize the risk of negative impact on the environment and human health.

Our environmental program is conducted as an integral part of our operations, and is geared toward preventive measures and constant improvement, where the goal is to meet or exceed applicable legal requirements, regulations and international agreements.



Staff turnover	2006
New employees	11%
Resigned	5%



Board of Directors

1 2 3 4 5 6 7 8 9 10

1 **PER-OLOF MÅRTENSSON**
(1937), Höganäs.
Chairman since 2000. Elected 1994
M.Sc.Pharm.
President Karo Bio AB 1991–2000.
Board memberships: BioInvent International AB (chairman), Photocure a/s (vice chairman), Alligator Bioscience AB (chairman) and Apodemus AB.
Shares in Karo Bio: 297,905

4 **DANA FOWLKES**
(1950), Chapel Hill, North Carolina, USA.
Elected 2000.
B.A, M.D., Ph.D.
Board memberships: General Partner, Hatteras BioCapital Fund LLC; Venture Partner, Hatteras Venture Partner III Fund; Director, Lost Horizon Resort Co.
Shares in Karo Bio: 735,847

LARS INGELMARK (no picture)
(1949) , Halmstad.
Elected 1999.
Senior vice president, Head of Life Science Venture, Sixth Swedish National Pension Fund.
Board memberships: Scandinavian Life Science Venture (chairman), Cefar AB (chairman), Svensk Våtmarksfond (chairman), A Carlsson Research AB, Inno-ventus AB and others.
Shares in Karo Bio: 7,000

6 **LAURENT LEKSELL**
(1952), Dalarö.
Elected 2006.
Ph.D. Business Administration.
Board memberships: Ortivus AB, Stockholm City Mission (chairman), American Chamber of Commerce, Bonit Invest SA and Bonit Invest AB.
Shares in Karo Bio: 850,000

5 **ULLA LITZÉN**
(1956), Stockholm.
Elected 2003.
MBA.
Board memberships: AB SKF, Atlas Copco AB, Boliden AB, and Posten AB.
Shares in Karo Bio: 16,500

2 **LEON E. ROSENBERG**
(1933), Princeton, New Jersey, USA.
Elected 2000.
B.A and M.D.
Professor, Princeton University.
Board memberships: Hana Biosciences Company, Medicines for Malaria Venture; Paul Rugers Society of Global Health Research.
Shares in Karo Bio: 1,754

3 **PER OLOF WALLSTRÖM**
(1949), Uppsala.
Elected 2005.
M.Sc. Pharm.
President Karo Bio AB.
Board memberships: Envirotainer Holding AB, Swedish Orphan Holding, ArosGruppen Holding AB (chairman) and SwedenBio.
Shares in Karo Bio: 135,000
Options in Karo Bio: -

7 **BO CARLSSON**
(1958), Stockholm.
Appointed 1997.
Project Manager.
Employee representative.
Shares in Karo Bio: 6,361
Options in Karo Bio: 5,003

8 **JOHNNY SANDBERG**
(1967), Stockholm.
Appointed 2006.
Research Investigator.
Employee representative.
Shares in Karo Bio: 5,250
Options in Karo Bio: 3,270

Deputy Directors

10 **JAN-ÅKE GUSTAFSSON**
(1943) Stockholm.
Elected 1987.
Professor, M.D., Ph.D.
Consultant & Co-Founder of Karo Bio AB.
Head of the Department of Medical Nutrition and Biosciences at Karolinska Institutet.
Shares in Karo Bio: 101,830

9 **HENRIK JERNSTEDT**
(1974) Uppsala.
Appointed 2005.
Research Scientist.
Employee representative.
Shares in Karo Bio: -
Options in Karo Bio: 1,102

Executive Management and Auditors

1 2 3 4 5 6 7 8 9

1 **PER OLOF WALLSTRÖM**
(1949)
M.Sc.Pharm.
President & Chief Executive Officer.
Employed by Karo Bio since 2005.
Shares in Karo Bio: 135,000
Options in Karo Bio: -

5 **CARL-MAGNUS ANDERSSON**
(1959)
Ph.D., Associate Professor.
Vice president Chemistry, CMC and IP.
Employed by Karo Bio since 2003.
Shares in Karo Bio: 4,165
Options in Karo Bio: 3,674

2 **ANDERS BERKENSTAM**
(1959)
Ph.D., Associate Professor.
Vice president Discovery Research.
Employed by Karo Bio since 2001.
Shares in Karo Bio: -
Options in Karo Bio: 11,714

7 **BERIT EDLUND**
(1948)
Director, Human Resources.
Employed by Karo Bio since 2001.
Shares in Karo Bio: 2,315
Options in Karo Bio: 12,966

9 **ANNELI HÄLLGREN**
(1965)
Ph.D.
Vice president Preclinical Development.
Employed by Karo Bio since March 2006.
Shares in Karo Bio: -
Options in Karo Bio: -

4 **BERTIL JUNGMAR**
(1961)
Vice president, Chief Financial Officer.
Employed by Karo Bio since 2001.
Shares in Karo Bio: 12,165
Options in Karo Bio: 14,349

8 **JENS KRISTENSEN**
(1958)
Ph.D., M.D.
Vice president Clinical Development.
Employed by Karo Bio since 2005.
Shares in Karo Bio: -
Options in Karo Bio: -

6 **PER OTTESKOG**
(1947)
Ph.D.
Senior vice president Investor Relations.
Employed by Karo Bio since 1987.
Shares in Karo Bio: 197,187
Options in Karo Bio: 12,549

3 **LARS ÖHMAN**
(1957)
Vice president Business Development.
Employed by Karo Bio since 1989.
Shares in Karo Bio: 6,632
Options in Karo Bio: 6,098

Auditors

PricewaterhouseCoopers AB.
Auditor in charge: Claes Dahlén (1950),
Sollentuna.
Authorized public accountant.
Auditor for Karo Bio since 2001.

Shareholdings are as of December 31, 2006, and include family members and shares held through companies. Information regarding options refers to the number of shares options held represents.

Administration Report

OPERATIONS

Karo Bio is an innovative drug discovery and development company specializing in the development of novel pharmaceuticals that target nuclear receptors for treatment of metabolic diseases.

The Company has expanded by adding in-house preclinical and clinical development resources and competence for development of drugs, primarily for treatment of metabolic diseases. With this strategy Karo Bio intends to bring selected compounds within niche therapeutic areas into late stage clinical development and, potentially, to the market. In addition to pursuing niche opportunities, Karo Bio continues to develop compounds aimed at treatment of broad patient populations to clinical proof of concept before outlicensing.

RESEARCH AND DEVELOPMENT

Karo Bio has a portfolio of four main proprietary projects, two partnerships with major pharmaceutical companies and one biotech partnership.

KB2115 – Severe Dyslipidemia

Karo Bio develops the pharmacologically selective thyromimetic KB2115 for treatment of severe dyslipidemia. In the beginning of the year, data from a two week phase I study was presented and it was demonstrated that the compound was safe and efficacious with an LDL lowering of up to 40 percent in healthy but overweight individuals with high plasma levels of cholesterol. In June Karo Bio also finalized a bioequivalence study with a newly developed formulation for KB2115 which consists of enteric coated tablets, suitable for once a day dosing in patients. The study included 34 healthy volunteers and showed that enteric coating can protect KB2115 from chemical modification in the stomach, hence eliminating a safety concern for longer exposure in man. The study further showed excellent pharmacokinetic properties and oral bioavailability of KB2115. In the fourth quarter, Karo Bio initiated a placebo controlled 12 week double blind and randomized phase II study in patients with primary hypercholesterolemia. The primary objective of this study is to determine the efficacy of KB2115 in lowering of LDL-cholesterol and assess the safety of the compound. The results will be available late in the second quarter 2007.

KB5359 – Dyslipidemia

During the year Karo Bio selected KB5359 as a candidate drug for treatment of dyslipidemia from its series of compounds that selectively modulate the thyroid hormone receptor (TR). In preclinical models KB5359 has an efficacy and safety profile that will be beneficial for treatment of common forms of dyslipidemia. KB5359 significantly lowers LDL cholesterol in several animal models without negative effects on the heart. KB5359 is liver selective and hence is less distributed to extra hepatic tissues. The liver selectivity adds to the attractive profile of KB5359 since the liver is the target organ regarding positive effects on blood lipids, limiting the potential for unwanted systemic effects. During the fall, Karo Bio has also showed that KB5359 has positive effects in atherosclerotic, diabetes and triglyceride animal models. Thus, KB5359 has the potential to lower several independent risk factors for the development of cardiovascular disease. Furthermore, the LDL lowering capacity of statins is significantly enhanced in combination with KB5359. Current priorities in this phase of development are toxicology studies as well as GMP manufacturing and development of a pharmaceutical formulation for clinical studies. Karo Bio aims to continue development of KB5359 through an outlicensing agreement with a partner.

KB3305 – Type 2 Diabetes

KB3305 has a favorable pharmacological profile in several different animal diabetes models and acts by selectively antagonizing the action of glucocorticoid hormone in the liver. In animals, KB3305 normalizes the hyperglycemia associated with type 2 diabetes. Preclinical safety and toxicology studies suggest that KB3305 is a safe and well-tolerated drug with more than a 100-fold safety margin over the expected clinical dose. During the year a new pharmaceutical formulation with improved bioavailability was developed and in the fourth quarter Karo Bio received approval for initiation of phase I clinical studies with KB3305. However these studies will be delayed due to technical issues with the capsules selected for the formulation. Alternative capsules and formulations are being evaluated.

ER beta selective compounds – Depression

ER beta selective compounds have potential for a number of important diseases such as inflammatory diseases, cancer and depression. Proof of principle in animal models for the use of ER beta selective agonists in depression has been obtained. During the year Karo Bio has continued to strengthen the concept of treating depression with ER beta selective agonists and further elucidated a potential mechanism of action of its compounds which now have entered the lead optimization phase.

In the fourth quarter Karo Bio presented key data on its compounds at the Neuroscience Meeting in Atlanta, USA. The data presented, based on studies in animal models, indicate that significant anti-depressant effects can be obtained with Karo Bio compounds and that Karo Bio's ER beta agonists have a novel and promising mechanism of action. Significant progress has been made regarding selectivity of lead compounds. Karo Bio expects to select a candidate drug and initiate preclinical development during 2007.

Karo Bio Partner Projects

Atherosclerosis – Wyeth Pharmaceuticals

The collaboration with Wyeth Pharmaceuticals is aimed at new treatments of atherosclerosis with the liver X receptor (LXR) as a target. Preclinical studies have shown that compounds which stimulate LXR have anti-atherogenic effects. During the spring Karo Bio received a milestone payment for the selection of a candidate drug. In August Wyeth initiated phase I clinical studies which triggered an additional milestone payment to Karo Bio. The collaboration was also extended in August for another year until August 31, 2007 with the intention to develop back up compounds and explore new clinical indications. The phase I studies are ongoing.

Estrogen Receptors – Merck & Co., Inc.

Merck and Karo Bio have a collaboration in the field of estrogen receptors. Estrogen receptors are important targets for several diseases in the field of women's health. The joint drug discovery phase has been concluded and Merck is responsible for the development phase. A candidate compound from the collaboration is progressing in phase I clinical development.

Osteoporosis – Radius Health, Inc.

Karo Bio announced a licensing agreement with Radius, a private US based company, in 2006. Under the terms of the agreement Radius acquired the exclusive worldwide rights, excluding the Nordic and Baltic countries, to a new class of Selective Androgen Receptor Modulators (SARMs) discovered by Karo Bio. Radius is advancing these SARM compounds in preclinical studies for the treatment of osteoporosis and frailty associated with loss of muscle mass.

ORGANIZATION

By the end of the year, Karo Bio had 73 (73) employees, of which 64 (64) are engaged in research and development.

RESULT AND FINANCIAL POSITION

Result

Net sales decreased to MSEK 44.0 as compared to MSEK 51.9 for the same period last year. The decrease is attributable to lower milestone payments received from partners. In 2006 Karo Bio received milestone payments from Wyeth Pharmaceuticals for the selection of a clinical candidate as well as initiation of clinical trials in the collaboration between Karo Bio and Wyeth Pharmaceuticals. Further, revenues included a payment from Radius Health, Inc. for access to Karo Bio's technology. No further obligation rests with Karo Bio, consequently the payment is fully recorded as revenue in the third quarter.

Operating expenses increased by MSEK 15.4 to MSEK 176.0 (160.6) which is mainly attributable to higher costs in the drug development projects regarding costs for clinical trials.

Operating loss amounted to MSEK 132.0 (108.7). Financial net amounted to MSEK 5.9 (–2.3) including a currency effect in 2005 of MSEK –5.2 related to financial items. The reported loss amounted to MSEK 126.1 (111.0).

Cash Flow

Cash flows from operating activities amounted to MSEK –110.4 (–90.0).

Liquid assets amounted to MSEK 93.8 (307.3) at the end of the year. Including other short-term investments, with duration exceeding 90 days, liquid assets amounted to MSEK 231.0 (346.9).

Capital Investments

Capital investments in equipment amounted to MSEK 1.1 (1.8).

Shareholders' Equity and Per Share Data

At the end of the year, warrants representing 1,014,470 shares were outstanding. The warrants were issued in conjunction with the implementation of the 2001 and 2003 stock option programs (warrants representing 612,000 and 402,470 shares respectively after adjustment for the effect of rights issues in accordance with the terms of the programs).

The share capital at the end of the year amounted to MSEK 38.7 with 77,412,795 shares issued and outstanding. The share capital was reduced by MSEK 116.1 from 154.8 through a resolution by the general meeting in May 2006 that was subsequently approved and registered by the Swedish Companies Registration Office. Total consolidated shareholders' equity amounted to MSEK 210.5 after taking into account the loss for the year.

Loss per share, based on the weighted average number of shares outstanding, amounted to SEK 1.63 (2.37). The Group's equity ratio at the end of the year was 83.5 percent (89.8) and equity per share was SEK 2.72 (4.35).

Parent Company

The Parent Company recorded revenues amounting to MSEK 44.0 (51.9) and is reporting a loss after financial items of MSEK 119.7 (112.3). A gain from the liquidation of the subsidiary Karo Bio USA, Inc. amounting to MSEK 6.5 is included in financial net.

Capital investments in equipment amounted to MSEK 1.1 (1.8).

Liquid assets and other short-term investments amounted to MSEK 231.0 (346.9) at the end of the year.

FUTURE DEVELOPMENT

Karo Bio will drive the prioritized projects KB2115, KB3305 KB5359 and ER beta into and further in clinical trials during 2007.

The first phase II study with KB2115 will be reported in the latter part of the second quarter 2007. Karo Bio plans for taking KB2115 through the entire phase II program on its own.

KB5359 is currently in the preclinical development phase which is expected to be completed by the end the first half of 2007. The goal is to enter into a collaboration agreement with KB5359.

The clinical development of KB3305 is delayed due to technical issues with the pharmaceutical formulation.

The collaborations with Merck and Wyeth are driven by each respective partner. Karo Bio expects the projects to continue in clinical development. Karo Bio incurs no cost for the projects but has rights to milestone payments and royalty on future drug sales.

There will be a need for capital until Karo Bio generates significant revenues primarily from drug sales in the market, either from own products or collaborations where Karo Bio receive royalty on the partner's product sales. Additional funding will be needed until such significant revenues exist.

PROPOSED TREATMENT OF LOSS

The Group's and the Parent Company's aggregate deficit as per the balance sheet total as follows.

	Group kSEK	Parent Company SEK
Loss carried forward from prior	9,290	19,260,051
Current year's loss	126,116	119,718,433
Aggregate deficit	135,406	138,978,484

The Board of Directors recommends that the Parent Company's aggregate deficit of SEK 138,978,484 be covered by SEK 138,978,484 from the statutory reserve.

The Company's net result for the financial year and financial position as of December 31, 2006 are shown on the appended income statement, balance sheet, cash flow statement and statement of changes in shareholders' equity and notes to the accounts, which are an integral part of the financial statements.

Income Statements

kSEK	Note	GROUP 2006	GROUP 2005	GROUP 2004	PARENT COMPANY 2006	PARENT COMPANY 2005
Net sales	1	44,021	51,913	38,953	44,021	51,913
Operating expenses	2–5					
Administrative expenses		–31,828	–34,572	–31,980	–31,828	–34,550
Research and development expenses		–144,969	–125,226	–123,456	–145,194	–125,227
Other operating income and expenses	6	782	–804	2,140	782	–804
		–176,015	**–160,602**	**–153,296**	**–176,240**	**–160,581**
Operating loss		**–131,994**	**–108,689**	**–114,343**	**–132,219**	**–108,668**
Income from financial investments						
Result from group companies	14	–	–	–	6,534	–
Interest income and other similar income	7	5,974	–2,061	7,507	5,974	–2,061
Interest expenses and other similar expenses	8	–96	–257	–462	–8	–1,553
		5,878	**–2,318**	**7,045**	**12,500**	**–3,614**
Loss after financial items		**–126,116**	**–111,007**	**–107,298**	**–119,719**	**–112,282**
Tax	9	–	–	–	–	–
LOSS FOR THE YEAR	10	**–126,116**	**–111,007**	**–107,298**	**–119,719**	**–112,282**
Loss per share (SEK)	11					
– based on weighted-average number of shares outstanding		–1.63	–2.37	–3.41		
– including warrants outstanding		–1.63	–2.37	–3.41		

Balance Sheets

ASSETS (kSEK)		GROUP			PARENT COMPANY	
At December 31	Note	2006	2005	2004	2006	2005
NON-CURRENT ASSETS						
Intangible assets						
Licenses and similar rights	12	–	–	78	–	–
Tangible assets						
Equipment	13, 20	8,632	13,124	18,531	7,284	10,937
Financial assets						
Shares in group companies	14	–	–	–	100	23,100
Total non-current assets		**8,632**	**13,124**	**18,609**	**7,384**	**34,037**
CURRENT ASSETS						
Current receivables						
Accounts receivable – trade		55	388	2,888	55	388
Other receivables		5,552	8,492	4,254	5,552	8,492
Prepaid expenses and accrued income	15	6,684	5,931	7,391	6,684	5,931
		12,291	**14,811**	**14,533**	**12,291**	**14,811**
Other short-term investments	16	137,270	39,610	115,399	137,270	39,610
Liquid assets	17	93,779	307,270	65,590	93,769	307,260
Total current assets		**243,340**	**361,691**	**195,522**	**243,330**	**361,681**
TOTAL ASSETS		**251,972**	**374,815**	**214,131**	**250,714**	**395,718**

SHAREHOLDERS' EQUITY AND LIABILITIES (kSEK)		GROUP			PARENT COMPANY	
At December 31	Note	2006	2005	2004	2006	2005
SHAREHOLDERS' EQUITY	18					
Share capital		38,706	154,826	154,825	38,706	154,826
Additional paid-in capital/statutory reserve		307,203	307,132	131,425	311,146	311,076
Accumulated loss		–9,290	–14,403	–	–19,259	–23,097
Loss for the year		–126,116	–111,007	–107,298	–119,719	–112,282
Total shareholders' equity		**210,503**	**336,548**	**178,952**	**210,874**	**330,523**
LIABILITIES						
Non-current liabilities	19					
Other non-current liabilities	20	712	1,644	2,573	–	–
Total non-current liabilities		**712**	**1,644**	**2,573**	**–**	**–**
Current liabilities						
Accounts payable – trade		16,043	18,041	7,359	16,043	18,041
Payables to group companies		–	–	–	90	29,625
Other current liabilities	20	2,684	2,956	5,946	1,677	1,904
Accrued expenses	21	20,697	14,299	16,620	20,697	14,299
Deferred revenues		1,333	1,327	2,681	1,333	1,327
Total current liabilities		**40,757**	**36,623**	**32,606**	**39,840**	**65,196**
TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES		**251,972**	**374,815**	**214,131**	**250,714**	**395,718**
Pledged assets		–	–	–	–	–
Contingent liabilities	22	46,686	43,226	40,118	46,686	43,226

Cash Flow Statements

kSEK	Note	GROUP 2006	GROUP 2005	GROUP 2004	PARENT COMPANY 2006	PARENT COMPANY 2005
Operating activities						
Operating loss before financial items		–131,994	–108,689	–114,343	–132,219	–108,668
Items not affecting cash flows						
Depreciation and amortization	5	5,559	7,233	12,369	4,720	6,175
Other		180	407	–76	180	189
		–126,255	**–101,049**	**–102,050**	**–127,319**	**–102,304**
Financial income received	23	7,781	5,670	4,001	7,781	5,670
Financial items paid	23	–95	–257	–470	–8	–1,553
Cash flow from operating activities before changes in working capital		**–118,569**	**–95,636**	**–98,519**	**–119,546**	**–98,187**
Changes in working capital						
Changes in current operating receivables		4,031	–1,638	3,576	4,031	–1,419
Changes in accounts payable		–1,998	10,682	358	–1,998	10,682
Changes in other current operating liabilities		6,177	–3,358	–17,105	6,177	–1,952
Cash flow from operating activities		**–110,359**	**–89,950**	**–111,690**	**–111,336**	**–90,876**
Investing activities						
Investment in licenses and similar rights		–	–3,700	–3,775	–	–3,700
Investment in equipment		–2,047	–2,704	–2,437	–1,071	–1,775
Sale of equipment		4	5	1,362	4	5
Investments in other short-term investments		–273,202	–63,984	–70,292	–273,202	–63,984
Sale and redemption of other short-term investments		172,113	138,600	13,000	172,113	138,600
Cash flow from investing activities		**–103,132**	**68,217**	**–62,142**	**–102,156**	**69,146**
Financing activities						
Proceeds from new share issues		–	263,413	113,482	–	263,413
Cash flow from financing activities		**–**	**263,413**	**113,482**	**–**	**263,413**
CASH FLOW FOR THE YEAR		**–213,491**	**241,680**	**–60,350**	**–213,492**	**241,683**
Liquid assets at the beginning of the year		307,270	65,590	125,940	307,261	65,578
Liquid assets at the end of the year		93,779	307,270	65,590	93,769	307,261

Statements of Changes in Shareholders' Equity

GROUP kSEK	Note	Share capital	Additional paid-in capital	Accu-mulated losses	Loss for the year	Total
Amount at January 1, 2004		**84,390**	**299,201**	**0**	**–208,741**	**174,850**
Currency translation differences			–2,200			–2,200
Loss for the year					–107,298	–107,298
			–2,200		**–107,298**	**–109,498**
Employee stock option program						
– value of employee services			118			118
New issues of shares						
– rights issue	18	56,300	34,438			90,738
– directed issue	18	14,075	8,609			22,684
– warrants exercise		60				60
		70,435	**43,165**			**113,600**
Treatment of loss			–208,741		208,741	0
Amount at December 31, 2004		**154,825**	**131,425**	**0**	**–107,298**	**178,952**
Effect from changes in accounting principles	18		249			249
		154,825	**131,674**	**0**	**–107,298**	**179,201**
Currency translation differences			4,815			4,815
Loss for the year					–111,007	–111,007
			4,815		**–111,007**	**–106,192**
Employee stock option program						
– value of employee services			126			126
Rights issue of new shares	18	92,896	170,517			263,413
		92,896	**170,643**			**263,539**
Treatment of loss				–107,298	107,298	0
Reduction of share capital	18	–92,895		92,895		0
Amount at December 31, 2005		**154,826**	**307,132**	**–14,403**	**–111,007**	**336,548**
Currency translation differences			1			1
Loss for the year					–126,116	–126,116
			1		**–126 116**	**–126 115**
Employee stock option program						
– value of employee services			70			70
			70			**70**
Treatment of loss				–111,007	111,007	0
Reduction of share capital	18	–116,120		116,120		0
AMOUNT AT DECEMBER 31, 2006		**38,706**	**307,203**	**–9,290**	**–126,116**	**210,503**

Also see note 18 for further information.

PARENT COMPANY kSEK	Note	Share capital	Statutory reserve	Accu-mulated losses	Loss for the year	Total
Amount at January 1, 2005		**154,825**	**140,433**	**0**	**–115,992**	**179,266**
Loss for the year					–112,282	–112,282
Employee stock option program - value of employee services			126			126
Rights issue of new shares	18	92,896	170,517			263,413
		92,896	**170,643**			**263,539**
Treatment of loss				–115,992	115,992	0
Reduction of share capital	18	–92,895		92,895		0
Amount at December 31, 2005		**154,826**	**311,076**	**–23,097**	**–112,282**	**330,523**
Loss for the year					–119,719	–119,719
Employee stock option program - value of employee services			70			70
			70			**70**
Treatment of loss				–112,282	112,282	0
Reduction of share capital	18	–116,120		116,120		0
AMOUNT AT DECEMBER 31, 2006		**38,706**	**311,146**	**–19,259**	**–119,719**	**210,874**

Also see note 18 for further information.

Accounting and Valuation Principles

THE GROUP

The consolidated financial statements have been prepared in accordance with international financial reporting standards IFRS as adopted by the EU, the Swedish Annual Accounts Act and the Swedish Financial Accounting Standards Council RR 30 Supplementary Accounting Regulations for Groups. The annual report is prepared in accordance with the Swedish Annual Accounts Act.

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 2005 and 2004, respectively.

New accounting standards

A number of new or updated accounting standards and interpretations are applicable for financial years beginning January 1, 2006 or later. These are IAS 19 (Update) Employee benefits, IAS 21 (Update) Net investment in a foreign operation, IAS 39 (Update) Cash flow hedge accounting of forecast intragroup transactions and IAS 39 (Update) Fair value option. These accounting standards and interpretations have no impact on the consolidated financial statements other than presentational or disclosures presented in the reports. In addition, there are certain accounting standards and interpretations that are not relevant to Karo Bio.

A number of new or updated accounting standards and interpretations are applicable for financial years beginning January 1, 2007 or later. These are IAS 1 (Addition) – Presentation of financial statements: Capital disclosures and IFRS 7 Financial instruments. These accounting standards and interpretations are deemed not to have a significant impact on the consolidated financial statements other than presentational or disclosures presented in the reports. In addition, there are certain accounting standards and interpretations that are not relevant to Karo Bio.

Critical accounting estimates and judgments

The preparation of financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company's accounting principles. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements, relate to the valuation of tax losses carried forward and the valuation of stock options issued to employees. For further information, see below regarding respective accounting and valuation principles and notes 9 and 27.

Consolidated financial statements

The consolidated financial statements have been prepared in accordance with the purchase accounting method. Thus, in addition to the Parent Company's equity, only the result from subsidiaries' operations after the date of acquisition is included in the Group's equity. The difference between the Group's cost for shares in subsidiaries and the fair value of identifiable assets and liabilities at the time of acquisition is reported as surplus values and is amortized over its estimated useful life. Inter-company receivables and payables as well as inter-company transactions have been eliminated.

The consolidated financial statements include all subsidiaries. A subsidiary is a company in which the Parent Company directly or indirectly has a controlling influence.

When translating financial statements of foreign subsidiaries, assets and liabilities of the subsidiary are translated at the closing day rate and income statement items are translated at the average rate. Currency translation differences are charged directly to equity.

Assets, liabilities and provisions

The financial statements have been prepared under the historical cost convention, except for financial assets and liabilities (including derivative instruments) at fair value through the income statement.

Assets and liabilities are stated at cost and nominal value respectively, unless otherwise indicated. Receivables are stated at the amounts expected to be received based on individual assessment.

Provisions are recorded when Karo Bio has a legal or informal commitment as a result of an event that has occurred, it is likely that a disbursement of resources will be required to settle the commitment and the amount can be reliably estimated.

Revenues

Karo Bio may receive four types of revenues from its strategic collaborative research projects: upfront payments, research funding, milestone payments and royalties. Upfront payments are received at the initiation of collaborations and are non-refundable. Research funding is received periodically as a fixed amount for a defined number of Karo Bio scientists working in the project. Milestone payments are triggered when compounds enter or pass a major step in the development process, as defined in the research collaboration agreement. These steps are usually linked to significant decision points in the partner's drug development process. Royalties are based on the sale of finished pharmaceutical products in the market. Research funding is reported as revenue in the period during which Karo Bio scientists are engaged in a collaboration in accordance with the research agreement. Upfront payments are reported as revenue over the collaborative research period for which Karo Bio is receiving research funding as specified in the research collaboration agreement, which usually is three years. Milestone payments are reported as revenue when all requirements specified in the research collaboration agreement for earning the milestone are met.

Other types of revenue, such as revenues from outlicensing agreements that are not research and development collaborations, are recorded when earned and possible to reliably estimate.

Income taxes

As required by IAS 12 Income Taxes, deferred income taxes on temporary differences between the tax basis of assets and liabilities and their carrying amounts in the financial statements are provided for in full, using the liability method. Deferred income tax is determined using tax laws and rates that have been enacted at the balance sheet date.

Financial instruments

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 through currency forward contracts. In accordance with IAS 39, all derivatives are to be measured at fair value defined as market value by Karo Bio. The derivatives currently used by the Company do not qualify for hedge accounting in accordance with IAS 39. The classification of these instruments provides for them to be reported in the balance sheet at fair value with changes in fair value included in other operating income and expenses in the income statement.

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 at fair value trough profit or loss (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.

Acquisitions and dispositions of short-term investments are reported as of the transaction day, the day when Karo Bio is committed to buy or sell the asset.

Transactions in foreign currencies

Karo Bio's functional and reporting currency is Swedish kronor.

Receivables and payables in foreign currencies are translated at the exchange rate at the closing day. Revenues and expenses are translated at the exchange rate for the month in which the transaction occurred.

The majority of the Group's revenues are received in US dollars while most expenses are incurred in Swedish kronor. To reduce the Group's exposure to fluctuations in currency exchange rates, forecasted net cash flows in foreign currencies are hedged through forward currency agreements.

Non-current assets

Tangible and intangible non-current assets are depreciated and amortized, using a straight-line depreciation and amortization method, over their estimated useful life based on the assets cost as per the following schedule.

	Years
Licenses	3–10
Laboratory equipment	4–7
Leasehold improvements, IT equipment and other equipment	4

Depreciation of the exclusive rights to technology licensed from Duke University (see Note 12) is being taken over a three-year period, beginning in May 2001. Due to rapid development in the biotech area, a longer depreciation period is not considered appropriate.

Non-current assets are regularly assessed for impairment in accordance with the accounting standard IAS 36 Impairment of assets, if there are indications that an asset may have decreased in value or the useful life has changed. If the recorded amount is higher than the recoverable amount, the asset will be written down to this amount.

Research and development

Costs regarding development activities shall, as stipulated by IAS 38 Intangible Assets, be capitalized and reported in the balance sheet if certain criteria are met, while costs for research activities are expensed. One important criterion for capitalization of development costs relate to the future economic benefit from the result of such activities. The development activities that Karo Bio is engaged in are exposed to such a high level of uncertainty regarding future economic benefit as per IAS 38 that the criteria are not met. Consequently, all costs for research and development are expensed as incurred.

Liquid assets

Liquid assets consist of bank holdings and short-term investments with maturities at the time of acquisition not exceeding 90 days. Short-term investments with maturities exceeding 90 days are reported as other short-term investments.

Pension costs

Employees in Sweden are entitled to retirement and family pension benefits in accordance with the nationwide ITP Plan. Commitments for theses pensions are secured through an insurance arrangement with Alecta Pension Insurance (Alecta). In accordance with an announcement from the Swedish Financial Accounting Standards Council's emerging issues group (URA 42), this arrangement is considered a defined benefit multi-employer plan. Karo Bio has not had access to such information to facilitate reporting of the plan as a defined benefit plan. Consequently, the ITP plan that is secured through an insurance arrangement with Alecta is reported, in accordance with IAS 19 Employee benefits, as a defined contribution plan. Premiums for pension insurance written with Alecta are expensed in the year they relate to. It is possible for participants in the ITP plan with a salary over a certain amount to make certain individualized choices as to how the premiums should be invested. In such situations premiums may be invested with other pension institutions than Alecta.

Leasing

Karo Bio has entered into leasing contracts with third parties in the ordinary course of business. These contracts are for office and laboratory space, laboratory equipment, automobiles and other equipment. Leasing contracts are classified as either financial or operating depending on the terms of the lease. A capital lease is a contract where the economic risks and rewards related to ownership of an asset in all material respects belong to Karo Bio. All other contracts are considered operational leases.

Capital leases are in essence reported as installment purchase contracts, where the equipment under lease is recorded as an asset and the net present value of future minimum lease payments are recorded as a liability. Equipment is depreciated as described under the heading Non-current assets.

Lease payments regarding operating leases are expensed in the period they relate to.

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 under the transition rules only is affected by the disclosure requirements. Program 2003 is considered an equity-settled payment transaction under IFRS 2, where the fair value of the options granted is 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 equity when options are exercised.

The accounting principle used for Program 2001 is to, upon exercise of the stock option, credit the exercise price to equity. No charge is taken to the income statement for stock options granted as compensation for employees.

Segment reporting

Karo Bio's operations entail only one segment, discovery and development of drugs, and the consolidated income statement and balance sheet is therefore the primary segment. Geographical areas are secondary segments and involve Europe, NAFTA and the rest of the world.

THE PARENT COMPANY

The Parent Company's accounting and valuation principles are the same as the Group's with the exception for leasing. All leasing contracts are reported as operating leases in the Parent Company. In addition, RR 32 Accounting for legal entities has been applied for the Parent Company.

Notes to the Financial Statements

NOTE 1 NET SALES

Net sales consist of research funding and milestone payment. Net sales in 2006 also included a technology access fee from Radius Health, Inc. and 2004 included the year's share of upfront payment from a collaboration partner.

NOTE 2 PERSONNEL AND REMUNERATION TO MEMBERS OF THE BOARD AND EXECUTIVE MANAGEMENT

AVERAGE NUMBER OF EMPLOYEES	2006		2005		2004	
	Number of employees	Men	Number of employees	Men	Number of employees	Men
Parent Company						
Huddinge, Sweden	72	41	76	43	85	47
Subsidiaries						
USA	–	–	–	–	0	0
Group	**72**	**41**	**76**	**43**	**85**	**47**

WAGES, SALARIES, OTHER REMUNERATION AND SOCIAL SECURITY EXPENSES	2006		2005		2004	
	Wages, salaries and other remuneration	Social security expenses (of which pension costs)	Wages, salaries and other remuneration	Social security expenses (of which pension costs)	Wages, salaries and other remuneration	Social security expenses (of which pension costs)
Parent Company						
Board and Presidents	4,080	1,873	7,886	3,036	3,315	1,471
		(449)		(383)		(340)
Other employees	38,477	22,462	37,369	20,516	43,652	23,623
		(8,125)		(6,730)		(7,694)
Subsidiaries						
USA	–	–	–	–	518	39
Group	**42,557**	**24,335**	**45,255**	**23,552**	**47,485**	**25,133**
		(8,574)		**(7,113)**		**(8,034)**

Of wages, salaries and other remuneration for the Group and the Parent Company, kSEK 2,810 (6,572 and 2,275, respectively) refers to the President. Of the amount for 2005, kSEK 4,296 is severance payment.

LEAVE OF ABSENCE DUE TO SICKNESS January 1–December 31	2006	2005	2004
Parent Company			
Leave of absence due to sickness, total	3.0%	2.3%	4.3%
whereof long-term sickness	1.0%	1.2%	3.3%
Leave of absence due to sickness			
men	1.0%	0.9%	2.4%
women	5.3%	4.0%	6.5%
Leave of absence due to sickness, employees			
under 30 years of age	–	–	–
30 – 50 years of age	3.0%	1.7%	3.1%
over 50 years of age	1.4%	4.5%	10.1%

The information provided applies, in accordance with the Swedish Annual Accounts Act, to Swedish employees only.
Information has been

REMUNERATION TO BOARD MEMBERS

The Board elected by the shareholders' meeting consists of seven Directors, including one woman, with one deputy Director and two Directors with one deputy appointed by employee organizations.

The Chairman of the Board receives annual remuneration of kSEK 410 and each Board member, who is not paid as an employee or consultant by the Company, receives kSEK 150 based on the decision at the May 3, 2006 shareholders' meeting. A total of kSEK 1,160 (910 and 1,040, respectively) in remuneration was paid as Directors' fee to Board members during 2006. Members of the Board are also reimbursed for direct expenses, such as travel costs. kSEK 110 (110) was paid for committee engagements for 2006.

One deputy Board member, Jan-Åke Gustafsson, professor at Karolinska Institutet, Stockholm, provides scientific consulting services to the Company and is therefore paid no remuneration for his service as Director. Fee for scientific services provided, amounting to kSEK 960 (960 and 960, respectively), was paid to this deputy Board member. No other remuneration was paid to members of the Board in 2006.

Karo Bio has an extensive academic network that is of utmost importance for the Company's success. Karo Bio has different types of collaborations with the institutions in the network. The network also includes an academic institution where a member of the Karo Bio Board, Jan-Åke Gustafsson, holds a professorship. Professor Gustafsson does not participate in Karo Bio's preparation of or decisions regarding financial terms in such collaborations.

REMUNERATION TO EXECUTIVE MANAGEMENT

A Compensation Committee, consisting of three Board members including the Chairman of the Board, is handling questions regarding executive management's compensation and benefits, including that of the President. Per-Olof Mårtensson, Chairman, and Lars Ingelmark served on the Committee during 2006 while Dr Leon E. Rosenberg served on the committee until September 2006 when Laurent Leksell took place on the committee. The Committee prepares remuneration matters for Board consideration and makes decisions in compensation matters of lesser significance. The Board makes all policy decisions regarding remuneration of executive management and the salary of the President.

Members of executive management are paid a fixed monthly salary and participate in an incentive bonus program. The program is based on achievement of goals set by the Compensation Committee. Maximum bonus for individuals covered by the program is equal to 40 percent of their annual base salary, with the requirement on the recipient to invest the net amount after tax of the portion of the bonus payment that exceeds 20 percent of the annual salary in Karo Bio shares in the market. The monetary information below regarding bonus represents the bonus for 2006, which is paid in 2007. Other benefits provided to executive management are company cars and health care insurance. Executive management is entitled to pension benefits in accordance with the nationwide ITP Plan as are all other Swedish employees, unless stated otherwise below. Pension benefits are based on a retirement age of 65 and paid as long as the retiree lives. Paid salary including bonus qualifies for pension benefits. The ITP Plan provides for no pension benefits for annual salaries currently exceeding kSEK 1,335.

Executive management is eligible to participate in company-wide stock-based incentive programs. See Note 27 Stock Option Programs for further information.

During 2006 executive management consisted of eight (six) persons in addition to the President, of which two are women. These people are: Carl-Magnus Andersson, Vice President Chemistry, Manufacturing and Control; Anders Berkenstam, Vice President Discovery Research; Berit Edlund, Director of Human Resources; Anneli Hällgren, Vice President of Preclinical Development; Bertil Jungmar, Chief Financial Officer; Jens Kristensen, Vice President of Clinical Development; Per Otteskog, Senior Vice President Investor Relations and Lars Öhman, Vice President Business Development. Carl-Magnus Andersson joined executive management in June 2006 and is included in the amounts below from this date.

Per Olof Wallström was appointed President in March 2005. Per Olof Wallström received a total fixed salary of kSEK 2,305 (1,807) in 2006 and a bonus for 2006 amounting to kSEK 455 (293). Wallström earns pension benefits in the form of a defined contribution of 18.5 percent of the annual salary. Pension costs totaled kSEK 449 (345) and other benefits amounted to kSEK 148 (85). Wallström held no stock options at year-end.

Other members of executive management received a total fixed salary of kSEK 8,089 (5,030 and 3,782, respectively) in 2006 and bonus for 2006 amounting to kSEK 1,578 (697 and 0, respectively). Pension costs amounted to kSEK 2,873 (1,748 and 1,657, respectively) and other benefits amounted to kSEK 341 (171 and 196, respectively). Severance payment amounted to kSEK 0 (0 and 2,408, respectively). Other members of executive management held in total stock options at year-end representing 61,350 (57,676 and 51,578, respectively) shares. No allocation was made during 2006.

AGREEMENTS REGARDING SEVERANCE PAY

The President has a termination period of six months and is entitled to one year salary as severance pay if terminated by the Company. Other members of executive management have a mutual termination period of up to six months and are entitled to severance pay of up to two years salary.

NOTE 3 PENSION COSTS

Commitments for retirement and family pension under the ITP plan are secured through an insurance arrangement with Alecta Pension Insurance (Alecta). Premiums regarding pension insurance written with Alecta totals kSEK 2,724 (2,376 and 3,004, respectively) for the year and premiums to other pension institutions under the ITP plan total kSEK 5,850 (4,737 and 5,030, respectively).

Alecta's surplus may be allocated to the insurance holders and the insured. At year-end, Alecta's surplus in the form of total consolidation level amounted to 143.1 percent (128.5 and 128.0, respectively). The total consolidation level is defined as the market value of Alecta's assets as a percentage of the actuarial commitments determined as per Alecta's assumptions, which are different from IAS 19 Employee benefits.

Also, please see accounting principles regarding pensions above.

NOTE 4 OPERATING EXPENSES BY NATURE

Operating expenses are distributed on expense type as follows.

	GROUP			PARENT COMPANY	
	2006	2005	2004	2006	2005
Depreciation	–5,559	–7,233	–12,369	–4,720	–6,175
Personnel costs	–68,537	–71,315	–73,922	–68,537	–71,315
Facilities costs	–8,530	–9,433	–11,912	–8,530	–9,433
External costs	–94,171	–71,817	–57,233	–95,235	–72,854
Other operating income and expenses	782	–804	2,140	782	–804
	–176,015	**–160,602**	**–153,296**	**–176,240**	**–160,581**

NOTE 5 DEPRECIATION AND AMORTIZATION

Depreciation and amortization costs are allocated to the Company's functions and types of assets as follows.

		GROUP			PARENT COMPANY	
	Note	2006	2005	2004	2006	2005
Function						
Administrative expenses		633	1,657	2,045	633	1,657
Research and development expenses		4,926	5,576	10,324	4,087	4,518
		5,559	**7,233**	**12,369**	**4,720**	**6,175**
Type of asset						
Licenses	12	–	78	3,905	–	78
Equipment	13	5,559	7,155	8,464	4,720	6,097
		5,559	**7,233**	**12,369**	**4,720**	**6,175**

NOTE 6 OTHER OPERATING INCOME AND EXPENSES

Other operating income and expenses include, when applicable, success fees paid, royalty to the Swedish Industrial Development Fund (for further information see note 22), and exchange gains and losses on transactions in foreign currency. Paid success fees amount to kSEK – (–1,046 and –, respectively) and net exchange gains and losses amount to kSEK –621 (236 and 1,920, respectively).

NOTE 7 INTEREST INCOME AND OTHER SIMILAR INCOME

	GROUP			PARENT COMPANY	
	2006	2005	2004	2006	2005
Interest income	6,575	3,111	2,371	6,575	3,111
Capital gains and dividends from short-term investments	–359	185	2,768	–359	185
Fair value gains and losses	–242	–149	–	–242	–149
Exchange differences	–	–5,208	2,368	–	–5,208
	5,974	**–2,061**	**7,507**	**5,974**	**–2,061**

Exchange differences relate currency translation of payables to the subsidiary Karo Bio USA, Inc. and Duke University.

NOTE 8 INTEREST EXPENSE AND OTHER SIMILAR EXPENSES

The Parent Company's interest expense 2005 includes inter-company interest expense amounting to kSEK 1,425.

NOTE 9 TAX

Because the Company is reporting losses for tax purposes, the Company is not currently paying any income taxes. Therefore, the existing unutilized tax losses carried forward from prior years have not been assigned a value in the financial statements, since it is not likely that they will be utilized in the next few years.

At year-end, the Parent Company's unutilized tax losses carried forward amounted to MSEK 1,144 (1,018 and 891, respectively). There is no statutory time limit for Swedish companies to utilize tax losses.

Unrecognized temporary differences relating to investments in subsidiaries in accordance with IAS12 Income Taxes amount to MSEK 0 (679 and 681, respectively) for the Group. These differences, which are deferred tax assets, are primarily due to the fact that the tax basis for investments in subsidiaries are the shares in subsidiaries while the carrying amount in financial statements is affected by goodwill amortization and write-downs and results in subsidiaries, leading to differences in tax basis which, in accordance with IAS 12 Income Taxes, are not recognized. The corresponding amount for the Parent Company is MSEK 0 (695).

RECONCILIATION BETWEEN ACTUAL AND NOMINAL TAX	GROUP			PARENT COMPANY	
	2006	2005	2004	2006	2005
Reported loss before tax	–126,116	–111,007	–107,298	–119,719	–112,282
Tax at nominal tax rate 28%	35,312	31,082	30,043	33,521	31,439
Tax effect from deductible items not recorded as expenses	–	4,276	1,740	–	4,276
Tax effect from other non-deductible items	–57	–79	–121	–57	–79
Tax effect from temporary differences	–	–1,278	–519	1,830	–
Effect from variance in tax rates	–	226	671	–	–
Tax effect of deficits for which tax assets are not considered	–35,255	–34,227	–31,814	–35,294	–35,636
Tax on reported loss	**0**	**0**	**0**	**0**	**0**

NOTE 10 LOSS FOR THE YEAR

The entire loss is related to the Parent Company's shareholders, no minority interest exist.

NOTE 11 LOSS PER SHARE

Warrants are non-dilutive as exercise of warrants would decrease the loss per share reported for 2004–2006. Per share data is calculated based on the following number of shares.

Number of shares outstanding (000)	2006	2005	2004
Weighted-average during the year	77,413	46,802	31,510
At year-end	77,413	77,413	43,918

The number of

NOTE 12 LICENSES AND SIMILAR RIGHTS

Licenses and similar rights consist of exclusive rights to technologies licensed from Duke University, Durham, North Carolina in 2001 and licenses from University of California, San Francisco for scientific rights that were acquired in 1996.

In 2001, as part of the Company's transfer pricing policy, the Parent Company acquired certain rights to technologies from a wholly-owned subsidiary.

	GROUP			PARENT COMPANY	
	2006	2005	2004	2006	2005
Opening balance acquisition cost	30,319	30,319	30,319	71,259	71,259
Acquisitions	–	–	–	–	–
Closing balance acquisition cost	**30,319**	**30,319**	**30,319**	**71,259**	**71,259**
Opening balance depreciation	–30,319	–30,241	–26,336	–71,259	–71,181
Depreciation for the year	–	–78	–3,905	–	–78
Closing balance accumulated depreciation	**–30,319**	**–30,319**	**–30,241**	**–71,259**	**–71,259**
Net book value	**0**	**0**	**78**	**0**	**0**

NOTE 13 EQUIPMENT

	GROUP			PARENT COMPANY	
	2006	2005	2004	2006	2005
Opening balance acquisition cost	83,494	85,178	89,565	78,851	80,535
Acquisitions	1,071	1,775	4,114	1,071	1,775
Sales and discards	–1,719	–3,459	–8,677	–1,719	–3,459
Exchange difference	–	–	176	–	–
Closing balance acquisition cost	**82,846**	**83,494**	**85,178**	**78,203**	**78,851**
Opening balance depreciation	–70,370	–66,647	–65,649	–67,914	–65,248
Sales and discards	1,715	3,432	7,619	1,715	3,431
Depreciation for the year	–5,559	–7,155	–8,464	–4,720	–6,097
Exchange difference	–	–	–153	–	–
Closing balance accumulated depreciation	**–74,214**	**–70,370**	**–66,647**	**–70,919**	**–67,914**
Net book value	**8,632**	**13,124**	**18,531**	**7,284**	**10,937**

Laboratory equipment with a carrying value of kSEK 1,567 (2,499 and 3,430, respectively) in the Group are financed with capital leases.

NOTE 14 SHARES IN GROUP COMPANIES

	PARENT COMPANY	
	2006	2005
Opening balance acquisition cost	722,340	722,340
Liquidation	–717,990	–
Closing balance acquisition cost	**4,350**	**722,340**
Opening balance write-downs	–699,240	–699,240
Liquidation	694,990	–
Closing balance accumulated write-downs	**–4,250**	**–699,240**
Net book value	**100**	**23,100**

The subsidiary Karo Bio USA, Inc. was liquidated in 2006, leading to a liquidation gain amounting to kSEK 6,534.

Subsidiary	Domicile	Reg.no.	Holding	No. of Shares	Book value
Karo Bio Research AB	Huddinge, Sweden	556588-3641	100%	1,000	100
					100

NOTE 15 PREPAID EXPENSES AND ACCRUED INCOME

	GROUP			PARENT COMPANY	
At December 31	2006	2005	2004	2006	2005
Prepaid rent	1,958	1,940	1,991	1,958	1,940
Accrued interest income	2,858	1,235	2,657	2,858	1,235
Other	1,868	2,756	2,743	1,868	2,756
	6,684	**5,931**	**7,391**	**6,684**	**5,931**

NOTE 16 OTHER SHORT-TERM INVESTMENTS

Other short-term investments consist of investments in liquid bonds with maturities of more than 90 days but less than five years at the time of acquisition.

NOTE 17 LIQUID ASSETS

	GROUP			PARENT COMPANY	
At December 31	2006	2005	2004	2006	2005
Short-term investments with maturities less than 90 days	59,803	261,505	51,108	59,803	261,505
Cash and bank balances	33,976	45,765	14,482	33,966	45,755
Liquid assets	**93,779**	**307,270**	**65,590**	**93,769**	**307,260**

NOTE 18 SHAREHOLDERS' EQUITY

Share capital consists of 77,412,795 shares (77,412,795 and 30,965,118, respectively) with a ratio value of SEK 0.50 (2 and 5, respectively). The share capital was reduced from kSEK 154,826 to 38,706 through a resolution by the general meeting in May 2006 that was subsequently approved and registered by the Swedish Companies Registration Office.

Accumulated currency translation difference amounts to kSEK –9,221 (–9,222 and –14,037, respectively).

Additional paid-in capital consists of statutory reserve. Proceeds from new share issues, in excess of corresponding share capital, were credited to the statutory reserve as required by the Swedish Annual Accounts Act. The statutory reserve is not available for distribution to shareholders as dividend, but can be utilized by the general shareholders' meeting to cover accumulated losses, which also has been done over the years.

A rights issue of 46,447,677 new shares was carried out in 2005. The issue generated kSEK 263,413 net of transaction costs amounting to kSEK 15,273.

During 2004, a new share issue with preferential rights to existing shareholders was carried out, resulting in 11,260,043 new shares. An additional 2,815,010 shares were issued based on the authorization granted at the special general meeting August 30, 2004. In total, kSEK 113,422 was generated net of transaction costs amounting to kSEK 6,216.

The effect from changes in accounting principles relates to the implementation of IAS 39 Financial Instrument: Recognition and Measurement. 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 increased other current assets and short-term investments, respectively, as of January 1, 2005.

At year-end, warrants representing 1,014,470 shares were outstanding. The warrants were issued in conjunction with the implementation of the Stock Option Program 2001 (warrants representing 612,000 shares) and Stock Option Program 2003 (warrants representing 402,470 shares).

No warrants were exercised during 2005–2006.

In accordance with the Board's policy for dividend, the Board of Directors will propose to the Annual Shareholders' Meeting on April 11, 2007, that no dividend be paid for the financial year 2006.

NOTE 19 NON-CURRENT LIABILITIES

None of the non-current liabilities falls due more than five years after the balance sheet date.

NOTE 20 CAPITAL LEASES

The present value of future minimum lease payments is reported as a liability in the balance sheet. Such payments fall due as outlined below.

	GROUP		
At December 31	2006	2005	2004
Within one year	1,007	1,051	1,051
Later than one but within five years	712	1,644	2,573
Later than five years	–	–	–
	1,719	**2,695**	**3,624**

Variable fees, which means the difference between the interest when entering into the agreement and paid interest, included in operating expenses during the year amounts to kSEK –16 (–22 and –13, respectively). No capital lease contracts have been entered into in 2006 or 2005, while equipment with a total cost of kSEK 2,472 was financed with leasing contracts during 2004.

The capital lease contracts pertain to laboratory equipment with a carrying value of kSEK 1,567 (2,499 and 3,430, respectively).

The interest rate in the contracts is variable and linked to the Swedish general interest rate. Karo Bio has the right to extend the leasing period or acquire, direct or indirectly via another entity, the equipment at a predetermined price upon expiration of the contract.

NOTE 21 ACCRUED EXPENSES

	GROUP			PARENT COMPANY	
At December 31	2006	2005	2004	2006	2005
Accrued payroll taxes	3,558	3,968	4,028	3,558	3,968
Accrued vacation	5,676	6,349	6,976	5,676	6,349
Other	11,463	3,982	5,616	11,463	3,982
	20,697	**14,299**	**16,620**	**20,697**	**14,299**

NOTE 22 CONTINGENT LIABILITIES

Between 1995 and 1997 the Swedish Industrial Development Fund provided partial financing amounting to MSEK 24 for Karo Bio's research regarding pharmaceutical compounds for the treatment of hypercholesterolemia. The amount received was recorded as revenue during this period. This amount including interest will be repaid through royalties on the revenues from the thyroid hormone projects until 2010. The amount reported as a contingent liability is the amount recorded as revenue plus accrued interest after deduction of royalties expensed.

NOTE 23 ADDITIONAL INFORMATION CASH FLOW STATEMENTS

	GROUP			PARENT COMPANY	
	2006	2005	2004	2006	2005
Interest received	9,402	5,741	2,217	9,402	5,741
Interest paid	–1	–11	–11	–8	–11
Income taxes paid	–	–	–	–	–

NOTE 24 OPERATING LEASES

Leasing costs for the year amounted to kSEK 6,798 (7,605 and 10,381, respectively) for the Group and kSEK 7,861 (8,663 and 10,128, respectively) for the Parent Company.

Future minimum lease payments on non-cancelable lease contracts fall due as follows. Most contracts have lease payments that are either linked to inflation or based on flexible interest rates.

The leasing agreements relate to laboratory and office space, laboratory equipment and cars.

	GROUP			PARENT COMPANY	
At December 31	2006	2005	2004	2006	2005
Within one year	7,018	6,834	6,557	7,967	7,889
Later than one but within five years	18,279	5,100	11,524	18,924	6,662
Later than five years	–	–	–	–	–
	25,297	**11,934**	**18,081**	**26,891**	**14,551**

NOTE 25 INTER-COMPANY PURCHASES AND SALES

Karo Bio AB did not purchase any services from subsidiaries in 2006 or 2005, while such purchases amounted to kSEK 1,769 in 2004.

NOTE 26 REMUNERATION TO AUDITORS

	GROUP			PARENT COMPANY	
	2006	2005	2004	2006	2005
PricewaterhouseCoopers					
Auditing	342	354	382	342	354
Other assignments	369	122	305	369	122
	711	**476**	**687**	**711**	**476**

NOTE 27 STOCK OPTION PROGRAMS

Karo Bio has introduced two stock option programs in accordance with decisions made at the Annual Shareholders' Meeting in April 2001 and 2003, respectively. The programs are stock option programs settled with shares in Karo Bio AB and cover permanent employees of Karo Bio.

The financial exposure from the stock option programs is hedged by warrants issued to a wholly-owned subsidiary. A specified portion of the warrants is reserved to cover payroll taxes and other related costs and is transferred to a bank under separate agreements. The agreements stipulate for the bank to provide cash to facilitate payment of such payroll taxes and other related costs. Cash will be generated from the reserved lot of warrants, which are held by the bank.

The terms of the stock option programs provide for adjustments of the exercise price and number of shares for each stock option if new shares are issued with preferential rights to shareholders. The figures below are adjusted accordingly, unless otherwise indicated.

PROGRAM 2003

The program originally involved 190,000 stock options, representing 317,300 shares. Additional warrants representing 85,170 shares are reserved to cover payroll taxes. Maximum allocation of stock options represents 33,400 shares to the President, a maximum 8,350 shares per person to executive management and key employees, and maximum 3,340 shares per person to other employees.

102,136 stock options, representing 170,567 shares, were allocated to employees in 2004, based on their performance during 2003. They were issued in four series and at no cost to employees. The stock options vest and become exercisable in one series per year over a four-year period until May 2008. Stock options may vest earlier in certain situations predefined in the terms of the program, such as long-term disability and employment terminated by the employer. Last date for exercise is in April 2011 for all series, provided continued employment. The exercise price is to SEK 20, 22, 24 and 26 for each series, respectively. Stock options representing 125,913 shares were outstanding at year-end.

Ernst & Young has been engaged to carry out a valuation of the stock options allocated. The valuation was made in accordance with IFRS 2 Share-based Payments. The Black-Scholes model for option pricing has been used for the valuation with an anticipated volatility of 50 percent and the share price as of April 30, 2004, which was SEK 23.50. Factual circumstances and expectations relevant to Karo Bio have been considered in accordance with the accounting standard, such as restrictions for exercise, vesting periods and expected life of stock options. Based on the foregoing, the value of the allocated stock options is MSEK 0.4. The valuation serves as the basis for financial reporting in accordance with IFRS effective January 1, 2005, to reflect the value of services employees provide.

PROGRAM 2001

The program originally involved 270,000 stock options, which represent 486,000 shares. Additional warrants representing 126,000 shares are reserved to cover payroll taxes. Options representing 177,643 shares were outstanding at year-end.

Stock options vest annually over four years and are exercisable between May 31, 2002 and April 30, 2008, provided continued employment. Stock options may vest earlier in certain situations predefined in the terms of the program, such as long-term disability and employment terminated by the employer. They were issued at no cost to employees. The stock options have an exercise price ranging between SEK 178 and 184.

According to the transition rules for implementation of IFRS, this program is not covered by IFRS 2 Share-based Payments other than disclosure requirements.

EFFECT ON FINANCIAL STATEMENTS

The accounting principles for stock option programs are described above.

The cost charged to the income statement in 2006 for Program 2003 amounts to kSEK 70 (126 and 118, respectively) with a corresponding entry to equity.

Future exercise of stock options will have a positive effect on the Company's financial position, as plan participants will pay monies to the Company to exercise options in accordance with the exercise price. Additional costs occurring as an effect of the program, consisting primarily of payroll taxes levied upon exercise, will be covered by exercise of the additional warrants held by an external party. There will be no adverse effect on the Company's financial position from the program, provided that the percentage at which payroll taxes are levied does not change significantly during the remainder of the exercise period.

INCREASE IN NUMBER OF SHARES

Exercise of all options outstanding under the two plans would lead to an increase of the number of shares by 0.5 percent, including warrants required to cover payroll taxes. The issued warrants would not imply dilution of earnings per share in 2001–2006, as a conversion to shares would lead to a decrease in the reported loss per share.

STOCK OPTION PROGRAMS IN ACQUIRED COMPANIES

At the time of acquisition, the now liquidated subsidiary Karo Bio USA, Inc. sponsored stock option programs for its employees. In conjunction with the acquisition of Karo Bio USA, Inc., Karo Bio AB issued warrants to cover shares to be issued in the event of the exercise of stock options. The exercise price of the stock options under the Karo Bio USA, Inc. plans, convertible into one Karo Bio AB share, ranged from USD 0.48 to USD 1.43. As of December 31, 2004, there were no further stock options outstanding and remaining warrants were cancelled.

Allocation of stock options (corresponding number of shares)	2006	2005	2004
Outstanding at January 1	315,929	298,838	235,571
Allocated	–	–	102,136
Effect from new share issue	–	127,944	54,271
Exercised	–	–	–12,011
Forfeited	–12,373	–110,853	–81,129
Outstanding at December 31	**303,556**	**315,929**	**298,838**
Vested	215,342	217,905	150,119

Weighted average exercise price for stock options, SEK	2006	2005	2004
Outstanding at the beginning of the year	114	123	172
Forfeited during the year	118	149	149
Exercised during the year	–	–	6
Outstanding at the end of the year	114	114	123
Exercisable at the end of the year	137	154	177

The stock options exercised in the analysis above relate only to options issued in conjunction with investment in a Group company.

Weighted average share price on the day of exercise for stock options exercised in 2004 was SEK 23. The weighted average remaining period for stock options outstanding at year-end was 3.2 years (3.6 and 4.4, respectively) with exercise prices ranging from SEK 20 to 184.

NOTE 28 FINANCIAL INSTRUMENTS AND RISKS AND SENSITIVITY ANALYSIS

Karo Bio, like any other company engaged in business, is exposed to various risks varying from time to time. The relevant risks to Karo Bio can be broken down into commercial risks and financial risks.

Karo Bio's financial policy determines allocation of responsibility for the finance operations, which financial risks the Company is willing to assume and guidelines for how such risks are to be reduced and managed. The policy, which is reviewed and approved annually by the Karo Bio Board of Directors, is developed to control and manage the following risks.

- Foreign currency risk
- Funding risk
- Liquidity risk
- Interest rate risk
- Credit risk in investments

Financial risk management is centralized in the Company and is the responsibility of the chief financial officer.

FOREIGN CURRENCY RISK

Changes in foreign currency rates have an impact on Karo Bio's earnings and equity in different ways:

- Earnings are affected when revenues and expenses are denominated in different currencies – transaction risk.
- Earnings are affected when assets and liabilities are denominated in different currencies – translation risk.
- Earnings are affected when the income statements of foreign subsidiaries are converted into Swedish kronor – translation risk.
- Shareholder's equity is affected when the balance sheets of foreign subsidiaries are converted into Swedish kronor – translation risk.

Operational risks

Karo Bio is operating in an international industry. Most of the Company's revenues are denominated in US dollars and approximately 83 (79 and 86, respectively) percent of expenses are incurred in Swedish kronor. The remainder of Karo Bio's expenses is mainly denominated in euros and US dollars. This leads to an exposure to currency fluctuations, a combination of both translation and transaction risks. Karo Bio's reporting currency is Swedish kronor.

The diagram indicates the effect on Karo Bio's earnings and operating result, if Swedish kronor strengthen by 10 percent. Both translation and transaction risks have been considered. The total effect on the operating result would be MSEK –1.4 (–2 and –1, respectively).

Currency effect on (MSEK)

Currency	Revenues	Operating result
USD	–4.4	–3.5
Euro	–	–1.0
Other	–	1.1
Total	**–4.4**	**–1.4**

Effect on consolidated revenues and operating result before hedging transactions if Swedish kronor strengthen by 10 percent.

The Company's financial policy provides that the cash flow exposure shall be hedged. Currency hedging is accomplished primarily through currency forward contracts. Between 50 and 90 percent of forecasted cash flows for a twelve month period shall be hedged. In this respect, a certain level of assurance must exist in order to consider possible transactions and related cash flows. Contracted cash flows such as research funding received in accordance with research collaboration agreements, are hedged for the contracted period of up to 36 months. However, not more than 50 percent of contracted cash flows are hedged to take into consideration future expenses related to the cash receipts. The effect of the policy is that the impact from currency fluctuation is delayed.

There were no currency forward contracts at year-end 2006 and 2005. The total nominal value of currency forward contracts at the end of 2004 amounted to MSEK 1, with an average remaining life of two months. Unrealized gains on these contracts amounted to MSEK 0 at the end of 2004. Currency forward contracts that matured in 2006 affected the operating result with MSEK –0.4 (0.0 and 1.9, respectively).

Translation of financial statements of foreign subsidiaries

The consolidated financial statements are affected by currency fluctuations when the income statements and balance sheets of foreign subsidiaries are translated into Swedish kronor to be included in the consolidated financial statements of Karo Bio. The Company's policy is not to hedge such exposure. Shareholders' equity was credited with MSEK 0.0 (4.8 and –2.2, respectively) in 2006 from such currency translation differences.

Financial risks

Currency risks in financial flows related to liabilities and investments is reduced by making investments in Swedish kronor, unless an investment in a foreign currency would serve as a hedge of an existing exposure.

Karo Bio's liabilities that are classified as non-operating for financial reporting purposes consist of an inter-company payable from the Parent Company to Karo Bio USA, Inc. and a payable to Duke University. Both these payables were settled by the end of 2006. The inter-company payable is not hedged. The payable to Duke University is considered by including the payments in the forecasted operating cash flow to be hedged. Consequently, the currency translation of both these payables leads to currency effects in the financial net amounting to MSEK 0.0 (–5.2 and 2.4, respectively) in 2006.

FUNDING RISK

The risk that the Company will not have access to necessary financing at all times is defined as funding risk. From time to time, the Company has raised additional funds in the capital market to secure sufficient funds for the operations and stability of the Company. A recurring review of funding needs is carried out in combination with an assessment of capital market developments to evaluate financing strategies.

LIQUIDITY RISK

Liquidity risk refers to the risk that the Company will not have sufficient monetary assets readily available to pay current foreseen or unforeseen expenditures. The risk is associated with the supply and maturity of short-term investments and the risk that there is no market for a specific instrument that the Company needs to sell. Liquidity risk is managed by structuring the maturities of investments based on cash flow forecasts and also limiting investments in bonds with low liquidity on the second-hand market. Weighted remaining duration of short-term investments was five months (two and nine, respectively) at year-end.

INTEREST RATE RISK

Interest rate risk is the risk that a change in interest rates will cause a negative impact on the value of interest-bearing assets. In accordance with the policy, investments are made with variable terms and maturities. The immediate impact on short-term investments if the interest rate would decrease by one percentage is 0.38 percent (0.15 and 0.61, respectively) or MSEK 0.7 (0.5 and 1.0, respectively).

CREDIT RISK IN INVESTMENTS

Credit risk refers to the risk that Karo Bio will not receive payment for an investment. The credit risk is divided into issuer's risk and counterpart's risk.

Issuer's risk is the risk that the securities, which Karo Bio has in its possession, will lose their value because the issuer cannot meet its commitments in the form of interest payments and payments on the due date.

Counterpart's risk is the risk that the party that Karo Bio buys investments from or sells investments to cannot provide securities or make payment in accordance with what has been agreed.

The policy manages credit risk by regulating which parties Karo Bio can do business with and what credit ratings are required for investments. There is no material concentration of credit risks.

FAIR VALUE OF ASSETS AND LIABILITIES

The fair value, defined as the quoted price in the market, for short-term investments amounts to MSEK 197 (301 and 167, respectively) while book value amounts to MSEK 197 (301 and 167, respectively). Fair value for currency forward contracts, defined as the value generated if the contract would be closed through a counter-contract, amounted to MSEK – (– and 0, respectively), with no book value. Book value corresponds to market value for other assets and liabilities.

NOTE 29 SEGMENT INFORMATION

Revenues, assets and investments in equipment and intangible assets are distributed among secondary segments as follows.

	GROUP		
	2006	2005	2004
Revenues			
NAFTA	44,021	51,913	38,953
	44,021	**51,913**	**38,953**
Assets			
Europe	251,972	374,815	214,129
NAFTA	–	–	2
	251,972	**374,815**	**214,131**
Investments in equipment and intangible assets			
Europe	1,071	1,775	4,114
	1,071	**1,775**	**4,114**

NOTE 30 TRANSACTIONS WITH RELATED PARTIES

Karo Bio has no transactions with related parties as defined in IAS 24 Related party disclosures to disclose other than those disclosed in note 2 regarding remuneration to members of the Board and executive management.

NOTE 31 EVENTS AFTER THE BALANCE SHEET DATE

There are no events after the balance sheet date to report.

The income statements and balance sheets will be presented for the annual general meeting on April 11, 2007 for adoption.

HUDDINGE FEBRUARY 7, 2007

Per-Olof Mårtensson
Chairman

Dana M. Fowlkes **Lars Ingelmark** **Laurent Leksell**

Ulla Litzén **Leon E. Rosenberg**

Bo Carlsson **Johnny Sandberg**

Per Olof Wallström
President

OUR AUDIT REPORT WAS ISSUED FEBRUARY 15, 2007.

PricewaterhouseCoopers AB

Claes Dahlén
Authorized Public Accountant

Audit Report

TO THE ANNUAL MEETING OF THE SHAREHOLDERS OF KARO BIO AB (PUBL.)
CORPORATE IDENTITY NUMBER 556309-3359

We have audited the annual report, the consolidated financial statements, the accounting records and the administration of the board of directors and the managing director of Karo Bio AB (publ.) for the year 2006. The Company's annual report is included in the printed version of this document on pages 18–39. The board of directors and the managing director are responsible for these financial statements and the administration of the company as well as for the application of the Annual Accounts Act when preparing the annual report and the application of international financial reporting standards IFRSs as adopted by the EU and the Annual Accounts Act when preparing the consolidated financial statements. Our responsibility is to express an opinion on the annual report, the consolidated financial statements and the administration based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in Sweden. Those standards require that we plan and perform the audit to obtain reasonable assurance that the annual report and the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and their application by the board of directors and the managing director and significant estimates made by the board of directors and the managing director when preparing the annual report and consolidated financial statements as well as evaluating the overall presentation of information in the annual report and the consolidated financial statements. As a basis for our opinion concerning discharge from liability, we examined significant decisions, actions taken and circumstances of the company in order to be able to determine the liability, if any, to the company of any board member or managing director. We also examined whether any board member or managing director has, in any other way, acted in contravention of the Companies Act, the Annual Accounts Act or the Articles of Association. We believe that our audit provides a reasonable basis for our opinion set out below.

The annual report has been prepared in accordance with the Annual Accounts Act and gives a true and fair view of the company's financial position and results of operations in accordance with generally accepted accounting principles in Sweden. The consolidated financial statements have been prepared in accordance with international financial reporting standards IFRSs as adopted by the EU and the Annual Accounts Act and give a true and fair view of the group's financial position and results of operations. The statutory administration report is consistent with the other parts of the annual report and the consolidated financial statements.

We recommend to the annual meeting of shareholders that the income statements and balance sheets of the parent company and the group be adopted, that the loss of the parent company be dealt with in accordance with the proposal in the administration report and that the members of the board of directors and the managing director be discharged from liability for the financial year.

STOCKHOLM FEBRUARY 15, 2007
PricewaterhouseCoopers AB

Claes Dahlén
Authorized Public Accountant

Corporate Governance

INTRODUCTION

Corporate governance for Karo Bio is based on Swedish law, primarily the Swedish Companies Act, the Listing Agreement with the Stockholm Stock Exchange and the rules and recommendations issued by relevant Swedish organizations. According to the Listing Agreement with the Stockholm Stock Exchange, companies listed on the A-list and larger companies on the O-list (market capitalization exceeding SEK 3 billion) are to follow the Swedish Code of Corporate Governance (the Code). Since Karo Bio's market capitalization does not exceed the threshold, Karo Bio does not explicitly follow the Code.

Narratives and documents in relation to corporate governance are also to be found on the Karo Bio the website www.karobio.com, where the by-laws are also available.

ANNUAL GENERAL MEETING

The Annual General Meeting of the Shareholders is Karo Bio's highest decision-making body. The Annual General Meeting is to be held not more than six months after the close of the financial year. The annual report including the financial statements for the preceding year is approved by the Annual General Meeting. Board of Directors and auditors are elected at the Annual General Meeting and other statutory matters are addressed. Special General Meetings can be held when deemed appropriate.

Right to participate and vote at general meetings rests with shareholders registered in the share book kept by the Swedish Securities Register Centre (VPC AB) on the date decided by the Board and also notifies the Company of their intention to participate in the meeting no later than the date decided by the Board. Each share has one vote.

BOARD OF DIRECTORS

Between Annual General Meetings, the Board of Directors constitutes the company's highest decision-making body. The Board consists of seven Directors, including one woman, with one deputy Director, elected by the shareholders' meeting and two Directors with one deputy appointed by employee organizations.

The work of the Board of Directors for the financial year 2006

The work of the Board of Directors is dictated by a board policy, which sets standards for the frequency and agenda of board meetings, pre-circulation of material for meetings, and matters to be brought to the board for information or decision. A section of the policy also regulates the division of responsibility between the Board, the Chairman of the Board and the President, as well as defining the President's authority. The Chairman prepares the board meetings together with the President. Presentations are made by the President and executive management at each scheduled board meeting on operational matters, including development and progress within research and development, business development, and financial reports and forecasts. The Board makes decisions in important areas such as strategy; scientific, marketing and financial plans; material agreements; budget; finance policy and other significant corporate policies as well as larger capital expenditures. In addition, the Board reviews the development and performance of the company. The Board held six scheduled and five additional board meetings during 2006.

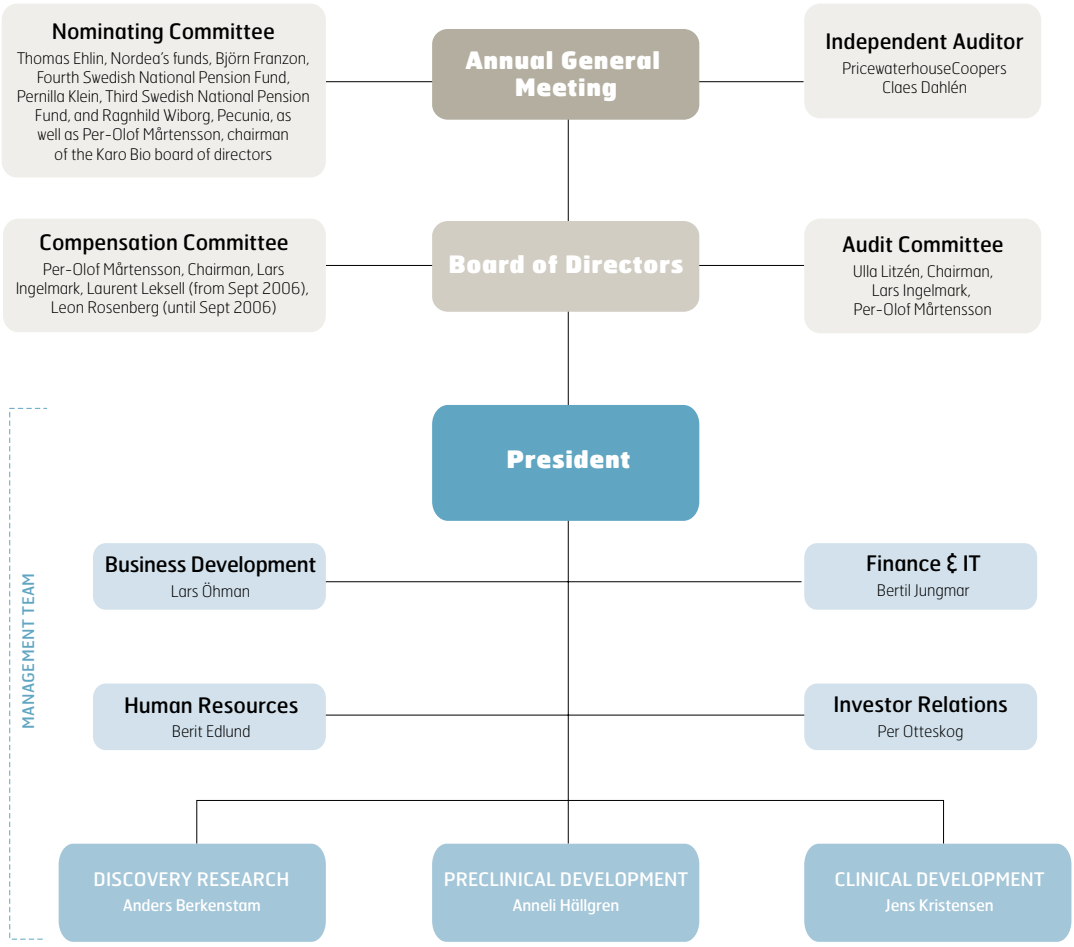
Board decisions are made after an open discussion lead by the Chairman. No dissenting opinions in relation to a decision have been recorded in the minutes during the year. The Board has at times decided to table a matter until a later meeting. Major initiatives taken by the Board in 2006 include matters regarding clinical projects, corporate strategy and selection of candidate drug.

Compensation Committee

A Compensation Committee, consisting of three board members including the chairman of the board, is handling questions regarding the executive management's compensation and benefits, including that of the President. The Committee prepares remuneration matters for board approval and makes decisions in compensation matters of lesser significance. The Board makes all policy decisions regarding remuneration of executive management and the salary of the President.

PRESIDENT & EXECUTIVE MANAGEMENT

The Board appoints a President with responsibility for the management of the company. An executive management team consisting of eight persons supports the President. They are responsible for different functions. The management team together decides, under the leadership of the President and based on the strategy and corporate goals decided by the Board, on important matters to be implemented in the organization. Each respective function head ensures that decisions are implemented and monitored.


Nominating Committee
Thomas Ehlin, Nordea's funds, Björn Franzon, Fourth Swedish National Pension Fund, Pernilla Klein, Third Swedish National Pension Fund, and Ragnhild Wiborg, Pecunia, as well as Per-Olof Mårtensson, chairman of the Karo Bio board of directors
Annual General Meeting
Independent Auditor
PricewaterhouseCoopers
Claes Dahlén
Compensation Committee
Per-Olof Mårtensson, Chairman, Lars Ingelmark, Laurent Leksell (from Sept 2006), Leon Rosenberg (until Sept 2006)
Board of Directors
Audit Committee
Ulla Litzén, Chairman, Lars Ingelmark, Per-Olof Mårtensson
President
MANAGEMENT TEAM
Business Development
Lars Öhman
Finance & IT
Bertil Jungmar
Human Resources
Berit Edlund
Investor Relations
Per Otteskog
DISCOVERY RESEARCH
Anders Berkenstam
PRECLINICAL DEVELOPMENT
Anneli Hällgren
CLINICAL DEVELOPMENT
Jens Kristensen

AUDIT

Independent auditor

Auditors are elected by the Annual General Meeting for a period of four years. The auditors are to audit the company's financial statements and the Board and management's administration. PricewaterhouseCoopers AB were elected auditors at the general meeting in April 2003 for the period until the annual general meeting 2007.

The company's independent auditor reports directly to the Board on selected board meetings as well as to the Audit Committee.

Audit committee

The Board established an audit committee in 2005 to handle certain matters regarding audit and internal control, as well as matters regarding financial reporting. During 2006, the committee held four meetings, at which also the Chief Financial Officer Bertil Jungmar participated as well as the auditor Claes Dahlén (three meetings) and the President Per Olof Wallström (two meetings). Matters dealt with by the committee during 2006 comprised a review of the earnings report as well as the annual report for 2005, review of the memorandum on the audit for 2005 from the external auditor, review of the plan for the audit 2006, review of the internal control structure, decision of principles regarding purchase of non-audit services, review of finance policy. In addition, the Committee has prepared and decided upon a recommendation to the nominating Committee regarding appointment of external auditor for 2007-2011 at the annual general meeting in April 2007.

NOMINATING COMMITTEE

The nominating committee prepares proposals to be presented to the annual general meeting for resolution as regards chairman at the general meeting, chairman and other members of the board of directors, remuneration to the board of directors et cetera, fees to and election of auditor, and principles for appointment of nominating committee.

At the general meeting on May 3, 2006 it was resolved to appoint a nominating committee as per the following.

The four largest shareholders as of August 31, 2006, not being represented in the board of directors, shall appoint one representative each, which together with the chairman of the board shall be members of the nominating committee in respect of the 2007 annual general meeting. The representatives shall be appointed and announced no later than in conjunction with the company's quarterly report for the third quarter 2006. The nominating committee shall appoint chairman among themselves, whereby the chairman of the board of directors not shall be chairman. Should a shareholder decline to participate in the nominating committee or leave the nominating committee before its work is completed, the right to appoint a representative shall turn to the closest largest shareholder not represented in the nominating committee. Should the ownership structure significantly change subsequent to the establishment of the nominating committee shall the composition of the nominating committee be changed in accordance with the above principles.

The term of office of the nominating committee runs until a new nominating committee has been appointed in accordance with the resolution on appointment of the nominating committee by the annual general meeting 2007.

If the nominating committee finds it necessary, it may utilize reasonable resources of external consultants at the account of the company.

Jörgen Vrenning, representing Catella Funds, is adjunct to the nominating committee as of February 6, 2007.

Karo Bio Share and Ownership Structure

Karo Bio's price per share gained in 2006 from SEK 8.80 to SEK 15.60, an increase of 77 percent. During the same period, the Stockholm Stock Exchange's index (OMX Stockholm) increased by 24 percent and its biotechnology index (OMX Stockholm Biotechnology) increased by 33 percent. As of year-end 2006, Karo Bio's market capitalization was MSEK 1207.6 compared to MSEK 681.2 at the beginning of the year. Based on a last price paid of SEK 19.40 on January 31, 2007, the market capitalization was MSEK 1,508.8.

Karo Bio has been traded on the Stockholm Stock Exchange since April 3, 1998 with the ticker KARO.

SHARE CAPITAL

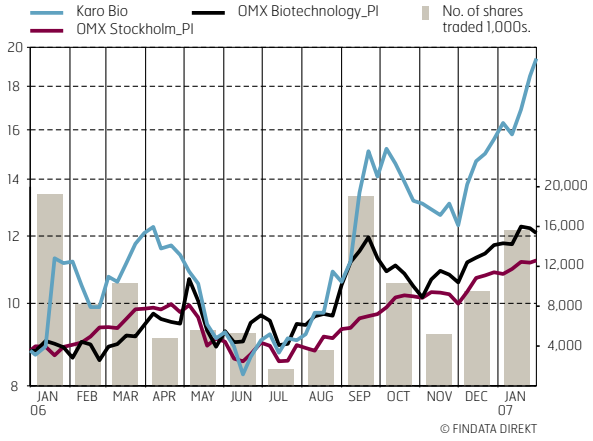
Karo Bio's share capital is MSEK 38.7 after a reduction from MSEK 154.8 as resolved by the annual general meeting in May 2006. The number of shares is 77,412,795 with a ratio value of SEK 0.50. There were also warrants outstanding representing 1,014,470 shares, of which 612,000 shares relate to the stock option program 2001 and 402,470 shares relate to the stock option program 2003.

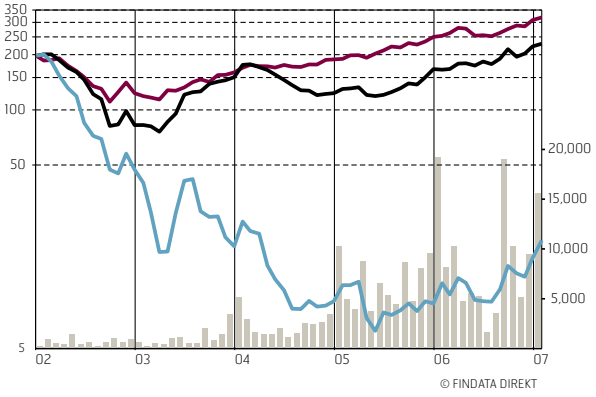
WARRANTS

At the annual general meeting in April 2000, it was resolved to issue a subordinated debenture at a nominal value of SEK 1,000, with 88,064 detachable warrants. The warrants were issued in connection with the acquisition in 2000 of Karo Bio USA, formerly Novalon Pharmaceutical Corporation, to compensate for the existing stock option plan in Novalon. The subordinated debenture was repaid during 2000. In May 2005, the remaining outstanding warrants, representing 3,219 shares, were canceled. Consequently, no warrants are outstanding under this program.

At the annual general meeting in April 2001, it was resolved to issue a subordinated debenture (series 2001/2008) at a nominal value of SEK 10,000, with 340,000 detachable warrants now representing 612,000 shares. The warrants entitles to subscription of shares at a subscription price of SEK 178 during the period May 31, 2001–May 31, 2008. The warrants, of which 70,000 representing 126,000 shares are to cover payroll taxes, are held by Karo Bio's wholly-owned subsidiary Karo Bio Research AB. The subordinated debenture was repaid in June 2001. The warrants serve as a hedge for stock options, representing 486,000 shares, of which 446,260 were issued by Karo Bio to employees of the Group at no

SHARE PRICE AND TRADING VOLUME





INVESTMENT BANKS COVERING THE KARO BIO SHARE

Investment bank	Analyst
ABG Sundal Collier	Alexander Lindström
Alfred Berg ABN AMRO	Mattias Häggblom
Carnegie	Camilla Oxhamre
Handelsbanken Capital Markets	Astrid Samuelsson
Kaupthing Bank	Benjamin Nordin
Nordea Markets	Stefan Wikholm
Redeye	Björn Andersson

cost. The exercise price for the stock options equals or exceeds the subscription price for the underlying warrants.

At the annual general meeting in April 2003, it was decided to issue four debentures (series 2003/2011:A–D), each with a nominal value of SEK 1,000, together with in total 241,000 detachable warrants for subscription of currently 402,470 shares. Each debenture has 60,250 such detachable warrants. The warrants, of which 51,000 representing 85,170 shares are to cover payroll taxes, are held by the wholly-owned subsidiary Karo Bio Research AB. The warrants serve as a hedge for stock options representing 317,300 shares, of which 170,567 were issued at no cost to Karo Bio employees. The subordinated debentures were repaid in June 2003. The warrants gives the holder the right to subscribe for new shares in Karo Bio during the period June 1, 2003–May 31, 2011 at the price SEK 20, 22, 24, and 26 for each respective series. The exercise prices for the stock options are identical to the subscription prices for underlying warrants.

Full utilization of all outstanding warrants will lead to an increase in the number of shares corresponding to 1.3 percent and an increase of the share capital by kSEK 507. Full utilization of all underlying outstanding stock options, including warrants required for payroll taxes, will lead to an increase in the number of shares by 0.5 percent.

DIVIDEND POLICY

Karo Bio has not distributed dividends since the company was founded in 1987. The board of directors does not intend to propose the distribution of dividends until the company receives significant royalty revenues or generates significant profits and cash flows by other means.

PRINCIPAL SHAREHOLDERS AS OF DECEMBER 31, 2006

Owner	No. of shares	Share of capital and votes, %
Nordea's funds	5,549,834	7.2
The Pecunia Fund	4,294,568	5.5
AMF Pension	3,871,000	5.0
Fourth Swedish National Pension	3,454,665	4.5
Catella Funds	2,485,000	3.2
Third Swedish National Pension Fund	2,137,000	2.8
Eikos	2,100,000	2.7
Banco Funds	1,948,500	2.5
Rasjö, Staffan	1,844,000	2.4
Sixth Swedish National Pension	1,830,520	2.4
Terra Funds	1,659,641	2.1
SEB Funds	1,594,500	2.1
Other shareholders	44,643,567	57.6
Total	**77,412,795**	**100.0**

Source: The Swedish Securities Register Centre (VPC AB) and information from shareholders. Shareholdings include family members and shares held through companies.

OWNERSHIP STRUCTURE AS OF DECEMBER 31, 2006

Shareholding No. of shares	No. of share-holders	Percentage of share-holders	No. of shares	Percentage of share capital
1–500	3,285	41.2	579,911	0.7
501–1,000	1,397	17.5	1,263,836	1.6
1,001–5,000	2,221	27.9	6,084,330	7.9
5,001–10,000	521	6.5	4,246,729	5.5
10,001–50,000	415	5.2	8,891,214	11.5
50,001–100,000	56	0.7	4,015,753	5.2
100,001–500,000	45	0.6	10,208,352	13.2
500,001–	29	0.4	42,122,670	54.4
Total	**7,969**	**100.0**	**77,412,795**	**100.0**

CHANGES IN SHARE CAPITAL

Year	Transaction	Increase in number of shares	Total number of shares	Total share capital (SEK)	Issue payment (SEK)[1)]
	As of January 1, 1998	–	3,943,586	39,435,860	–
1998	Stock split 2:1	3,943,586	7,887,172	39,435,860	–
1998	New issue – IPO	1,050,000	8,937,172	44,685,860	96,600,000
1998	New issue – IPO [2)]	240,000	9,177,172	45,885,860	22,080,000
2000	New issue in kind	2,206,198	11,383,370	56,916,850	699,759,830[3)]
2000	New issue - directed placement	600,000	11,983,370	59,916,850	196,868,448
2000	Exercise of warrants	15,731	11,999,101	59,995,505	78,655
2001	Exercise of warrants	26,970	12,026,071	60,130,355	134,850
2002	Exercise of warrants	26,586	12,052,657	60,263,285	132,930
2003	New issue – rights issue	4,821,850	16,874,507	84,372,535	118,578,253
2003	Exercise of warrants	3,547	16,878,054	84,390,270	17,735
2004	Exercise of warrants	12,011	16,890,065	84,450,325	60,055
2004	New issue – rights issue	11,260,043	28,150,108	140,750,540	90,737,898
2004	New issue	2,815,010	30,965,118	154,825,590	22,684,468
2005	Reduction of share capital	–	30,965,118	61,930,236	–
2005	New issue – rights issue	46,447,677	77,412,795	154,825,590	263,413,134
2006	Reduction of share capital	–	77,412,795	38,706,398	–

1) Issue amount, net of any transaction costs
2) Consequent to over-allotment option
3) New share issue in kind, no cash issue amount

Five Year Summary[1)]

	GROUP				
(MSEK, unless otherwise indicated)	**2002**	**2003**	**2004**	**2005**	**2006**
Net sales	177.7	85.1	39.0	51.9	44.0
Administrative expenses	–54.7	–45.4	–31.9	–34.6	–31.8
Research & development expenses	–175.6	–166.8	–123.5	–125.2	–145.0
Other operating income and expenses	–6.2	2.3	2.1	–0.8	0.8
Operating loss before goodwill expenses	**–58.8**	**–124.8**	**–114.3**	**–108.7**	**–132.0**
Goodwill amortization and write-down	–241.8	–94.3	–	–	–
Operating loss	**–300.6**	**–219.1**	**–114.3**	**–108.7**	**–132.0**
Financial net	16.1	10.4	7.0	–2.3	5.9
Loss after financial items	**–284.4**	**–208.7**	**–107.3**	**–111.0**	**–126.1**
BALANCE SHEETS					
Licenses and similar rights	13.8	4.0	0.1	–	–
Goodwill	94.4	–	–	–	–
Equipment	30.1	23.9	18.5	13.1	8.6
Total non-current assets	**138.3**	**27.9**	**18.6**	**13.1**	**8.6**
Other current assets	11.0	17.1	14.5	14.8	12.3
Cash, bank balances and short-term investments	201.1	184.0	181.0	346.9	231.0
Total current assets	**212.1**	**201.1**	**195.5**	**361.7**	**243.3**
Total assets	**350.4**	**229.0**	**214.1**	**374.8**	**251.9**
Shareholders' equity	269.1	174.9	179.0	336.6	210.5
Non-current liabilities	8.1	4.7	2.5	1.6	0.7
Other current liabilities	73.2	49.4	32.6	36.6	40.7
Total shareholders' equity and liabilities	**350.4**	**229.0**	**214.1**	**374.8**	**251.9**
CASH FLOW STATEMENTS					
Cash flow from operating activities	**–70.9**	**–128.6**	**–111.7**	**–89.9**	**–110.4**
Net investment in fixed assets	–10.3	–7.1	–4.9	–6.4	–2.0
Net investment in other short-term investments	–	–	–57.2	74.6	–101.1
Cash flow from investing activities	**–10.3**	**–7.1**	**–62.1**	**68.2**	**–103.1**
Cash flow from financing activities	**0.1**	**118.6**	**113.5**	**263.4**	**–**
Cash flow for the year	**–81.1**	**–17.1**	**–60.3**	**241.7**	**–213.5**
Operating cash flow	–81.2	–135.7	–116.6	–96.3	–112.4
KEY RATIOS AND DATA					
Equity	269.1	174.9	179.0	336.6	210.5
Return on equity, %	–68.8	–94.0	–60.6	–43.1	–46.1
Return on capital employed, %	–68.6	–93.3	–59.4	–42.4	–45.7
Operating margin before goodwill expenses, %	–33.1	–146.7	–293.1	–209.4	–300.0
Operating margin, %	–169.2	–257.5	–293.1	–209.4	–300.0
Profit margin, %	–160.1	–245.2	–275.1	–213.9	–286.6
Equity ratio, %	76.8	76.3	83.6	89.8	83.6
Interest-bearing assets (net)	201.1	184.0	181.0	346.9	231.0
Investment in licenses and similar rights	5.1	3.9	3.8	3.7	–
Net capital investments	5.3	3.2	1.1	2.7	2.0
Average number of employees during the year	133	117	85	76	72
Of which engaged in research and development	110	97	74	67	63

1) International Financial Reporting Standards (IFRS) are applied for the financial years 2004–2006. Figures for 2002–2003 are presented in accordance with the accounting principles applied by Karo Bio for the financial year 2004. For a description of the accounting policies applied for the years 2002–2003, please refer to the 2004 annual report.

	GROUP				
	2002	2003	2004	2005	2006
PER SHARE DATA (SEK) [2) 3)]					
Loss per share					
– average number of shares	–13.39	–8.30	–3.41	–2.37	–1.63
– shares at end of year	–13.38	–7.46	–2.44	–1.43	–1.63
Cash flow from operating activities per share					
– average number of shares	–3.82	–5.40	–3.70	–2.06	–1.45
– shares at end of year	–3.82	–4.85	–2.65	–1.24	–1.45
Equity per share, year-end	12.65	6.25	4.08	4.35	2.72
Share price at end of year [4)]	47.21	18.04	9.06	8.80	15.60
Share price/equity per share, year-end, % [4)]	373	289	222	202	574
NUMBER OF SHARES (millions) [2) 3)]					
Average number of shares	21.3	25.1	31.5	46.8	77.4
Average number of shares including warrants	21.9	26.0	32.5	47.8	78.4
Number of shares, year-end	21.3	28.0	43.9	77.4	77.4
Number of shares, year-end including warrants	21.9	29.0	44.9	78.4	78.4

1) International Financial Reporting Standards (IFRS) are applied for the financial years 2004–2006. Figures for 2002–2003 are presented in accordance with the accounting principles applied by Karo Bio for the financial year 2004. For a description of the accounting policies applied for the years 2002–2003, please refer to the 2004 annual report.
2) Warrants are non-dilutive as exercise of warrants would reduce losses and improve cash flow per share for each respective year.
3) The number of shares for the period prior to rights issues has been adjusted for the bonus element in accordance with IAS 33 Earnings per share.
4) Information on share price has been adjusted for new share issues.

Definitions

OPERATING CASH FLOW
Cash flow from operating activities and cash flow from investments in equipment and licenses

EQUITY
Shareholders' equity

RETURN ON EQUITY
Loss after financial items as a percentage of average equity

RETURN ON CAPITAL EMPLOYED
Operating loss and financial income as a percentage of the average total assets less non interest bearing liabilities

OPERATING MARGIN BEFORE GOODWILL AMORTIZATION
Operating loss before goodwill amortization as a percentage of net sales

OPERATING MARGIN
Operating loss as a percentage of net sales

PROFIT MARGIN
Loss for the year as a percentage of net sales

EQUITY RATIO
Equity as a percentage of total assets

INTEREST BEARING ASSETS (NET)
Cash, bank balances and short-term investments

NET CAPITAL INVESTMENTS
Capital investments in equipment net of disposals

LOSS PER SHARE
Loss in relation to the number of shares

OPERATING CASH FLOW PER SHARE
Cash flow from operating activities and cash flow from investments in equipment and licenses per share

EQUITY PER SHARE
Shareholders' equity in relation to outstanding shares at year-end

SHARE PRICE/EQUITY PER SHARE
Share price as a percentage of shareholders' equity per share at year-end

AVERAGE NUMBER OF SHARES
Weighted-average number of shares out-standing during the year

AVERAGE NUMBER OF SHARES, INCLUDING WARRANTS
Weighted-average number of shares, including warrants, outstanding during the year

NUMBER OF SHARES, YEAR-END
Number of shares outstanding at the end of the year

NUMBER OF SHARES, YEAR-END, INCLUDING WARRANTS
Number of shares, including warrants, out-standing at the end of the year

Glossary

ABSORPTION Uptake of an active compound in the body, eg through the gastro intestinal tract or the skin

ADME Preclinical testing of a compound, addressing the properties Absorption and Distribution in the body, as well as Metabolism and Excretion

AGONIST A compound that has a stimulating effect

ANTAGONIST A compound that has inhibiting/blocking effect

ATHEROSCLEROSIS Atherosclerosis originates from deposits of fatty substances such as cholesterol and calcium. The atherosclerotic process may begin early in life and over time lead to a build-up known as plaque, which hardens as people get older. The consequences are restricted blood flow, especially in arteries and areas where the blood vessels branch. There is also in creased risk of blood clot formation. When this occurs in the heart, the result is a heart attack and, in the brain, a stroke. Blood flow in the extremities may also be restricted, which causes pain during exercise

BIOAVAILABILITY Describes how much an active compound is taken up in the body

CARDIOVASCULAR DISEASE Examples of diseases that fall within this category are congestive heart failure and cardiac arrhythmia (any deviation from the normal sinus rhythm of the heart). Elevated lipids in the blood, hyper-cholesterolemia, is a risk factor associated with cardiovascular diseases

CD Candidate drug. A compound which has desired effects in relevant animal models and which therefore is further developed towards clinical development

CLINICAL STUDY Testing and evaluation of pharmaceuticals in humans

DOUBLE BLIND Neither patient, doctor or nurse in a clinical study is aware about what is administered to the patient (generally placebo or active compound but can also be other pharmaceuticals for comparison)

DYSLIPIDEMIA Imbalance in lipid/cholesterol metabolism

ER BETA A new form of the estrogen receptor. The discovery of this receptor can lead to new treatment principles in women's health care

ESTROGEN Female sex hormone

GLUCOCORTICOID The hormone that is the natural ligand to the glucocorticoid receptor hormone and is produced in the adrenal cortex, and thus also referred to as adrenocortical hormone. The hormone regulates the body's use of carbohydrates, fat and protein and is a normal response to stress

GLUCOCORTICOID RECEPTOR The receptor for glucocorticoid hormone

HORMONE Compound secreted from the body's glands and transported through the blood to the organ in which it has its effects

HYPERCHOLESTEROLEMIA (HIGH CHOLESTEROL) Elevated levels of blood lipids, cholesterol

HYPERLIPIDEMIA High levels of blood lipids

IND Investigational New Drug Application. An application to the FDA or corresponding authority for permission to start testing a pharmaceutical in human beings

INDICATION Disease and patient category intended for medical treatment

INSULINE Hormone responsible for uptake of blood sugar in tissues

LDL Low Density Lipoprotein particles (the "bad cholesterol")

LEAD COMPOUND A compound that has the desired activity in vitro and in relevant animal models

LIGAND A substance, for example, a hormone or compound that binds with a receptor protein

LIPIDS Fat components

LIVER SELECTIVE A compound which preferentially acts in the liver

LXR Liver X Receptor, regulates cholesterol metabolism and is target for new drugs against atherosclerosis

METABOLIC SYNDROME Collective name for obesity, dyslipidemia, type 2 diabetes and hypertension

NCE New chemical entity

NDA New drug application

NUCLEAR RECEPTORS Receptors inside a cell that bind to ligands (often hormones) and regulate gene transcription

ORPHAN DRUG A drug intended for a rare indication with a great medical need and which receives fast track development status from the authorities and market exclusivity for a number of years

PHARMACOKINETICS Studies of up-take, break down and excretion of pharmaceuticals

PHASE IA A first clinical study phase where the compound is given as a single dose to healthy volunteers with the primary objective to study safety and pharmacokinetics

PHASE IB Has the same objective as Phase Ia but with repeated dosing under a few weeks time

PHASE II First clinical studies in choosen patient category for which the drug is evaluated. The primary objective is to find a dose to secure effect and safety before Phase III studies

PHASE III Clinical studies conducted with a large patient population for which the drug is developed. The primary objective is to assure safety and confirm effect in a large data base of a selected patient category under long time treatment. The aim with this part of clinical development is to assure that the launched product is safe in clinical practice

PLASMA APHERESIS Method for cleaning the blood from excess lipid levels

PPAR "Peroxisome proliferator activated receptor", which exists in several forms and which is an important target for treatment of type 2 diabetes

PRECLINICAL DEVELOPMENT These tests are required to gain the permission of the authorities to test the compounds on human beings

PROOF OF CONCEPT Proof for intended effect of a drug in patients

RECEPTOR A protein on the cell surface or inside the cell that recognizes and binds to ligands, for example, steroid hormones

STAD Selective Thyroid hormone Agonist for treatment of Dyslipidemia

STATIN Drugs used for lowering of elevated levels of blood cholesterol

STRUCTURE BIOLOGY Studies of the structure and function of proteins

STRUCTURE-BASED DRUG DESIGN Design of novel compounds based on the three-dimensional structure of, for example, a receptor protein

SYNTHESIS Chemical production of a substance

THERAPEUTIC DOSE INTERVAL Dose interval for which a drug is expected to have effect without side effects

THERAPY Disease treatment method

THYROID HORMONE An iodine-containing hormone synthesized and secreted by the thyroid gland, which is essential for normal metabolic processes and mental and physical development

TISSUE A collection of cells specialized to perform a particular function. The cells may be of the same type or of different types. Aggregates of tissue constitute organs

TRIGLYCERIDS Fat made up of glycerol and fat acids

TYPE 2 DIABETES A form of diabetes, which develops in adult and often obese patients

Annual General Meeting and Further Information

ANNUAL GENERAL MEETING

The Annual General Meeting of Karo Bio AB (publ) will be held on Wednesday April 11, 2007 at 4.00 p.m. in Strindbergsalen, Berns, Berzelii Park, Stockholm, Sweden. The Notice for the Annual General Meeting is available on Karo Bio's web site at www.karobio.com/agm.

Right to participate and notice

To be entitled to participate in the Annual General Meeting, shareholders must have their holdings registered in their names at the Swedish Securities Register Centre (VPC AB) by April 3, 2007, and must notify the company of their intent to participate in the meeting by no later than April 4, 2007 at 4.00 p.m.

Notice of intent to participate in the Annual General Meeting shall be made in writing, including name, address and telephone number, either via mail to Karo Bio AB, attention Eva Kruse, Novum, SE-141 57 Huddinge, Sweden, fax +46 8 774 52 80, e-mail agm@karobio.se or on Karo Bio's web site at www.karobio.com/agm.

Share registration

Shareholders whose shares are registered under the name of a nominee through a bank notary department or other nominee must, to be entitled to participate in the Annual General Meeting, temporarily register their shares in their own names. Such registration must be in effect no later than Tuesday April 3, 2007, which means that shareholders must notify their nominee well in advance of that date.

FURTHER INFORMATION

Scheduled information events:

Annual General Meeting	April 11, 2007
Quarterly Report – January–March	April 19, 2007
Quarterly Report – April–June	July 12, 2007
Quarterly Report – July–September	October 16, 2007
Earnings Report for 2007	February 7, 2008

Financial reports, press releases and other information are available on Karo Bio's web site. Karo Bio's financial reports and press releases may be downloaded and subscribed to on the website at www.karobio.com/finance. Financial reports are available on the web site upon release.
Karo Bio has electronic distribution as the primary means for distribution of financial reports. The annual report will be mailed to shareholders and others specifically subscribing to the printed version. Printouts of quarterly reports are mailed upon request. For further information, please contact Per Olof Wallström, President & CEO, phone +46 8 608 60 20, Per Otteskog, Senior Vice President Investor Relations, phone +46 8 608 60 18 or Bertil Jungmar, Chief Financial Officer, phone +46 8 608 60 52, or e-mail: investor@karobio.com

Narva. Photo: Mats Lundqvist, Jenny Hallengren, Getty Images and Johnér Print: Alfa Print, 2007

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KARO BIO